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Structural Adjustment, Macroeconomics and Equity in Colombia

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STRUCTURAL ADJUSTMENT, MACROECONOMICS AND EQUITY IN COLOMBIA

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Colombia, like most other Latin American countries, has been immersed in the 1990s in a rapid process of structural reforms. Contrary to regional patterns, however, this process has involved both a liberalization of the economy and an attempt to increase social sector spending to address the sizable equity gaps accumulated in the country. This has been part of a major political reform, the major manifestation of which was the replacement of the century-old 1886 Constitution by a new political charter in 1991. As we will see, the attempt to mix a more liberal economy with an active social policy has been no easy task. Difficulties have been reflected in rising fiscal strains. At the same time, the economy continued to grow at moderate rates up to early 1998, with two troublesome features: more instability than in the past, particularly in aggregate domestic demand growth, and a weakening of tradable sectors. International shocks, the strongly contractionary monetary policy used to manage them, and uncertainties associated with rising violence led to the strongest recession in several decades in 1998-1999.

The social reflections of these policies have been mixed. On the positive side, several indicators of living conditions and coverage of social services have improved at a faster rate than in the past. Also, though at a moderate pace and a pro-cyclical pattern, urban poverty has continued its slow, long-term decline. On the negative side, employment has been negatively affected and unemployment has experienced a recent, sharp increase. Income distribution and rural poverty have shown a mixed record. There is evidence that structural reforms have had adverse effects on

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[*]/ Executive Secretary, Economic Commission for Latin America and the Caribbean, CEPAL/ECLAC and Advisor to the Executive Secretary, respectively.

urban income distribution and a significant anti-rural bias. In the countryside, however, reforms strongly hit rural rents and, thus, income distribution actually improved in a generally adverse scenario. Thus, the major gains were those experienced by the top decile of urban income distribution while the major losses were those of the top decile of the rural distribution. These distributive changes have largely netted out, generating only small variations in the overall income distribution.

This paper analyzes the link between structural adjustment, macroeconomic performance and social indicators in Colombia. The first two sections briefly overview structural reforms, the evolution of macroeconomic policy, and their outcomes. The third takes a look at the labor market. The fourth considers the evolution of social policy and major indicators of living conditions. The fifth analyzes in greater detail the evolution of poverty and income distribution. Finally, the sixth draws some conclusions.

I.   STRUCTURAL REFORMS

A.   The liberalization of external economic relations

The liberalization that took place in Colombia in the early 1990s is generally known in the country by the term *apertura* or opening up of the economy. This term was used by the Gaviria Administration[1] in a broad way, to include the liberalization of external economic relations and domestic markets, and the redefinition of the role of the State, including central bank independence.[2]   According to this definition, it included policies to increase domestic competition,

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[1]/ This paper covers basically two Administrations, those of César Gaviria (August 1990-August 1994) and Ernesto Samper (August 1994-August 1998). However, some references are also made to that of Virgilio Barco, which ended in August 1990, and of Andrés Pastrana, which started in August 1998.
[2]/ See DNP (1991), Hommes et al. (1994), and Ocampo (1999).

particularly among financial intermediaries, a moderate liberalization of the labor market and a more ambitious reform of the social security system. However, we will concentrate our analysis on the two basic components of structural reforms: the liberalization of external economic relations and the redefinition of the role of the State. As we will see, the term *apertura* or "liberalization" is certainly inadequate to describe the latter process.

Trade liberalization, the reform of the foreign exchange regime and the elimination of virtually all regulations on foreign direct investment are the three components of the liberalization of external relations which took place from 1990 to 1993. Trade liberalization was launched at the end of the Barco Administration, in February 1990. Both this program, as the more ambitious one put in place by the Gaviria Administration a few months later, focused on a rapid dismantling of quantitative import restrictions, a more gradual reduction of tariffs (over five and three years, respectively), and the substitution of tariff and non-tariff protection by a more competitive exchange rate. However, as part of a macroeconomic adjustment program (see Section II), in August 1991 the tariff schedule due for 1994 was adopted. Thus, the elimination of import controls took place in nine months, and tariffs were reduced in 18 months from an average of 43.7 to 14.3%. In March 1992, when a virtual common Colombian-Venezuelan tariff was adopted, the average tariff was further reduced, to 11.7%. To stabilize the effects of volatile international prices, a system of variable levies was designed for agriculture. Simultaneously, from 1990 to 1992 exports subsidies were cut, from an average of 15 to 6%. Finally, the real devaluation, which was initially expected to compensate falling protection and export subsidies, did not take place. Rather, for macroeconomic reasons, real appreciation was the rule from mid-1991 to mid-1997 (Table 1).

Integration efforts accelerated in a parallel fashion. In December 1989, the Presidents of the Andean Group countries launched an initiative to negotiate a customs union in the region. By early 1992 Colombian-Venezuelan trade had been fully liberalized. With a lag, a similar process took place with other Andean countries, with the exception of Peru. A virtual common Colombian-Venezuelan tariff was designed in March 1992; this was the basis for the Andean common tariff, which was adopted (with some exception) in December 1994. A free trade treaty was signed with Chile in 1993, and the Group of Three Treaty (Colombia-Mexico-Venezuela), which will generate a free trade zone with Mexico after a transition of ten years, was signed in 1994. In more recent years, integration negotiations have concentrated on the strengthening of the Andean Community, including the (still incomplete) incorporation of Peru into that scheme, and in the trade negotiations between the Andean Community and Mercosur.

The liberalization of foreign exchange controls was more limited in scope. The major innovation introduced in 1991 was decentralization of foreign exchange transactions: financial intermediaries were allowed to manage such transactions without prior controls by the central bank (*Banco de la República*). However, most transactions continued to be highly regulated, including the obligation to channel them through intermediaries legally allowed to operate in the market. Strong regulations on the final use of external lending and some sectoral discrimination were also maintained. An important innovation was introduced in February 1992, which allowed firms, for the first time, to contract credits abroad for working capital.

An additional liberalization of foreign exchange controls was adopted in September 1993. Domestic financial intermediaries were then allowed to lend to foreigners in international

currencies and to invest abroad in liquid assets. More importantly, the traditional system of regulation of capital flows based on their *final use* was replaced by a price-based system based on their *maturity.* Debts of less than certain maturity were forced to keep a deposit or reserve requirement in the central bank or to pay its opportunity costs to the bank. In May 1997, the maturity-based system was replaced with a flat forced deposit on all capital inflows.[3] Both systems have been actively used to either discourage or encourage capital inflows, as well as to maintain a good debt profile.[4] These restrictions have been combined with specific rules on import payments and export prefinancing, controls on net foreign exchange assets of financial intermediaries and complementary regulations of foreign investment funds and service transactions.

Finally, foreign direct investment was also liberalized in 1990 and 1991. This process had started in 1987, when the autonomy to manage it—restricted up to then by Decision 24 of 1970 of the Andean Group—was given back to Andean countries. Based on this autonomy, the Barco Administration eliminated most sectoral restrictions on FDI and increased the caps to profit remittances. In 1990 and 1991, FDI was freed from all sectoral restrictions, except national defense and toxic waste disposal. All capital and profit remittance caps were abolished. Prior authorizations were also eliminated, except for investment funds, financial intermediation and public utilities. In 1991, the Andean Group granted all foreign firms access to intra-regional free trade rules. Investment abroad by Colombian firms was simultaneously freed.

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[3]/ Explicit taxes on capital inflows were decreed by the government in January 1997 but were ruled unconstitutional by the Constitutional Court in March, due to the procedure used to decree them.
[4]/ For a history of capital controls in recent years and estimation of their effects, see Cárdenas and Barrera (1997) and Ocampo and Tovar (1997 and 1999). Both agree that they have improved the debt profile but disagree on their effect on the magnitude of capital flows.

B.   Growth and reform of the public sector

The political reform implemented in Colombia in parallel to the above more traditional structural reforms generated significant effects on the size and the structure of the State. This particular mix of economic liberalization and increasing public sector expenditure is certainly peculiar in the Latin American context and, as we pointed out, largely reflects an attempt to complement liberalization with a more active social policy. Trends in the structure of the State have followed a more normal pattern.

Consolidated public sector expenditures, net of intragovernmental transfers, increased from 30% of GDP in 1990 to 36-38% in recent years (Table 1).[5] The most important decisions that led to this expansion were those adopted by the 1991 Constitutional Assembly to significantly increase transfers to departments and municipalities to finance social spending, to extend the coverage of the social security system and to reform the judicial system. It has been estimated that the expenditure dynamics decreed by the 1991 Constitution and the Laws that implemented it had permanent costs equivalent to over 4% of GDP.[6] On the less structural side, both the Gaviria and the Samper Administrations increased expenditures in specific areas (defense and justice, in the first case; social spending and infrastructure, in the second).

The expansion has, nonetheless, been accompanied by a parallel increase in public sector revenues, particularly central government taxes and social security contributions. For this purpose, five tax reforms have been adopted throughout the decade (in 1990, 1992, 1995, 1997 and 1998).

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[5]/ For a detailed analysis of trends in public sector finances in recent years, see Comisión de Racionalización del Gasto y de las Finanzas Públicas (1997), Hernández and Gómez (1998), Ocampo (1997) and Sánchez et al. (1995) See also Cordi (1998) for estimates of the size of the public sector.
[6]/ See Ocampo (1997).

As a result of them, the basic VAT rate increased from 10 to 16% (it is expected to decrease to 15% in November 1999), its coverage was significantly expanded, the maximum income tax rate increased from 30 to 35%, and several new mechanisms were introduced to improve controls. Simultaneously, basic social security contributions were raised from 13.5% of the wage bill in 1990 to 25.5% in 1996.[7] Given higher revenues, increased expenditures were consistent with balanced overall public sector finances up to 1995. In recent years, the signs of fiscal deterioration have become evident, particularly in central government finances. However, due to the net surpluses in the rest of the public sector, the peak consolidated public sector deficit—between 3% and 4% of GDP in 1997-1999—remained significantly below the imbalances of the early 1980s, which exceeded 7% of GDP in 1982 and 1983.

The growth of the State has been accompanied since the early 1990s by significant changes in its structure, which include, in particular, central bank independence, decentralization and access of the private sector to areas traditionally reserved to the State. Central bank independence in monetary and foreign exchange management was decreed in the 1991 Constitution. As was indicated, there has been a decentralization in social spending, matched by rapid growth of transfers from the national to the regional and local governments, from less than 30% of central government tax revenues in 1990 to 40% in 1998. This is expected to further increase in the next few years. The decentralization model that has evolved over this process is a hybrid between the principal/agent and the local choice models. This hybrid model has been difficult to manage, as it has turned out to be hard to define the precise responsibilities of different levels of government and to coordinate financing sources.

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[7]/ These rates include contributions for pensions, health and professional risks, paid by the employer as well as the employee.

Privatization and the opening up of traditional areas of State action to the private sector has covered mining, financial services, social security and infrastructure. Manufacturing has played a secondary role, as the State was never a major investor in this sector in Colombia. Nonetheless, the presence of state investments and firms in all these areas continued to be important. Several mechanisms of association with or concessions to private investors in infrastructure have also been designed. In 1994, the old public utilities tariff commission was substituted by three regulating Commissions—for Energy and Gas, Telecommunications, and Water and Sanitation. The implicit model that has evolved is thus a mixed one, in which private and (national and municipal) public sector firms were expected to coexist, in competition, in those sectors where that was possible, or under several forms of association.

II.   MACROECONOMIC POLICY AND PERFORMANCE

A.   Policy

Macroeconomic policy was subject to sharp stop-go cycles during the period. Because of rising inflation, a harsh stabilization package was adopted in December 1990/January 1991, which included drastic monetary contraction, revaluation, the acceleration of the trade liberalization program and a moderate fiscal restraint (Table 1). However, the massive open market operations of the central bank, which characterized this policy, were subject to significant criticism. Thus, beginning in September 1991, the newly independent central bank accelerated exchange rate appreciation, but made a U-turn in monetary policy. Since late 1991, it focused on reducing domestic interest rates to slow down the accumulation of international reserves associated with interest arbitrage operations and to reduce the quasi-fiscal costs of open market operations. As

a result of the policy shift, all monetary and credit aggregates boomed. Simultaneously, the rapid increase in government revenues, enhanced by the 1992 tax reform, was translated into one of the most rapid expansions of public sector expenditure in Colombian economic history. Overall fiscal balances remained, nonetheless, under control. The 1991 "stop" was, thus, followed, by a striking "go" in 1992 and 1993.

By late 1993, the central bank became increasingly concerned with the rapid increase in aggregate demand. This set the stage for a return to a more restrictive monetary stance in 1994. As fiscal policy continued to be expansionary, the combined actions of the central bank and the government meant that the economy effectively moved into an expansionary fiscal-contractionary monetary policy mix. The initial preoccupation of the central bank in moving into a more restrictive policy was how to regain monetary control under the conditions of a more open economy. This led to the decision, in January 1994, to establish a foreign exchange rate band. Flexibility within the band was seen as essential to regaining monetary control.[8] Aside from this flexibility, the new exchange rate system had two major features: it was dirty floating, as the central bank intervened in the market within the band, and it *preannounced exchange rate policy* for the first time in contemporary Colombian economic history. A new wave of appreciation followed, accompanied by rising interest rates and a reduction in the rate of growth of monetary and credit aggregates— though at a very slow pace. The explicit 7% revaluation of the exchange-rate band in December 1994 was largely a ratification of the revaluation that had been experienced throughout the year. Price-based capital controls were strengthened in August 1994; a more moderate move in that

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[8]/ See Urrutia (1995).

direction in March 1994 had been clearly insufficient to stop the private debt boom, which had

followed the partial liberalization of the capital account in September 1993 (see Section I). [9]

A rapid increase in interest rates during the second semester of 1994 led to heated

macroeconomic debates in 1995–1996, a reflection of significant differences between the

Government and the central bank on how restrictive monetary policy should be to guarantee the

reduction in aggregate demand growth and inflation, objectives which both clearly shared.[10]

Negotiations between the Administration and *Banco de la República* led in mid-1995 to a more

balanced fiscal-monetary policy mix: interest rates were subject to temporary controls in June-

August 1995, some reserve requirements were reduced and fiscal policy was marginally

tightened. However, the renewed rapid increase of interest rates in late 1995 led to a new wave

of controversies in the early part of 1996. The controversies were further complicated by

discussions on the effects of the domestic political crisis on economic activity. New agreements

between the government and the central bank led, in February and March of 1996, to some

liberalization of foreign borrowing. These measures were accompanied by a move to a more

expansionary monetary stance, which allowed interest rates to fall starting in the second quarter

of 1996. Reserve requirements were generally reduced to facilitate this process.

However, the reduction of interest rates was not rapid enough to avoid both a building up of

capital inflows during the second semester of 1996, a new revaluation wave and an important

slowdown of economic activity. Stronger capital controls were adopted during the first semester of

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[9]/ A basic reason for that was the acceleration of inflows due to expectations by private agents that controls would be strengthened. See Banco de la República (1995).

[10]/ The government views of the fiscal-monetary policy mix were summarized in mid-1996 in Ministerio de Hacienda y Crédito Público (1996).

1997 to induce exchange-rate depreciation. The accumulated reduction in interest rates and the policy-induced exchange-rate depreciation, in the context of a moderate fiscal restraint, facilitated a recovery of economic activity through 1997.

However, this recovery was short-lived. During 1998, macroeconomic developments were dominated by exchange rate speculation, associated particularly to international shocks in the capital and commodity (particularly oil) markets. The run on reserves was particularly severe in January-February, May-June, and August, largely coinciding with similar processes in regional or emerging markets worldwide. To defend the exchange rate band's ceiling, the central bank used domestic interest rates as the adjustment variable, with particular severity during the second run. Domestic interest rates increased dramatically, particularly in May-June, rapidly exceeding in real terms even the previous records in late 1995 and early 1996. The normalization of emerging markets, a 9% devaluation of the exchange rate band in September, and the reduction of reserve requirements and central bank interest rates decreed since late 1998, facilitated a strong reduction in interest rates since then. However, by mid-1999, economic conditions remained complex: the economy faced a credit crunch and a strong recession, and rising violence was generating considerable uncertainties. To avoid increasing interest rates in the face of a new speculative attack, the exchange rate band was devalued again and widened in June 1999. Soon thereafter, the government announced that it would negotiate an IMF loan for the first time since the late 1960s.

B.   Macroeconomic performance

Effects of the 1991 stabilization package were reflected in a slowdown in GDP growth, to 2%, and a stagnation in domestic demand. The expansionary monetary and fiscal policies that followed led to a spectacular boom in aggregate domestic demand, which increased in real terms by 10.0% in 1992 and 12.1% in 1993. As Figure 1 indicates, the major source was a large boom in private demand, which replaced the external sources of demand expansion that had predominated during the 1980s.[11] Economic growth picked up, reaching 5.4% in the latter year. The new policy mix, which characterized 1994 and 1995, led to a substitution of the private by a strong public sector demand stimulus. GDP growth accelerated, to 5.8% in 1994 and 1995. The recovery of economic growth in 1992-1995 was strongly dependent on non-tradables (Table 1). Many tradable sectors, particularly agriculture and some light manufactures experienced, indeed, deep crises during the period (see below)*.*

The difference between the growth of aggregate domestic demand and GDP indicates that, in the very open trade regime in place since 1990, increased domestic demand was transmitted largely into an import boom. Simultaneously, as a result of a strong exchange rate appreciation, and despite the positive effects of integration agreements on interregional sales, the export boom, which had started in the mid-1980s, came to an end in mid-1991. Both factors induced a negative contribution of the external sector to aggregate demand and a sharp deterioration in the current account of the balance of payments. The deficit was basically financed by long-term capital flows, particularly by growing foreign direct investment. On the other hand, the 1991 stabilization

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[11]/ Figure 1 follows Taylor (1998). Changes in demand associated to private investment and variations in the savings rate are included in the private sector. Those due to public sector consumption and investment, as well as those due to variations in the tax rate, are included in the public sector. Finally, the external sector includes the effects of export growth and variations in the propensity to import.

package had been successful in breaking the rise in inflation. However, since 1992, the continuation, at a slower pace, of the downward trend in inflation, in the midst of a very rapid growth of domestic demand and monetary aggregates, was clearly associated with real exchange rate appreciation and the absorption of the demand boom by a deterioration of the current account of the balance of payments. A tripartite social pact (incomes policy), signed in December 1994, also facilitated this process in 1995.

The evolution of savings and investment also experienced an abrupt turn associated with the demand boom. After reaching, relative to GDP, a three-decade minimum in 1991 the real investment rate increased sharply, reaching by 1995 a three-decade peak (Table 1). This cycle was sharper for private investment, and particularly for real rather than nominal investment, indicating strong fluctuations in the relative price of capital goods. Indeed, the nominal private investment rate was *not* particularly high in 1995 and not very different from those reached in the late 1970s. This indicates that the high real private investment ratio was basically a reflection of the reduction in the relative price of capital goods or, what is equivalent, of a massive transfer of resources towards private capital accumulation associated with the real appreciation of the peso and lower import tariffs. The increase in private investment coincided with a collapse of private savings. As a result, whereas the private sector ran consistent surpluses since the mid-1970s, peaking at 4% of GDP in 1991, these surpluses fell dramatically in 1994, generating a record deficit of over 6% of GDP. There is no comparable deterioration of the private sector balance in Colombian economic history. The deterioration of private balances was, thus, the major domestic counterpart of the deterioration of the balance of payments.[12]

High interest rates were finally reflected in economic activity in 1996. GDP grew modestly, 2.0%, reflecting a demand pattern which was established in 1995: a contraction in private demand, a positive but weakening fiscal stimulus and a return of export growth, led by the boom in oil and mining. Despite slow domestic demand growth, inflation rose, reflecting supply shocks from indexed services (education and public utilities). Nonetheless, the rapid growth of domestic demand, which had characterized the 1992-1994 boom, was finally brought under control. This was reflected in an improvement of the trade balance for the first time since 1992.

The moderate easing of monetary policy through 1996 set the stage for economic recovery, which took place beginning in the second quarter of 1997. By the last quarter of that year and the first quarter of 1998, it was in full swing, with annual rates of growth exceeding 5%. On the demand side, the expansionary effects of fiscal policy declined considerably and were substituted by a recovery of private demand. However, recovery was brief. The contractionary monetary policy adopted to face the speculative attacks on the peso, combined with an austere fiscal policy, oriented to correct the structural fiscal imbalance, manifested into an outright recession during the second semester. Annual GDP growth slowed down to 0.6% in 1998; a negative figure is expected for 1999. The slowdown coincided with historically high investment rates up to 1997 (20.7% of GDP in 1996-1997), but a strong contraction ensued since 1998. From the perspective of a strong inertia, the reduction in inflation is also a relative success, particularly as the historical "floor" of domestic inflation over the past quarter century (20%) was broken in 1997 and one digit inflation levels have been the rule through most of 1999.

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[12]/ See Ocampo and Tovar (1997).

Overall, economic growth has maintained a moderate long-term path. GDP growth fell from 4.0% in 1985-1991 to 3.6% in 1991-1998, but the latter figure does not include the full effects of the 1998-1999 recession. The expectation that structural reforms would, by themselves, generate faster economic growth has thus been frustrated so far. Labor productivity growth has been dynamic, though at the cost of rising unemployment (see below), and has been compensated by rising capital-intensity in the economy as a whole, at least partly a result of relative price incentives generated by the structural reforms. Thus, the major objective of liberalization policies, the growth of total factor productivity, experienced a slowdown in the 1990s with respect to the patterns typical before the debt crisis: 1.2% vs. 2.4% in 1950-1980, according to ECLAC estimates. Moreover, economic and, particularly, aggregate demand growth has been more unstable than in the past, reflecting the sharp stop-go cycles in monetary policy. Thus, the standard deviation of GDP growth increased from 1.3 in 1985-1991 to 2.0 in 1991-1998. Greater volatility is largely explained by the pattern followed by aggregate demand: the standard deviation of its growth rate increased from 2.1 to 5.1 between these two periods. Central bank independence has been reflected, paradoxically, in a more pro-cyclical monetary management than was typical in Colombia in the past. As we have seen, the increase in public sector expenditure also fueled the demand boom up to 1995 and the slowdown of demand growth in recent years.

As we have seen, the joint effects of real exchange rate appreciation and trade liberalization was a sharp deterioration of the current account of the balance of payments, which has been difficult to reverse in recent years. As Table 1 indicates, although the trend of the trade account was moderately positive in 1996-1998, increasing interest payments and, particularly,

profit remittances, were reflected in a further deterioration of the current account. On the domestic side, this reflected the inability to reverse the adverse trends in domestic savings. On the external side, this took place despite a renewed upward trend in the ratio of exports to GDP and, particularly, regardless of the dynamism of real oil exports. Thus, the lack of a clear positive trend in the trade balance was associated both with the evolution in key commodity prices—particularly oil—and with the evolution of the real exchange rate. Rising oil prices and domestic recession will generate, however, a significant improvement of external balances in 1999.

Heated domestic debates surround the analysis of the determinants of the real appreciation. The dominant view by the central bank and most academic observers was that overvaluation largely reflected fiscal pressures. Some authors also emphasized the effects of the rapid growth of private spending in the early part of the decade.[13] Alternative views underscore the effects of capital inflows and the fact that, in the context of strong indexation, the *nominal* exchange rate has *real* effects of a permanent or (at least) prolonged character.[14] Although, as we have seen, up until the Russian crisis, the central bank board was sympathetic to price-based capital account regulations, it manifested a revaluation bias when fixing the nominal exchange rate.[15]

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[13]/ See the papers collected in Montenegro (1997) and Carrasquilla (1999).

[14]/ Ocampo and Gómez (1997). However, the strongest criticism to the orthodox idea, according to which revaluation was associated to fiscal conditions came from the most influential entrepreneurial analyst, Javier Fernández. See Prospectiva Económica y Financiera, several issues.

[15]/ This preference was "revealed" in two ways. First, two explicit decisions were adopted by the bank which resulted in nominal appreciation (the change in the system of exchange rate certificates in October 1990 and the revaluation of the exchange rate band in December 1994), despite strong pressures on the ceiling of the band on several occasions since 1995. Second, the exchange rate bands were always fixed on the basis of expected inflation; since the inflation targets were not met prior to 1997, this generated a real appreciation, as there was no ex-post corrections in the band to adjust for this fact.

It should be emphasized that, despite the high current account deficits, the magnitude and structure of external financing remained quite favorable. In particular, foreign direct investment became the major source of financing, increasing from less than 1% of GDP in the early part of the decade, to an average of 4.3% of GDP in 1996-1998. Growth was faster in non-oil activities, particularly in service sectors that were subject to restrictions prior to 1990. Thus, external accounts have been consistent with external debt ratios below those typical in the 1980s and an excellent debt profile.

C.   Structural changes

During the second half of the 1980s growth and diversification of Colombian exports had emerged as the most notorious characteristic of the renewed dynamism of the economy. The export ratio (exports as percentage of GDP) increased from 15.6% in 1985 to 22.7% in 1991. This dynamic performance took place in a policy environment characterized by non-neutral high protection and export subsidies, combined with an active devaluation policy. Throughout this period, exports diversified rapidly: coffee fell from half to a fifth of exports of goods, as the share of non-traditional exports increased from less than a third to half of total exports; minerals, mainly oil and coal, also increased their export share.[16]

Despite the boom of intrarregional exports, the real appreciation of the exchange rate led to a slowdown of export growth and a stagnation of export diversification after 1991. Non-traditional exports experienced a strong slowdown, particularly light manufactures and agricultural goods, whereas the better performance of more sophisticated manufactures was

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[16]/ Ocampo (1999).

facilitated by the growth of regional markets, to which they are mainly exported. Also, revaluation led to an import boom, mainly of consumer and capital goods.

At a more global level, the policy environment of the 1990s resulted in a strong bias against tradable sectors, mainly manufacturing and agriculture, while benefiting non-tradable activities (Table 2). On the tradable side, agricultural production experienced a sharp slowdown since the early 1990s, strongly affecting coffee, among exportables, and cereals, cotton and oilseeds, among importable crops. Some exportables (bananas, flowers, palm oil and sugar) and non-tradable agricultural and pecuary production expanded, but this was insufficient to counteract the contraction of the affected crops. As we will see below, the agricultural crisis generated significant distributive effects, and generated the strongest lobby against trade liberalization. This led to the return to selective protection and a more active agricultural policies since 1993, which were, nonetheless, unable to reverse the slow growth and structural changes in agricultural production.[17]

With respect to manufacturing, labor-intensive activities, especially those with a high export coefficient (apparel and leather, in particular) were hurt in the early 1990s by exchange rate appreciation, as were capital-intensive sectors which faced strong import competition (e.g., paper and rubber). However, rapid domestic demand growth benefited the production of construction materials and transport equipment, though the latter was also subject to selective protection. Some sectors continued the persistent boom experienced since the mid-1980s (chemicals) and benefitted from the boom in intra-regional trade. Demand contraction in 1996

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[17]/ Balcázar et al. (1998), Jaramillo (1998), and Ocampo and Perry (1995).

and 1998-1999 strongly affected most manufacturing activities.[18] Although the contractionary effects of trade liberalization were stronger in manufacturing than its expansionary effects, the perception that liberalization had adverse effects on manufacturing development was not as forceful as that of agriculture. The industrial lobby against trade liberalization was, thus, weak and fragmented. A major reason for this result was the massive transfer of resources towards fixed capital investment which took place over the period (see above), which largely benefited manufacturing firms. Mining performance has been the exception to slowdown on the tradable side. Due to the major oil discoveries of the late 1980s and early 1990s, and to a parallel boom of coal and gas production, this sector has experienced rapid growth over the decade.

The slow growth of agriculture and manufacturing in the post-liberalization period was initially compensated by a boom in construction and services. Among the latter, those which grew fastest were financial, government and telecommunication services. Reliance of growth in the post-liberalization period on non-tradable sectors indicates that demand expansion was the major driver of growth in the first half of the 1990s. Up to 1995, this factor prevailed over the contractionary demand effects of trade liberalization. The competition-productivity-growth link used to defend liberalization played no role in the process. As we have seen, the demand engine was exhausted by the rapid turnaround of the balance of payments, leading to contractionary policies and a GDP slowdown, which has hit non-tradable activities since 1996, with particular severity in the case of construction activities.

Overall, structural changes in the 1990s indicate, contrary to simplistic analyses of the link between trade policy and export dynamics, that the real exchange rate has certainly been more

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[18]/ For a detailed analysis of manufacturing during liberalization, see Garay et al. (1998).

important than the "bias" or the "neutrality" of the trade regime as a determinant of Colombian exports. Also, contrary to the links emphasized in the literature, the elimination of the "bias against agriculture" implicit in the protectionist trade regime which prevailed up to 1989, was accompanied by a slowdown of agricultural growth. Finally, dependence on non-tradable sectors has also made GDP growth more dependent on demand management, which has at the same time become more pro-cyclical than in the past. Thus, the new policy mix has determined a structure of economic growth that is more volatile and more sectorally disperse than in the past.

III.   THE LABOR MARKET

A.   Global trends

As Figure 2 indicates, the 1980s were a time of very rapid growth in labor force participation, largely as a result of the rapid incorporation of women into the labor force. However, the first half of the decade was characterized by slow economic growth and employment generation; urban unemployment thus increased rapidly, peaking at 14.7% of the labor force in June 1986. The return to stable, moderate growth in the second half of the decade led, on the contrary, to a rapid growth in employment and a reduction in unemployment. These trends continued until 1992 in large urban centers.

Despite the demand boom and rapid economic growth, employment generation in the large urban areas slowed down considerably after 1992. The employment rate in large urban areas stagnated at 1992 levels until 1995. A temporary reversal in the upward trend in labor force participation was thus crucial for the additional reduction in unemployment, which reached an average of 8.8% in 1993-1995, the lowest level since the early 1980s. These trends are also

evident in the national surveys, although in this case the turning points seem to have been reached with a one-year lead.

The deterioration of the urban labor market has been significant given the reduction of employment and, since 1998, the renewed increase in labor participation rates. Unemployment rapidly increased since 1996, reaching after 1998 the highest levels in recorded history. The same trends can be seen in the national household rate, with a one year's lead. Whereas the lack of employment dynamism in 1992-1995 can hardly be attributable to weak domestic demand and activity, and must thus be found in more structural factors, slow GDP and demand growth have certainly played a crucial role in weak employment generation since 1996.

A more detailed analysis of national surveys offers a closer look at labor market dynamics in the 1990s. As a first step, Table 3 breaks down changes in the labor market into those caused by changes in the labor supply and those deriving from changes on the demand side. Those originating on the supply side are broken down, in turn, into those associated with demographic factors and those having to do with variations in labor participation. Changes on the demand side are broken down into employment in tradable and non-tradable sectors, and in unemployment. All variables are measured as proportions of total population.

Labor supply increased at a slow rate, relative to population, when the economy was expanding. This was the net effect of two opposing patterns: an upward trend in the relative size of working-age population and a downward trend in labor participation, with a sharp break in the latter case with respect to trends in the 1980s. In 1995-1997, the demographic factors ceased to

exert an upward pressure on labor supply but, as we have seen, labor participation started to do so in 1998.

On the demand side, two features stand out in the 1990s: weak job creation throughout the decade and a sharp rise in unemployment in recent years. The low rate of job creation is evident in a decrease of 2.2 percentage points (of total population) in the employment rate between 1991 and 1997. It is interesting to note that sluggish rate of job creation is a feature not only of the recent adjustment phase, but also of economic expansion in the first half of the decade. Indeed, employment as a proportion of total population, grew modestly between 1991 and 1995. The fall in labor participation was thus crucial to counteract the modest rate of job creation in this period. This favorable mix of trends in labor supply and employment underwent a drastic change since 1996. The collapse of job creation translated then into a significant rise in unemployment, which climbed, relative to total population, by 2.9 percentage points between 1995 and 1997.

B.   Composition and sources of job creation

The overall analysis of job creation can be extended to the single-digit level for different categories of economic activity. In particular, changes in employment can be translated into weighted changes in the differential between the growth of per capita output and of labor productivity in each sector (Table 4). The results of this exercise show that in the course of the decade there has been a general decline in tradable sectors, particularly agriculture and manufacturing. Specifically, these sectors have experienced a decrease in per capita output along with increases in labor productivity, with the result being a sharp decline in the

employment rate, equivalent to 7.0 percentage points of the total population between 1991 and 1997. On the other hand, non-tradable sectors (construction and services) experienced an increase in per capita output that has outpaced the growth of labor productivity. Consequently, non-tradable sectors have been steady contributors to the job creation process. However, this process has been strongly pro-cyclical, as it concentrated in 1991-1995. The slowdown in job creation by non-tradable sectors since 1996 and the long-term decline of employment in tradable sectors has led to a sharp decrease in total employment in the economy as a whole.

These general sectoral trends have some particular sector-specific features. On the one hand, the downturn in employment in the agricultural sector between 1991 and 1995 was extremely pronounced. This was particularly true in rural areas, where the share of total employment represented by tradable sectors (basically agriculture) fell sharply (Table 2). On the other hand, the decrease in total employment in tradable sectors experienced between 1995 and 1997 was primarily attributable to manufacturing and was fundamentally an urban phenomenon.

The non-tradable sectors, for their part, have experienced a significant upswing in the course of the decade, with their share of total employment rising from 57.0% in 1991 to 63.2% in 1997. However, as noticed, job creation in non-tradables was particularly rapid during the economic expansion in the first half of the decade, but gave way to a slowdown in job creation during the subsequent adjustment. Among the non-tradable sectors, the pro-cyclical performance of employment in construction stands out.

These trends indicate that the contribution of tradables to the growth of the economy's labor productivity is basically the joint effect of slow growth in output and a negative trend in job creation. This was particularly true of the agricultural sector in 1991-1995, and of manufacturing in 1995-1997. More rapid output growth in non-tradables facilitated a positive contribution to both employment generation and productivity growth, particularly during the expansionary phase. Additional decomposition exercises (not shown) indicate that the effects of the reallocation of output and labor across sectors on overall labor productivity have been minimal.

The analysis of employment growth can be extended by matching the employment dynamics in each sector according to educational attainment, occupational position and gender. Two main patterns are defined when sectoral employment is matched with educational attainment: skilled employment creation has been concentrated in the non-tradable sector, while job destruction in the tradable sector has hit the less educated most severely (Table 5).

The destruction of low skilled jobs (workers with primary and incomplete secondary education, i.e., up to 10 years of schooling), between 1991 and 1995 was led by the agricultural sector, but shifted to the manufacturing sector in 1995-1997. In the case of non-tradables, the demand for low-skilled labor had a clear cyclical pattern, largely related to the construction sector. During the boom phase this sector was very dynamic in the generation of low-skill employment, but its crisis in recent years has been an additional blow to less educated workers. On the other hand, the sectoral dynamics of the demand for intermediate skills (complete secondary education, 11 years) and for workers with incomplete and complete university studies

(12-15, and 16 years or more, respectively) has been concentrated in non-tradables, with some biases for the former in commerce and transport, and for the latter in financial and other services.

The evolution of employment rates by occupational categories and gender shows three distinctive patterns (Table 5). The first is a sharp cyclical pattern of wage earners in the private sector. Indeed, during the boom phase, this type of employment was the most dynamic. However, between 1995 and 1997 employment losses have concentrated in this occupational category. Second, self-employment shows an important dynamism throughout the decade. Together with a reduction in wage employment since 1996, it suggests an important informalization process in recent years. Finally, female employment rates have increased in relative terms, although there is a slowdown in this dynamic in recent years.

IV.   SOCIAL POLICY AND BASIC NEEDS

During the seventies and eighties, social spending fluctuated within 7 and 10% of GDP, with a slight increasing trend and two cycles. If pension payments are excluded, the first of them was a decreasing phase between early seventies and 1977, followed by an increase in the latter year and 1984. The second had a decreasing phase during the years of macroeconomic adjustment in the mid-1980s and a recovery in the rest of the decade (Figure 3).

An impressive increase of social spending took place in the 1990s. In 1994 it had reached 12.2% and peaked at 15.4% of GDP in 1996-1997. Half of the increase has been associated with the expansion of the social security system. The other half has been associated with transfers to departments and municipalities for social spending—particularly education and health—and with

direct expansion of central government social outlays. At a sectoral level, social security expenditures explain an important part of the increase, but education and health have also shown an important dynamism. As a result, whereas Colombia was regarded until very recently as a country that underinvested in social sectors, this has largely ceased to be true.[19]

Long-term efforts in social policy have resulted in a sustained and substantial improvement in indicators of basic needs and the coverage of social services. Indeed, indicators of health and educational attainment, the characteristics of dwelling or the availability of public utilities show a steady improvement over the past few decades. As a result, poverty measured by unsatisfied basic needs declined from 70.2% in 1973 to 45.6% in 1985 and to 37.2% in 1993, according to census data (Table 6). The gap between rural and urban areas has also declined, but remained large. Also, gender discrimination fell and in some cases (such as life expectancy and education) women's achievements overcame those of men.[20]

This positive trend experienced a slowdown in the 1980s[21] but has speeded up in recent years. Increased expenditure was reflected in a significant expansion of social services in 1993-1997 (Table 6). The most rapid expansion was that experienced by the health coverage of the social security system, which increased from 24% to 57% over this period. School attendance rates also increased, particularly for secondary education. The coverage of water and sewage also increased rapidly. Increased coverage benefited, in particular, poor people and rural areas.[22] As a result of this fact and the increased coverage of other public utilities, poverty, as measured by

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[19]/ See the relevant regional comparisons in ECLAC (1999).
[20]/ DNP (1998).
[21]/ Londoño (1997).
[22]/ Sánchez and Núñez (1999).

unsatisfied basic needs, declined: from 33 to 27% in 1993-1997, according to household surveys, faster than the rate at which this index improved in 1985-1993. Moreover, the improvement was particularly rapid in rural areas.

V.   INCOME DISTRIBUTION AND POVERTY

A.   General trends

Contrary to the positive trends in indicators of basic needs, poverty, measured by the proportion of population below the poverty line, and income distribution exhibited an adverse trend up to the late 1960s or early 1970s, but improved considerably in the latter decade.[23] The significant reduction in rural surplus labor and the lagged effects of the educational policies adopted since the 1950s, which were reflected in significant increases in human capital since the mid-1960s, were the two major factors behind this lagged but strong improvement in these social indicators in the 1970s. The Colombian economy thus reached the 1980s in the midst of a rapid improvement in income distribution and poverty. Macroeconomic events in the 1980s and structural adjustment in the 1990s would determine major shifts in these trends.

Changes in national income distribution from 1978 on are summarized in Table 7. Table 8 provides more detailed information on income distribution for the four years on which our analysis of national household surveys will focus (1978, 1991, 1995 and 1998). The available information for the country's largest cities makes it possible to estimate consistent quarterly

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[23]/ See Carrizosa (1987), Londoño (1995), Misión de Empleo (1986), Ocampo (1992 and 1999), Reyes (1987) and Urrutia (1984).

income distribution figures since 1984, and wage differentials since 1976. These series appear in Figure 4 and 5.[24]

Throughout the period analyzed, income distribution in Colombia has remained highly skewed. Looking at figures for the country as a whole, in 1978 the wealthiest decile of the population received 42.2% of total income, while the poorest half of the population received 17.1%. In 1998, the former figure had risen to 44.5% while the latter had fallen to 15.0%; the middle income groups (deciles 6-8) also experienced a reduction in their shares in total income (Table 8). Overall, the Gini coefficient experienced an increase of 3.4 percentage points (Table 7). It is interesting to note that, as a reflection of the greater demographic dependence characteristic of the poorest households, income distribution among the working-age population is somewhat less skewed. The less uneven distribution patterns correspond to wages and independent-labor income, whereas the distribution of capital revenues, investment income and pensions are highly skewed (not shown).

The variations that have occurred since 1978 reflect major positive and negative distributive shocks. These shocks have tended to offset each other, however, since they have generally affected urban and rural households in opposite directions. For this reason, their

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[24]/ For the purposes of the analysis, the income-distribution deciles were grouped into five income brackets: deciles 1 and 2, where the nation's extremely poor are concentrated; deciles 3, 4, and 5, where most of the rest of the poor are found; deciles 6, 7, and 8, which correspond to middle-income groups; the two top deciles are considered separately. The information was adjusted to correct for traditional sorts of problems and to align it with national accounts data. This includes, in Colombia, the problems associated to censoring of high incomes in some surveys, due to the limited number of digits allowed in the questionnaires to report incomes. For a detailed analysis of the problem and the solutions used to solve it, see Pérez et al., (1996) and Núñez and Jiménez (1998). In Figure 5, educational levels have been grouped in three categories: (1) university attainment, which includes only persons with complete university education; (2) secondary attainment, those with complete secondary and incomplete university education; (3) primary attainment, the rest, including an increasing small group of persons with no education. For groups 2 and 3, Paasche wage indicators were estimated.

effects on national income-distribution indicators have been moderate. It is also interesting to note that trends in the large cities are not always of the same magnitude as trends in urban areas in general, although they usually move in the same direction. This indicates that the patterns observed in large cities differ from those displayed by small and medium-sized ones.

During the period 1978-1991, income distribution worsened notably in rural areas and improved in urban areas. The deterioration in rural areas outweighed improvements in urban areas, producing a moderate increase in the Gini coefficient. In the case of major cities, the available quarterly information indicates that improvements during the second half of the 1970s were interrupted at the beginning of the 1980s, throughout which the distributive situation was essentially trendless (Figure 4). Looked at in terms of changes in relative wage broken down by educational attainments, the available data for large cities indicate a sharp narrowing of differentials between 1976 and 1981 or 1982, depending on the series, followed by a stagnation in relative wages in 1983-1991 (Figure 5).

The period 1991-1995 experienced large distributive shocks, which were, in many ways, the opposite to those of the previous phase. While levels of inequality rose notably in the cities (six percentage points in the Gini coefficient for large cities and four points in urban areas as a whole), they fell even more steeply in rural areas (13 percentage points). These strong distributive shocks in urban and rural areas tended to offset each other, with the result that income distribution in 1995 was very similar to that in 1991. These trends were accompanied by a sharp increase in the rural-urban income gap (see below). These trends were virtually continuous, although there was a temporary turnaround in the urban Gini coefficient in 1993.

The increased skewness of the distribution of wage income in large cities when broken down by educational attainment was reflected in rising incomes for workers with university degrees relative to other wage earners, but not in the wages of workers with a secondary education relative to those having only primary education. Adverse trends in urban distribution generally continued in 1995-1998. In rural areas, there was a reversal of the favorable distributive trends characteristic of 1991-1995, though the estimated Gini coefficients remained below those in the early part of the decade and experienced a somewhat erratic pattern.[25]

These trends are borne out by other recent studies, including Reyes et al. (1996), Berry and Tenjo (1998) and Cárdenas et. al. (1998) for large cities, Leibovich (1998) for rural areas, and DNP (1998) for the country as a whole. They are also consistent with analyses by Robbins (1998) and Núñez and Sánchez (1998) on changing wage differentials. The moderate deterioration in distribution over the last two decades is inconsistent, however, with the moderate improvement shown in Londoño (1997) for the period 1978-1993. The deterioration in rural distribution in recent years is not consistent, either, with other estimates, which rather indicate that it continued to improve up to 1997.[26]

Londoño (1997) also estimated that there was an improvement in secondary income distribution equivalent to three percentage points of the Gini coefficient in 1978-1993. These estimates are consistent with the detailed calculation of the redistributive effects of social spending by Vélez (1996) and May et al. (1996). Sánchez and Núñez (1999) estimated an

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[25]/ A few outliers explain this fact. Also, correction factors for 1995 rather than annual-specific ones are used to adjust the data for 1996-1998.

[26]/ Sánchez and Núñez (1999) estimate that the rural Gini fell from 0.49 to 0.44 in 1993-1997. ECLAC (1999) estimates that it fell from 0.49 to 0.40 in 1994-1997.

additional improvement in secondary income distribution equivalent to three percentage points of the Gini coefficient in 1993-1997, which reflects both a rapid increase in social spending (see Section IV) and better targeting. These improvements would offset the deterioration in primary income distribution shown in Table 7. For this reason, it may be concluded that the notable improvement in income distribution during the 1970s was followed by two decades of a moderate deterioration in primary income distribution. However, the redistributive effects of increased social spending and better targeting led to a significant improvement in secondary income distribution, which exceeded by two percentage points of the Gini coefficient the deterioration in the primary distribution, thus generating a moderate long-run improvement in the global (primary + secondary) income distribution.

B. <u>A more detailed look at the socio-demographic and economic determinants of primary income distribution</u>

These trends reflect a combination of socio-demographic and economic factors that have an impact on the primary distribution of income. Three socio-demographic changes are reflected in Table 8: (1) a reduction in the demographic dependency rate in the rural sector, as reflected in the relative increase of population in working age (in the cities, the transition occurred prior to the period we are analyzing); (2) a reduction in the size of households; and (3) an increase in average levels of schooling. A fourth phenomenon of a strictly economic nature, which affected the second of the aforementioned factors, was the increase of job opportunities, especially for women. A joint effect of demographic and labor-market effects has been the sharp drop in the economic dependency rate, defined as the ratio of the economically dependent population (inactive and unemployed) to the employed population.

All of these trends were much more pronounced in 1978-1991 and then slowed down sharply or broke off altogether. The most notable cases were the reduction in employment rates and the deceleration in the rate of increase in the average level of schooling among the adult population. The first of these trends has already been analyzed in Section III. The second of these phenomena may be related to the tightening of social spending in the 1980s. Indeed, the sharp rise in social spending in more recent years has been reflected in further increases in the rates of school attendance (Section IV), which will have a lagged effect on the level of schooling among the adult population.

These trends occurred within a context of striking socio-demographic disparities, both between households in different income brackets and between rural and urban households. Thus, poor households continued to exhibit a smaller proportion of members of working age, more numerous households, lower educational levels, fewer job opportunities and, as a consequence of these conditions, higher rates of economic dependency. Between urban and rural areas, the most notable difference throughout the period analyzed has been in the area of educational opportunities. At the beginning of the period, demographic dependency in rural areas was also notably greater, but this differential has narrowed in the past two decades.

Improvements in the area of job opportunities in 1978-1991 were clearly progressive, both in rural and urban areas. Its reversal in the 1990s was, in contrast, regressive, particularly during the boom years, 1991-1995. These trends were reflected in an improvement—also of a progressive nature—in economic dependency rates in 1978-1991, but also a deterioration in the

1990s. The improvement in the distribution of educational opportunities also followed a progressive pattern in the cities throughout the two decades. Improvements in this variable in rural areas proceeded at a very fast pace, but were relatively even across income brackets. The main adverse trends had to do with differences between urban and rural areas: although educational opportunities and the demographic dependency rate improved more in rural areas, slower job creation translated into a less favorable trend in economic dependency rates in the countryside, particularly in 1991-1995.

With the exception of the phenomena of a strictly economic nature associated with job creation, we should *not* expect the foregoing variables to explain the changes in distribution that occurred during the period under analysis. Indeed, the above-mentioned factors would have generated, by themselves, a gradual *improvement* in income distribution. This is particularly true in the case of the improved distribution of educational opportunities, which is the most important factor in cross-sectional analyses of income determinants. The only relevant case in which a better distribution of educational opportunities coincided with improved income distribution was in urban areas during the second half of the 1970s and the early 1980s. However, as we shall see below, even in this case it is not clear that the improved distribution of educational opportunities was the main factor at work. This so, the explanation for these changes must be sought in those economic factors that affected job creation and opportunities throughout the period in question.[27]

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[27]/ Two recent studies come to similar conclusions. Leibovich (1998) shows that socio-demographic factors tended to improve rural income distribution through the 1988-1995 period. For this reason, the major changes observed in this variable during the period--a turn for the worse in 1988-1991, and an improvement thereafter--are associated with changes in the rate of return of the various determinants of income. Similarly, Cárdenas et al., (1998) find that, although the improvement in income distribution in the large cities in 1976-1982 is largely explained by the improvement in the distribution of educational opportunities, the deterioration observed in the 1990s is accounted for by factors unrelated to this variable.

The analysis of the relation between macroeconomic events and income distribution must take into account the fact that there may be significant differences between changes in real household income and in gross domestic product,[28] and between changes in *per capita* income and *per worker* income. The latter relationship can be expressed as: y = w e a, where (y) is per capita income, (w) per worker income, (e) the employment rate and (a) the proportion of working age population.

From the point of view of income patterns, the 1978-1991 period saw a very moderate increase in per capita household income, which increased at an annual rate of only 0.7% (see Table 9). This rate is below that of per capita GDP, which expanded also at a moderate annual rate (1.4%). The slower increase in household income in relation to GDP growth was basically due to the sharp decline in the proportion of total income received by households owing to a relative increase in corporate profits that were not transferred to households (from 12.7% to 21.2% of total gross income). This moderate increase in per capita income occurred within the context of a decline in per worker income in both rural and urban areas. Thus, changes in the other determinants of per capita income played a decisive role in generating the modest improvement experienced in real household income.

Expanding job opportunities, which made it possible for the labor market to absorb the increasing number of women participating in the labor market, had a very favorable effect on per capita income, especially in the cities. This factor, which had a disproportionately favorable effect on poor households, was clearly the key factor behind the improvement in income

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[28]/ These variations are associated to changes in the terms of trade, in net transfers from the rest of the world, in households' share in income and in the prices of the consumer baskets relative to overall producer prices.

distribution in the cities, since trends in income per employed person were regressive despite the improved distribution of educational opportunities. This indicates that the sharp reduction in education-based wage differentials was *not* the main reason for the improvement in urban income distribution during these years. In rural areas, the greater proportion of working age population also helped to counteract the effects of the reduction in per worker income, which had a strong adverse effect on poor workers. Indeed, only the top income decile escaped the general decrease in wage and non-wage income registered in Colombia's rural areas during this period. Overall, the deterioration in rural income distribution proved to be a stronger force than the improvement in the urban distribution. It is interesting to note that this occurred despite the reduction of the urban/rural income differential: rural per capita income was equivalent to 61% of the level of urban per capita income in 1978, but had risen to 64% in 1991.

The annual growth rate of per capita household income in 1991-1995 was quite high: 4.4%, slightly above to that for per capita GDP (3.9% annual). This increase was wholly concentrated in urban areas. In fact, while the income per capita of urban households rose at an annual rate of 9%, that of rural households actually *declined* at a rate of 5.2% (Table 9). This huge rural-urban distributive shock was manifested in a rapid widening of the income gap between cities and rural areas, as the per capita income of rural households fell from 64% of that of urban households in 1991 to only 42% in 1995. Unlike what had occurred in the preceding years, these trends were chiefly the reflection of changes in the levels of income per employed person, which were compounded by a reduction in employment rates in rural areas.

The downturn in rural incomes was attributable to the severe agricultural crisis that Colombia experienced in the early 1990s. This not only resulted in fewer job opportunities for low- and medium-income households, but also drove down non-wage rural income sharply, a fact that had a very strong impact on the highest rural income decile. For reasons probably associated with migration to the cities,[29] total wages and income per employed person improved for the poorest rural households, however. These factors, along with the decimation of agricultural profits and rents, which dealt a hard blow to the highest decile, translated into a strong improvement in rural income distribution.

In urban areas, the combined impact of the increased supply of unskilled workers, due to rural migration, and the skilled labor demand bias induced by the sectoral reallocation of labor towards non-tradables (see Section III) and the biases in technical change, was to raise the wages and the employment opportunities of the highly educated workers—and hence the relative income of households in the highest deciles—much more rapidly. Just as importantly, urban non-wage incomes registered an unprecedented upswing, which was quite possibly associated with the domestic demand boom rather than economic liberalization as such. This also was particularly beneficial to the most wealthy urban households. The deterioration in urban income distribution was the net outcome of all these forces.

Thus, the relative steadiness of overall distribution indicators in 1991-1995 disguises major distributional changes, many of which were associated with the structural reforms under way. The big winners in this process were the richest urban households, and the big losers were

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[29]/ An additional factor may have been non-agricultural employment opportunities in rural areas. See, on this, Jaramillo (1998).

the richest rural households. As a whole, the reforms also had an extremely strong urban bias, as reflected in the sharp increase in the rural/urban income gap. The interruption of the upward trend in employment and the skewing of labor demand toward higher skills levels were the factors that had the strongest adverse impact on poor households, but these households did benefit from higher levels of income per employed person both in the city and in rural areas.

Economic adjustment since 1996 adversely hit household incomes, with two exceptions. First of all, labor incomes of the more educated workers performed better, due to the structural trends in labor demand. Secondly, rural rents experienced a recovery, benefiting the highest rural deciles. These two factors, rather than reduced employment opportunities explain the deterioration in income distribution experienced in 1995-1998. Indeed, compared with the years of economic expansion, 1991-1995, during which employment opportunities were distributed in a regressive fashion, falling employment after 1995 hit all households in a similar way in urban areas and in a progressive fashion in rural areas.

C.   <u>**Poverty: its extent and severity**</u>

Trends in poverty indicators give a more positive picture of social progress in recent decades than do changes in income distribution. Improvements in indicators for unsatisfied basic needs and coverage of social services (Section IV) have been coupled with a reduction in the extent of poverty as measured by income. These findings are consistent with those of parallel studies, particularly May et al. (1996) and DNP (1998). Improvements in poverty indicators are less pronounced, however, than those of unsatisfied basic needs. In addition, they concentrated in

large cities, a fact that has led to a growing concentration of poverty and, in particular, extreme poverty, in rural areas.

Table 7 and Figure 4 summarize the changes that have occurred in the extent and severity of poverty as measured on the basis of two alternative sets of income (poverty-line) criteria. The first approach is based on the national poverty line, but unlike traditional estimates, the line is adjusted on the basis of the trend in the low-income CPI rather than on changes in food prices. This methodological difference eliminates the fluctuations associated with variations in relative food prices. The second criterion is the international poverty line (US$60/month, estimated at parity exchange rates).

As comparative studies indicate, Colombian poverty lines are considerably higher than those used to define poverty in comparative international studies. In fact, estimates using the international poverty line of US$60 per month are more favorable than those that use Colombia's extreme poverty lines.[30] Measurements based on the Colombian lines also exceed ECLAC estimates for 1994 and 1997 by six and ten percentage points, respectively.[31]

The above-mentioned table and figure indicate that poverty has diminished at a slow rate in Colombia over the past two decades. The overall reduction in poverty amounts to 1.5 and 0.9 percentage points. Poverty gaps have declined somewhat in urban areas, but have increased in the countryside. Indeed, over the long term, rural poverty has increased by 5.5 and 1.8

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[30]/ See Ocampo et al. (1998) and May et al. (1996).
[31]/ See ECLAC (1999).

percentage points, respectively. Furthermore, the downward trend in poverty levels has not been uniform over time.

Table 10 shows changes in the extent of poverty according to the customary breakdown into the effects of growth and income distribution. This brings together the analysis pursued in the preceding sections with an examination of poverty trends. Urban poverty decreased between 1978 and 1991, and during the first half of the 1990s, but increased in 1995-1998. This pattern has been shaped chiefly by growth in urban income. The distributive effects were moderately positive until 1991 (but only with estimates using the international poverty line), extremely adverse in 1991-1995 and moderately adverse during the recent adjustment. For the period under examination as a whole, reductions in urban poverty have been associated with significant increases in real incomes.

Rural poverty trends were opposite to those exhibited by urban poverty in 1978-1991, but similar in the 1990s. However, distributive effects have been much stronger. In 1978-1991, the main factor behind the increase in rural poverty were adverse distributive trends, since incomes trended upward. In 1991-1995, the decline in rural income alone would have increased poverty by between 8 and 11 percentage points, but this adverse effect was counteracted by a very favorable distributive shock. For the period as a whole, the weak performance of rural vis-à-vis urban incomes has been the major factor behind the increase in rural poverty.

Statistical analyses of the determinants of poverty[32] indicate that the risk of a family being poor diminishes as the educational level of the head of household (and, to a lesser extent, of the spouse) and the age of the head of household rise. It increases, on the other hand, with the number of dependents, especially children under 10 years old, and when the head of household is a woman. These analyses also indicate that there has been an increasing bias against rural households. Finally, as expected, the probability of being poor is lower when the head of household is employed in a formal position (wage earner, business owner and retiree, in particular). Self-employment has become an increasingly adverse factor in relation to poverty over the past two decades.

D.   **Formal analyses of the links between macroeconomics, liberalization policies and equity**

Ocampo et al. (1998) used multiple regression analysis to determine the effects of different macroeconomic variables on the Gini coefficient and the poverty headcounts ratios in large urban areas in 1981-1995. The strongest and most consistent effects found were those of protection on income distribution. According to the estimated coefficients, a 10% increase in protection improves the Gini coefficient by about one percentage point. As average tariff and non-tariff protection fell from 46% in 1987 to 8% since 1992, its estimated effects of income distribution was an increase of some four percentage points of the urban Gini coefficient. Faster economic growth also has an adverse effect on income distribution. There is also some support for the positive effects of exchange rate devaluation on income distribution, but this result is somewhat less consistent. Other variables, including fixed capital formation, social expenditure, minimum wages, unemployment

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[32]/ See May et al. (1996) and Ocampo et al. (1998).

and inflation, seem to exercise no influence on income distribution. It is interesting to point out that similar exercises using data up to 1998 tend to confirm the effect of trade liberalization on the urban Gini coefficient, but not that of GDP growth.

On the other hand, according to the same study, more rapid economic growth reduces poverty. An increase in economic growth by 1% reduces poverty by about 1.5 percentage points. There is also some evidence that reduced unemployment, protection and revaluation may increase poverty, but these results are statistically weaker. Similar exercises, using data up to 1998 give an important role to minimum wages as a determinant of poverty. Indeed, this variable seems to be the only consistent determinant of reductions of extreme poverty since the mid-1980s.

Existing analyses of returns to education indicate that they have experienced significant changes over the period of analysis. Three major changes have been identified by Núñez and Sánchez (1998): a moderate reduction in the return per year of education in the 1970s and 1980s (from 8.0% in 1976 to 5.8% in 1990); a significant reduction in the "premium" associated with completing secondary education, which was very sharp and turned negative in 1976-1982, and improved somewhat since the mid-1980s; and a significant increase in the premium of completing university education over the past few decades.

Both Robbins (1998) and Núñez and Sánchez (1998) associate relative wage shifts to major changes in the demand for labor. Robbins identified a major shift in the relative demand for labor with higher educational levels in the mid-1980s (specifically between 1983 and 1985, depending on the city), i.e., during the years of macroeconomic adjustment. Whereas the supply of more educated

labor tended to outpace its demand up until then, the opposite was true since the second half of the 1980s. His regression analysis indicated that these effects could be associated with trade and exchange rate policies. Trade liberalization biased the demand for labor towards higher education and, thus, increased wage differentials; devaluation had a similar effect. The first of these effects is similar but the second opposite to those found by Ocampo et al. (1998). Thus, the change in the skill bias was associated, according to Robbins, to large devaluation in the mid-1980s. The continuation in the skill biases in the demand for labor in the 1990s was associated with trade liberalization, with revaluation having some mitigating effects.

Econometric results by Ocampo et al. (1998) also indicated that trade liberalization widened wage differentials, particularly those between workers with university education and the rest, and thus increased the labor Gini coefficient. They also showed that faster economic growth had a similar effect (although its effects on the Gini coefficient were statistically weak), and that fixed capital formation widened wage differentials, particularly between workers with university education and the rest, and thus worsened the distribution of wage income. Other results indicated that human capital formation had a positive effect on wage differentials and equity. In particular, it tended to reduce the wage dispersion between workers with primary education and the rest. Finally, according to this study, minimum wages have a favorable effect on wages for workers with primary education, but no overall effect on income distribution.

VI.   CONCLUSIONS

This paper has analyzed the effects of structural reforms in Colombia in the 1990s. It concludes that the attempt to combine economic liberalization with a more active social policy

was no easy task, as reflected in rising fiscal stains. Also, the economic authorities experienced large difficulties in dealing with a more open economy. These difficulties gave rise to sharp stop-go cycles in monetary policy and exchange-rate appreciation up to 1997, which were reflected, in turn, in a more volatile GDP and aggregate demand growth than in the past. From the point of view of the sources of aggregate demand growth, the export-led growth characteristic of late 1980s was interrupted in the early 1990s. Rising domestic demand was thus the basis of rapid GDP growth in 1992-1995, led first by private demand and later by public sector spending. The demand stimulus became eventually unsustainable due to rising external deficits and was thus followed by a series of adjustments since 1996, the most severe of which was during the recent international financial crisis. Rising oil and mining production led to renewed export growth since 1995. Sectoral growth became more dispersed with the tradable sectors experienced a sharp deterioration, particularly in agriculture and manufacturing.

This structural transformation had large effects on the labor market, the most important of which was the weak capacity of the economy to create new jobs. This phenomenon is evident since the 1992-1995 boom, but was then counteracted by favorable labor supply trends. By sectors, weak performance of employment in tradable sectors since the boom years was compensated by the positive response of non-tradable sectors, but this factor ceased to operate as the domestic demand-led expansion was exhausted.

Less-skilled workers have been the most affected by the reduction in labor demand. Sectoral shifts are partly responsible for the skill bias: the reduction of employment in tradables was a hard blow to the less educated, as rising demand for labor in non-tradables during the

boom years concentrated in more educated labor. Beyond that, it is evident that the economy experienced labor-saving technical change, affecting workers of all educational levels, but more severely those with less skills.

The strong expansion in social spending was reflected in an improvement of living condition and in the coverage of social services, and a significant improvement in secondary income distribution. On the contrary, primary income distribution remained highly skewed and deteriorated further in the 1990s. This was the result of strong distributive shocks that partially netted out. The rural-urban income gap increased sharply in the first half of the 1990s, reflecting the urban bias of the trade liberalization process. However, between 1991 and 1995, rural distribution improved as a result of the destruction of rural rents, but this was followed by adverse trends in more recent years. On the urban side, distribution worsened considerably in the 1990s, basically due to the skill bias generated by structural and technological change.

Both urban and rural poverty improved in the first half of the 1990s but deteriorated during the recent adjustment period. Over the long term, urban poverty has decreased and rural poverty has increased. This has been basically determined by real income growth in urban and rural areas, respectively, but over shorter periods variations in income distribution have had important effects on rural poverty.

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TABLE 1

POLICY AND POLICY INDUCED VARIABLES

	1975 - 79	1980 - 85	1986 - 90	1991-98	1990	1991	1992	1993	1994	1995	1996	1997	1998
REAL EXCHANGE RATE (1994 = 100)	81.0	73.0	103.0	102.5	114.8	113.0	106.7	107.5	100.0	102.1	98.9	93.3	98.5
REAL INTEREST RATE													
DEPOSIT RATE (90 DAYS)		10.3	6.4	5.9	4.9	4.8	-0.5	2.5	5.4	9.5	8.6	4.7	11.6
AVERAGE LENDING RATE			14.1	14.4	12.6	12.8	8.1	10.9	14.3	18.1	17.6	13.3	19.4
GROWTH OF REAL DOMESTIC SUPPLY													
M1	4.1	0.2	2.7	0.3	-15.4	-1.2	9.9	8.5	6.7	-11.2	-1.7	5.1	-19.1
M3		10.3	4.0	63.7	1.1	-2.0	11.3	13.3	15.2	10.9	0.7	6.9	2.0
GROWTH OF REAL DOMESTIC CREDIT		11.7	7.7	7.8	8.0	-6.9	11.0	24.4	17.6	14.7	2.0	8.1	-4.2
TOTAL GOVERMENT EXPENDITURE (% OF GDP)													
DANE (ACCRUALS)	20.3	28.1	30.1		30.1	29.7	30.7	32.0	34.3	35.4			
BANCO DE LA REPUBLICA (CASH PAYMENTS NET OF TRANSFERS)					30.4	31.8	31.0	31.3	31.4	34.0			
MINISTRY OF FINANCE									30.3	32.0	35.8	37.2	36.0
OVERALL FISCAL SURPLUS OR DEFICIT, NET OF PRIVATIZATIONS (% of GDP)	-1.5	-5.3	-1.5	-1.1	-0.5	0.0	-0.1	0.1	0.1	-0.4	-1.9	-3.1	-3.3
CENTRAL GOVERMENT	-0.2	-3.3	-0.9	-2.0	-0.7	0.4	0.2	-0.3	-1.4	-2.4	-3.7	-4.0	-4.5
REST OF PUBLIC SECTOR	-1.3	-2.0	-0.6	0.9	0.2	-0.4	-0.3	0.4	1.5	2.0	1.8	0.9	1.2
PRIVATIZATIONS									2.6	0.3	0.9	3.6	0.5
GDP GROWTH	5.0	2.6	4.6	3.6	4.3	2.0	4.0	5.4	5.8	5.8	2.0	2.8	0.6
VALUE ADDED TRADABLES	4.9	1.8	5.7	1.7	5.1	2.2	0.8	2.1	1.3	4.7	-0.4	1.3	1.5
VALUE ADDED NON TRADABLES	5.1	3.2	3.7	4.3	3.2	2.0	5.4	5.3	7.8	6.2	4.3	3.4	0.1
AGGREGATE DOMESTIC DEMAND GROWTH	4.8	2.4	3.4	5.7	2.3	0.1	10.0	12.1	12.0	4.8	1.9	4.5	0.0
URBAN EMPLOYMENT (% OF WORKING AGE POPULATION)	45.8	48.2	50.9	53.8	52.2	53.5	54.6	55.0	54.6	54.6	52.9	52.6	52.6
URBAN UNEMPLOYMENT (% OF LABOR FORCE)	9.4	11.1	11.4	10.7	10.5	10.2	10.2	8.6	8.9	8.8	11.2	12.4	15.3
INFLATION (CPI END YEAR)	23.9	26.7	26.3	21.6	32.4	26.8	25.1	22.6	22.6	19.5	21.6	17.7	16.7
EXPORTS (% OF GDP AT 1975 PRICES)	15.0	14.4	18.5	25.1	20.7	22.7	23.1	23.3	22.0	23.8	27.6	28.5	30.1
EXTERNAL ACCCOUNT BALANCES													
(% OF GDP AT 1994 PARITY EXCHANGE RATE)													
TRADE ACCOUNT	3.5	-3.1	3.9	-1.2	4.3	6.2	2.3	-2.8	-3.3	-3.3	-2.9	-3.1	-2.8
CURRENT ACCOUNT	1.5	-6.8	0.3	-3.3	1.2	4.9	1.7	-3.7	-5.2	-5.6	-5.6	-6.6	-5.8
FOREIGN DIRECT INVESTMENT (% OF GDP AT 1994 PARITY EXCHANGE RATE)	0.3	1.7	1.1	2.5	1.0	0.9	1.3	1.2	2.1	1.2	3.6	6.2	3.2
EXTERNAL DEBT (% OF EXPORTS OF GOODS AND SERVICES)	155.0	235.0	250.4	202.1	207.8	190.6	188.4	194.8	192.1	192.3	211.8	211.6	235.0
GROSS FIXED CAPITAL FORMATION (% OF GDP AT 1975 PRICES)	15.6	17.1	15.5	18.2	14.0	12.9	13.9	18.0	20.7	21.7	20.6	20.8	17.3

Sources: Banco de la República, DANE (National Statistical Department), DNP (National Planning Department) and Ministry of Finance

TABLE 2

SECTORAL COMPOSITION OF GDP AND EMPLOYMENT

Economic Sector	GDP				Employment		
	1985	1991	1995	1998	1991	1995	1997
Agriculture	21.9%	21.8%	19.3%	18.3%	26.7%	22.2%	22.9%
Mining	2.3%	4.6%	4.3%	5.0%	1.2%	0.8%	0.7%
Manufacturing	21.2%	21.4%	19.0%	17.8%	15.0%	15.7%	13.2%
Electricity, water and gas	1.0%	1.1%	1.1%	1.1%	0.6%	0.5%	0.9%
Construction	4.4%	3.0%	3.7%	3.0%	4.5%	6.1%	5.3%
Commerce	12.1%	11.5%	11.9%	11.6%	20.7%	21.7%	21.9%
Transport	9.4%	8.6%	8.7%	9.4%	5.0%	5.5%	5.5%
Financial Services	14.2%	14.6%	16.3%	16.2%	3.6%	4.6%	5.0%
Other services	13.2%	13.2%	12.9%	14.1%	22.6%	22.8%	24.7%
TOTAL	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Tradables	45.4%	47.8%	42.6%	41.1%	43.0%	38.7%	36.8%
Urban					14.2%	14.1%	12.5%
Rural					28.8%	24.7%	24.3%
Non-tradables	54.3%	52.0%	54.7%	55.4%	57.0%	61.3%	63.2%
Urban					43.9%	47.0%	49.4%
Rural					13.1%	14.3%	13.8%

Source: National Household Surveys and National Accounts

TABLE 3

DECOMPOSITION OF GLOBAL CHANGES
IN THE LABOR MARKET

(% changes of rates, defined in relation to total population)

		1991-1995	1995-1997	1991-1997
CHANGES IN LABOR SUPPLY	**Total * /**	1.2%	-0.6%	0.5%
	Demographic	2.2%	-0.1%	2.2%
	Participation	-1.0%	-0.6%	-1.6%
CHANGES IN LABOR DEMAND	**Employment * /**	0.7%	-2.9%	-2.2%
	Tradables	-3.9%	-3.0%	-7.0%
	Non-tradables	4.7%	0.1%	4.8%
	Unemployment	0.5%	2.1%	2.6%

*/ The decomposition excludes the combined effects of the changes in both components.

Note: For definitions see text.

Source: National Household Surveys. Data processed by the authors.

TABLE 4

SECTORAL DECOMPOSITION OF LABOR PRODUCTIVITY, PER CAPITA OUTPUT AND EMPLOYMENT CHANGES

	1991-1995	1995-1997	1991-1997
Labor productivity growth			
Agriculture	18.7%	-4.1%	13.8%
Mining	65.6%	22.7%	103.2%
Manufacturing	-2.8%	18.4%	15.2%
Electricity, water and gas	34.1%	-38.6%	-17.6%
Construction	7.2%	14.1%	22.3%
Commerce	13.2%	1.1%	14.5%
Transport	2.5%	10.6%	13.3%
Financial services	-3.0%	0.1%	-2.9%
Other services	11.7%	4.4%	16.6%
TOTAL	**10.4%**	**4.2%**	**15.0%**
Tradables	12.0%	5.6%	18.3%
Non-tradables	10.8%	4.0%	15.2%
Per capita output growth			
Agriculture	-0.7%	-3.9%	-4.6%
Mining	9.0%	8.5%	18.3%
Manufacturing	2.7%	-3.7%	-1.1%
Electricity, water and gas	11.7%	2.6%	14.6%
Construction	46.9%	-4.1%	40.8%
Commerce	19.8%	-0.9%	18.7%
Transport	13.6%	6.1%	20.4%
Financial services	24.4%	4.4%	29.9%
Other services	13.4%	9.9%	24.6%
TOTAL	**11.2%**	**1.2%**	**12.5%**
Tradables	1.7%	-2.6%	-0.9%
Non-tradables	19.8%	4.2%	24.8%
Change in the employment rate (relative to total population)			
Agriculture	-4.4%	0.0%	-4.3%
Mining	-0.4%	-0.1%	-0.5%
Manufacturing	0.8%	-2.9%	-2.1%
Electricity, water and gas	-0.1%	0.3%	0.2%
Construction	1.7%	-1.0%	0.7%
Commerce	1.2%	-0.4%	0.8%
Transport	0.5%	-0.2%	0.3%
Financial services	1.0%	0.2%	1.2%
Other services	0.3%	1.2%	1.5%
TOTAL	**0.7%**	**-2.9%**	**-2.2%**
Tradables	-3.9%	-3.0%	-7.0%
Non-tradables	4.7%	0.1%	4.8%

Source: National Household Surveys. Data processed by the authors.

TABLE 5

CHANGES IN THE EMPLOYMENT RATES

Average years of education	1991-1995	1995-1997	1991-1997
A.- By educational attainment			
0-5 Years	**-3.0%**	**-2.5%**	**-5.6%**
Tradables	-3.7%	-1.4%	-5.1%
Non-tradables	0.6%	-1.1%	-0.5%
6-10 Years	**0.3%**	**-3.0%**	**-2.7%**
Tradables	-0.5%	-1.4%	-2.0%
Non-tradables	0.8%	-1.6%	-0.7%
11 Years	**3.2%**	**0.3%**	**3.5%**
Tradables	0.6%	-0.3%	0.3%
Non-tradables	2.6%	0.6%	3.2%
12 - 15 years	**0.0%**	**0.6%**	**0.7%**
Tradables	-0.1%	-0.1%	-0.2%
Non-tradables	0.1%	0.7%	0.8%
16 and more	**0.2%**	**1.7%**	**2.0%**
Tradables	-0.3%	0.3%	0.0%
Non-tradables	0.5%	1.5%	2.0%
Total	**0.7%**	**-2.9%**	**-2.2%**
Tradables	-3.9%	-3.0%	-7.0%
Non-tradables	4.7%	0.1%	4.8%
B.- By occupational category			
Private sector wage earner	3.7%	-3.4%	0.3%
Public sector wage earner	-1.9%	-0.3%	-2.2%
Employers	-0.3%	-0.5%	-0.9%
Workers in household activities	-0.2%	-0.2%	-0.4%
Self-employed	2.2%	1.8%	4.0%
Family workers without payment	-2.8%	-0.2%	-3.0%
C.- By gender			
Male	-0.8%	-1.8%	-2.6%
Female	1.5%	-1.1%	0.4%
TOTAL	**0.7%**	**-2.9%**	**-2.2%**

Note: Sectoral contribution of each sector to the employment ratio
refered to total population.

Source: National Household Surveys. Data processed by the authors.

TABLE 6

INDICATORS OF SOCIAL PROGRESS

	CENSUS DATA		QUALITY OF LIFE SURVEY	
	1985	1993	1993	1997
A.-UNSATISFIED BASIC NEEDS				
NATIONAL				
Poor (%)	45.6	32.2	32.7	26.9
Extremely poor (%)	22.8	13.5	13.5	9.0
URBAN				
Poor (%)	32.3	20.6	20.6	17.5
Extremely poor (%)	12.6	6.1	4.0	3.3
RURAL				
Poor (%)	72.6	58.9	60.9	49.6
Extremely poor (%)	44.4	30.8	35.5	22.8
B. COVERAGE RATES				
SCHOOL ATTENDANCE (NET)				
Primary	61.5		75.2	83.4
Secondary	37.7		47.8	59.7
SOCIAL SECURITY HEALTH				
% of total population			23.7	57.2
PUBLIC UTILITIES				
Energy	78.5		86.0	93.8
Water	73.1		80.0	85.6
Sewage	59.4		63.3	70.8
C.QUALITY OF HOUSING				
Inadequate materials	13.8	7.3	7.3	7.6
Overcrowding	19.4	12.8	12.8	11.0
Lack of access to basic utilities	21.8	10.4	10.4	5.7

Source: DNP

TABLE 7

INCOME DISTRIBUTION AND POVERTY

	year	GINI Household per capita income	NATIONAL POVERTY LINE				INTERNATIONAL POVERTY LINE			
			Incidence	Intensity	Poverty gap	Foster-Greer Thorbecke	Incidence	Intensity	Poverty gap	Foster-Greer Thorbecke
TOTAL NATIONAL	1978	0.5039	56.5	45.3	25.6	14.7	20.2	32.6	6.6	3.2
	1991	0.5284	60.5	47.3	28.6	17.2	23.2	38.4	8.9	4.9
	1992	0.5258	59.4	45.2	26.8	15.5	20.1	35.5	7.1	3.7
	1993	0.5219	57.3	45.0	25.8	15.0	18.5	36.5	6.7	3.6
	1994	0.5278	55.4	44.3	24.5	14.0	17.9	35.0	6.3	3.3
	1995	0.5314	53.9	43.9	23.7	13.5	16.8	35.8	6.0	3.1
	1996	0.5334	53.0	43.0	22.8	12.8	15.4	35.4	5.5	2.9
	1997	0.5427	54.7	45.8	25.1	15.0	18.4	40.6	7.5	4.6
	1998	0.5378	55.0	46.6	25.6	15.6	19.3	41.4	8.0	4.9
URBAN AREA	1978	0.5030	53.4	43.7	23.3	12.9	13.8	28.0	3.9	1.7
	1991	0.4842	48.0	40.1	19.2	10.2	8.1	27.7	2.2	1.0
	1992	0.5030	51.6	41.2	21.3	11.3	11.0	27.8	3.1	1.3
	1993	0.4935	50.8	41.5	21.1	11.5	10.5	29.1	3.1	1.4
	1994	0.5124	46.1	39.5	18.2	9.6	8.2	28.3	2.3	1.0
	1995	0.5252	44.8	39.6	17.7	9.3	7.6	29.8	2.3	1.0
	1996	0.5132	43.6	38.7	16.9	8.8	7.1	29.1	2.1	1.0
	1997	0.5228	46.7	40.8	19.0	10.2	9.6	29.5	2.8	1.3
	1998	0.5246	45.7	41.4	18.9	10.2	9.5	30.2	2.9	1.3
RURAL AREA	1978	0.4767	60.6	47.1	28.5	17.0	28.5	35.5	10.1	5.2
	1988	0.5572	71.1	51.4	36.6	23.2	36.0	40.5	14.6	8.2
	1991	0.5624	69.6	49.0	34.1	21.0	32.0	39.0	12.5	6.9
	1992	0.5189	66.6	48.9	32.5	20.1	29.8	40.2	12.0	6.8
	1993	0.4995	67.7	48.5	32.9	19.9	30.7	37.4	11.5	6.2
	1994	0.4754	66.0	47.8	31.6	19.2	28.9	37.9	11.0	5.9
	1995	0.4373	65.6	46.8	30.7	18.2	26.6	37.6	10.0	5.4
	1996	0.5033	67.3	51.3	34.5	22.4	32.2	45.8	14.7	9.6
	1997	0.4810	69.6	52.1	36.3	23.9	34.6	46.3	16.0	10.5
	1998	0.4977	66.1	49.8	32.9	20.8	30.3	41.8	12.7	7.6

Note: Data correspond to septembers, except 1978, June, and 1991, December.
Source: National Household Surveys. Data processed by the authors.

TABLE 8

INCOME DISTRIBUTION, HOUSEHOLD AND LABOR MARKET CHARACTERISTICS

Deciles	1978 TOTAL	1-2	3-5	6-8	9	10	1991 TOTAL	1-2	3-5	6-8	9	10	1995 TOTAL	1-2	3-5	6-8	9	10	1998 TOTAL	1-2	3-5	6-8	9	10
PER CAPITA INCOME DISTRIBUTION (1978 constant pesos)																								
National total	100.0	4.0	13.1	25.7	15.0	42.2	100.0	3.6	12.3	24.3	14.7	45.1	100.0	3.6	12.2	24.2	14.6	45.4	100.0	3.2	11.8	24.6	15.8	44.5
Urban area	100.0	4.2	13.0	25.5	15.3	42.1	100.0	4.4	13.8	26.2	15.5	40.2	100.0	3.9	12.4	23.8	14.3	45.6	100.0	3.6	12.1	25.0	16.1	43.2
Rural area	100.0	4.2	14.2	27.3	15.2	39.1	100.0	3.3	11.5	21.6	12.6	51.0	100.0	4.7	15.9	29.0	16.1	34.3	100.0	3.5	13.8	26.7	15.4	40.6
7 largest cities	100.0	4.2	13.2	26.2	16.0	40.4	100.0	4.3	13.3	25.8	15.5	41.0	100.0	3.9	12.2	23.4	14.1	46.4	100.0	3.4	11.6	25.1	16.7	43.2
INCOME DISTRIBUTION OF THE WORKING AGE POPULATION																								
National total	100.0	4.0	13.1	25.6	15.0	42.3	100.0	3.6	12.4	24.3	14.7	45.1	100.0	3.6	12.2	24.2	14.6	45.5	100.0	3.2	11.8	24.6	15.9	44.5
Urban area	100.0	4.2	13.0	25.4	15.3	42.0	100.0	4.4	13.8	26.1	15.4	40.2	100.0	3.9	12.5	23.8	14.3	45.6	100.0	3.6	12.1	25.0	16.1	43.1
Rural area	100.0	4.2	14.3	27.3	15.2	39.0	100.0	3.3	11.6	21.7	12.7	50.7	100.0	4.7	15.9	29.0	15.9	34.5	100.0	3.5	13.9	26.8	15.4	40.5
7 largest cities	100.0	4.3	13.2	26.1	16.0	40.4	100.0	4.3	13.3	25.8	15.5	41.1	100.0	3.9	12.2	23.4	14.1	46.3	100.0	3.4	11.5	25.3	16.7	43.1
HOUSEHOLD SIZE																								
National total	5.6	6.8	6.2	5.5	4.9	4.2	4.7	5.6	5.1	4.5	4.0	3.5	4.4	5.3	4.8	4.2	3.8	3.5	4.3	5.3	4.7	4.1	3.6	3.3
Urban area	5.5	6.6	5.9	5.3	4.9	4.3	4.5	5.3	4.8	4.4	3.9	3.4	4.3	5.0	4.7	4.1	3.7	3.5	4.2	5.1	4.5	4.0	3.6	3.2
Rural area	5.8	6.8	6.5	5.8	5.2	4.0	4.9	5.6	5.4	4.9	4.2	3.8	4.6	5.3	5.2	4.5	3.9	3.3	4.5	5.4	5.1	4.4	3.9	3.1
7 largest cities	5.4	6.5	5.8	5.3	4.9	4.4	4.3	5.1	4.8	4.2	3.7	3.3	4.2	4.9	4.5	4.0	3.6	3.3	4.0	4.9	4.4	3.8	3.6	3.1
AVERAGE YEARS OF SCHOOL ATTENDANCE (POPULATION OF 18 AND OLDER)																								
National total	4.5	2.7	3.5	4.3	5.6	7.6	6.3	3.8	5.0	6.5	8.2	9.6	6.7	4.2	5.3	6.8	8.5	10.7	7.0	4.4	5.5	7.0	9.2	11.4
Urban area	5.8	3.9	4.7	5.7	7.3	8.9	7.8	5.3	6.6	7.9	9.3	11.0	8.2	5.9	7.0	8.2	10.0	11.7	8.5	6.0	7.0	8.5	10.5	12.4
Rural area	2.6	2.1	2.3	2.6	2.6	3.6	4.2	3.1	3.7	4.3	4.9	5.6	4.5	3.7	3.9	4.4	5.1	6.0	4.4	3.3	3.7	4.4	5.2	6.7
7 largest cities	6.3	4.1	4.9	6.2	7.9	9.6	8.3	6.0	7.0	8.5	10.2	11.6	8.4	6.0	7.1	8.4	10.1	12.0	9.0	6.4	7.3	9.2	11.3	13.0
% OF WORKING AGE POPULATION																								
National total	72.8	62.6	68.0	76.5	82.0	85.5	74.4	65.6	69.8	77.9	83.9	85.2	76.1	66.5	72.3	79.6	84.8	86.9	75.9	66.8	71.4	80.0	84.3	86.1
Urban area	75.8	64.3	72.9	79.8	83.1	86.5	74.3	60.7	70.4	79.1	84.6	86.7	76.6	64.4	73.0	81.4	85.3	87.5	76.7	65.2	73.1	81.3	86.1	86.5
Rural area	68.8	62.5	62.9	71.1	78.1	82.6	74.6	68.4	70.5	76.9	83.1	83.7	75.5	67.8	70.7	78.9	83.4	86.7	74.6	67.0	70.7	77.4	84.4	83.0
7 largest cities	77.1	65.8	73.4	81.9	84.8	86.8	75.6	61.9	71.7	81.0	85.2	87.2	76.9	64.0	73.1	82.3	85.4	88.4	77.7	65.4	74.6	83.0	85.5	87.4
EMPLOYMENT RATE: EMPLOYEES/WORKING AGE POPULATION																								
National total	44.9	35.4	39.7	48.1	53.0	54.1	53.6	46.8	50.2	56.2	56.9	61.5	52.7	42.7	47.9	56.0	60.1	62.7	51.9	43.4	48.1	54.8	57.3	61.1
Urban area	43.1	29.8	38.8	47.5	49.7	53.2	52.9	42.8	50.9	55.3	56.3	61.5	53.2	40.1	49.9	56.7	60.8	62.8	51.3	39.8	48.0	54.8	56.0	61.5
Rural area	47.6	40.2	41.6	49.0	55.4	61.2	54.5	49.8	50.1	56.1	61.0	61.9	51.9	43.6	47.5	52.1	61.0	65.7	53.1	45.7	48.6	54.7	59.8	64.9
7 largest cities	43.9	31.1	40.0	48.3	49.6	53.5	54.0	42.0	51.3	56.8	59.5	63.2	54.4	40.4	50.8	58.8	61.2	64.2	52.3	40.0	49.7	55.3	58.7	61.9
UNEMPLOYMENT RATE: UNEMPLOYED/ECONOMICALLY ACTIVE POPULATION																								
National total	5.1	6.3	6.2	4.8	4.8	3.3	7.1	8.2	7.9	7.3	6.8	4.1	7.4	10.4	9.3	6.8	5.3	3.9	11.8	17.0	14.5	11.0	8.7	5.2
Urban area	7.4	12.4	8.9	6.7	6.7	3.0	9.3	14.6	10.5	8.7	7.7	4.2	9.1	17.9	11.1	7.6	4.9	3.7	14.5	26.1	17.9	12.2	8.7	4.7
Rural area	2.0	2.0	2.7	2.0	1.3	1.4	4.2	5.6	4.9	3.9	2.6	3.2	4.9	7.1	6.0	5.1	2.6	2.2	7.2	9.5	9.0	7.2	3.9	3.9
7 largest cities	8.0	14.1	10.3	6.5	6.1	3.7	9.2	15.8	11.0	8.4	5.8	3.9	8.4	17.6	10.2	6.7	4.6	3.4	14.4	27.7	17.4	12.1	6.8	4.6
DEPENDENCY RATE: INACTIVE AND UNEMPLOYED/EMPLOYED																								
National total	205.9	351.6	270.1	171.7	130.1	116.1	150.8	225.6	185.7	128.4	109.6	91.0	149.4	252.1	188.8	124.4	96.2	83.4	153.7	244.8	191.3	128.1	107.3	90.1
Urban area	206.4	421.6	253.7	163.6	142.1	117.4	154.5	284.8	179.2	128.9	109.9	87.6	145.4	287.3	174.8	116.6	92.7	81.9	154.3	285.6	185.3	124.5	107.4	88.0
Rural area	205.2	298.1	281.9	187.0	131.1	97.8	146.0	193.8	183.1	131.8	97.3	93.1	155.1	238.4	197.4	143.4	96.6	75.5	152.6	227.0	191.1	136.2	98.0	85.7
7 largest cities	195.4	388.4	240.3	152.7	138.0	115.1	145.1	284.5	171.6	117.2	97.3	81.3	138.9	286.8	169.2	106.9	91.2	76.0	145.9	282.2	169.8	118.1	99.4	84.7
FORMALITY RATE: FORMAL EMPLOYMENT/TOTAL EMPLOYMENT																								
National total	60.4	43.0	60.6	64.4	66.8	61.1	59.6	33.9	56.6	67.2	72.2	64.5	60.4	35.3	57.9	66.7	69.3	67.0	55.8	26.9	51.1	62.3	68.4	68.0
Urban area	67.0	61.6	66.5	71.0	69.5	61.1	64.9	45.0	63.1	70.8	70.8	67.4	64.7	47.8	62.2	70.0	69.8	66.9	60.2	33.1	55.0	66.6	70.6	70.5
Rural area	51.9	33.1	49.9	57.9	58.5	55.8	53.0	24.8	49.3	61.5	67.1	61.6	54.5	27.1	51.1	61.7	63.3	64.8	48.7	20.4	46.0	56.2	60.1	57.4
7 largest cities	68.7	63.8	68.3	73.2	72.1	59.9	68.7	52.3	68.1	74.6	73.4	66.3	66.2	50.4	66.1	70.4	70.6	66.2	64.2	41.6	59.0	71.1	72.8	70.2

Source: National Household Surveys. Data processed by the authors.

<table>
<tr><td colspan="25" align="center">TABLE 9</td></tr>
</table>

TABLE 9

DECOMPOSITION OF THE PER CAPITA INCOME GROWTH

	1978 - 1991						1991 - 1995						1995-1998						1978-1998					
	TOTAL	1 - 2	3 - 5	6 - 8	9	10	TOTAL	1 - 2	3 - 5	6 - 8	9	10	TOTAL	1 - 2	3 - 5	6 - 8	9	10	TOTAL	1 - 2	3 - 5	6 - 8	9	10
EMPLOYED POPULATION AVERAGE INCOME																								
National total	-0.80	-2.18	-1.54	-1.00	-0.20	0.33	4.26	6.57	4.35	3.74	2.27	3.41	-0.21	-4.73	-1.62	0.29	4.22	0.05	0.14	-1.21	-0.61	-0.02	0.93	0.89
Urban area	-0.88	-1.37	-0.89	-0.43	-0.54	-0.70	7.76	5.09	5.14	4.11	3.65	12.66	-2.07	-5.73	-2.91	-0.48	3.54	-3.65	0.33	-0.97	-0.20	0.36	0.82	0.94
Rural area	-0.57	-2.53	-2.28	-1.98	-1.36	3.32	-4.39	8.70	4.22	3.59	0.23	-13.58	2.87	-7.49	-2.29	-0.68	2.40	13.47	-0.80	-1.59	-1.25	-0.92	-0.58	-0.01
7 largest cities	-0.16	-0.54	-0.44	-0.06	-0.31	0.38	5.27	3.12	3.12	1.77	2.25	9.47	0.88	-4.61	-1.83	4.39	7.66	-0.93	1.00	-0.53	-0.03	0.97	1.37	1.91
EMPLOYED RATE: EMPLOYEES/WORKING AGE POPULATION																								
National total	1.43	2.40	1.95	1.24	0.54	1.00	-0.46	-2.34	-1.23	-0.11	1.52	0.54	-0.45	0.54	0.13	-0.68	-1.58	-0.83	0.77	1.12	1.04	0.69	0.40	0.64
Urban area	1.70	3.22	2.31	1.20	0.98	1.16	0.15	-1.70	-0.52	0.69	2.14	0.56	-1.21	-0.26	-1.27	-1.10	-2.65	-0.70	0.94	1.64	1.17	0.76	0.62	0.77
Rural area	1.07	1.76	1.51	1.08	0.75	0.08	-1.25	-3.32	-1.36	-1.91	-0.01	1.65	0.75	1.60	0.75	1.71	-0.64	-0.42	0.57	0.67	0.83	0.58	0.39	0.30
7 largest cities	1.70	2.59	2.09	1.30	1.48	1.34	0.22	-1.04	-0.26	0.90	0.79	0.42	-1.30	-0.31	-0.73	-1.99	-1.40	-1.20	0.94	1.41	1.20	0.71	0.91	0.78
% OF WORKING AGE POPULATION																								
National total	0.17	0.35	0.19	0.14	0.17	-0.02	0.62	0.36	0.98	0.58	0.29	0.54	-0.11	0.16	-0.41	0.14	-0.21	-0.33	0.21	0.33	0.25	0.22	0.14	0.03
Urban area	-0.15	-0.41	-0.26	-0.07	0.14	0.02	0.84	1.63	0.97	0.80	0.22	0.26	0.04	0.41	0.05	-0.07	0.31	-0.38	0.06	0.08	0.01	0.09	0.18	0.00
Rural area	0.62	0.70	0.89	0.60	0.47	0.10	0.32	-0.22	0.08	0.69	0.10	0.96	-0.43	-0.42	-0.02	-0.65	0.42	-1.43	0.41	0.36	0.61	0.43	0.40	0.02
7 largest cities	-0.14	-0.44	-0.17	-0.08	0.04	0.03	0.46	0.91	0.50	0.41	0.06	0.37	0.36	0.72	0.67	0.29	0.02	-0.38	0.04	-0.03	0.08	0.07	0.04	0.03
PER CAPITA INCOME																								
National total	0.65	-0.16	0.19	0.22	0.50	1.35	4.42	4.06	4.01	4.28	4.26	4.64	-0.76	-4.12	-1.89	-0.25	2.21	-1.12	1.18	-0.06	0.56	0.92	1.58	1.68
Urban area	0.45	0.77	0.86	0.63	0.52	0.37	9.04	4.88	5.64	5.86	6.36	13.88	-3.17	-5.60	-4.02	-1.62	0.93	-4.60	1.41	0.43	0.93	1.28	1.79	1.86
Rural area	1.08	-0.79	-0.49	-0.69	-0.33	3.58	-5.18	4.03	2.73	2.15	0.32	-12.27	3.22	-6.59	-1.62	0.32	2.15	10.90	0.06	-0.87	-0.10	-0.05	0.15	0.31
7 largest cities	1.32	1.32	1.32	1.14	1.15	1.84	6.10	2.93	3.39	3.19	3.18	10.55	-0.09	-4.27	-1.89	2.45	5.97	-2.45	2.19	0.69	1.25	1.91	2.59	3.03

Note: For methodology see text.
Source: National Household Surveys. Data processed by the authors.

TABLE 10

ESTIMATED EFFECTS OF ECONOMIC GROWTH AND INCOME DISTRIBUTION ON POVERTY

	1978 - 1991				1991 - 1995				1995 - 1998				1978 - 1998			
	GROWTH	DISTRIBUTION	RESIDUAL	TOTAL	GROWTH	DISTRIBUTION	RESIDUAL	TOTAL	GROWTH	DISTRIBUTION	RESIDUAL	TOTAL	GROWTH	DISTRIBUTION	RESIDUAL	TOTAL
NATIONAL TOTAL																
National poverty line	-2.9	5.5	0.3	2.9	-7.2	1.0	-0.3	-6.4	1.2	0.9	-0.1	2.0	-8.7	6.7	0.5	-1.5
International poverty line	-2.1	1.9	0.1	-0.1	-4.6	0.7	-0.8	-4.7	1.0	1.7	0.2	2.9	-6.7	4.7	0.2	-1.8
URBAN AREA																
National poverty line	-1.9	0.2	0.0	-1.8	-14.7	7.0	-0.3	-8.0	5.2	0.1	-0.8	4.5	-10.0	4.9	-0.1	-5.2
International poverty line	-1.0	-1.8	0.0	-2.8	-5.6	2.9	-1.2	-3.9	2.3	1.6	0.0	3.9	-6.0	3.7	-0.5	-2.8
RURAL AREA																
National poverty line	-4.5	12.6	0.9	9.0	8.1	-14.6	2.6	-4.0	-4.7	4.6	0.6	0.5	0.5	4.5	0.4	5.5
International poverty line	-4.7	8.7	-0.6	3.5	11.2	-13.1	-3.4	-5.4	-3.5	7.1	0.0	3.7	0.7	0.7	0.5	1.8

Source: National Household Surveys. Data processed by the authors.

FIGURE 1

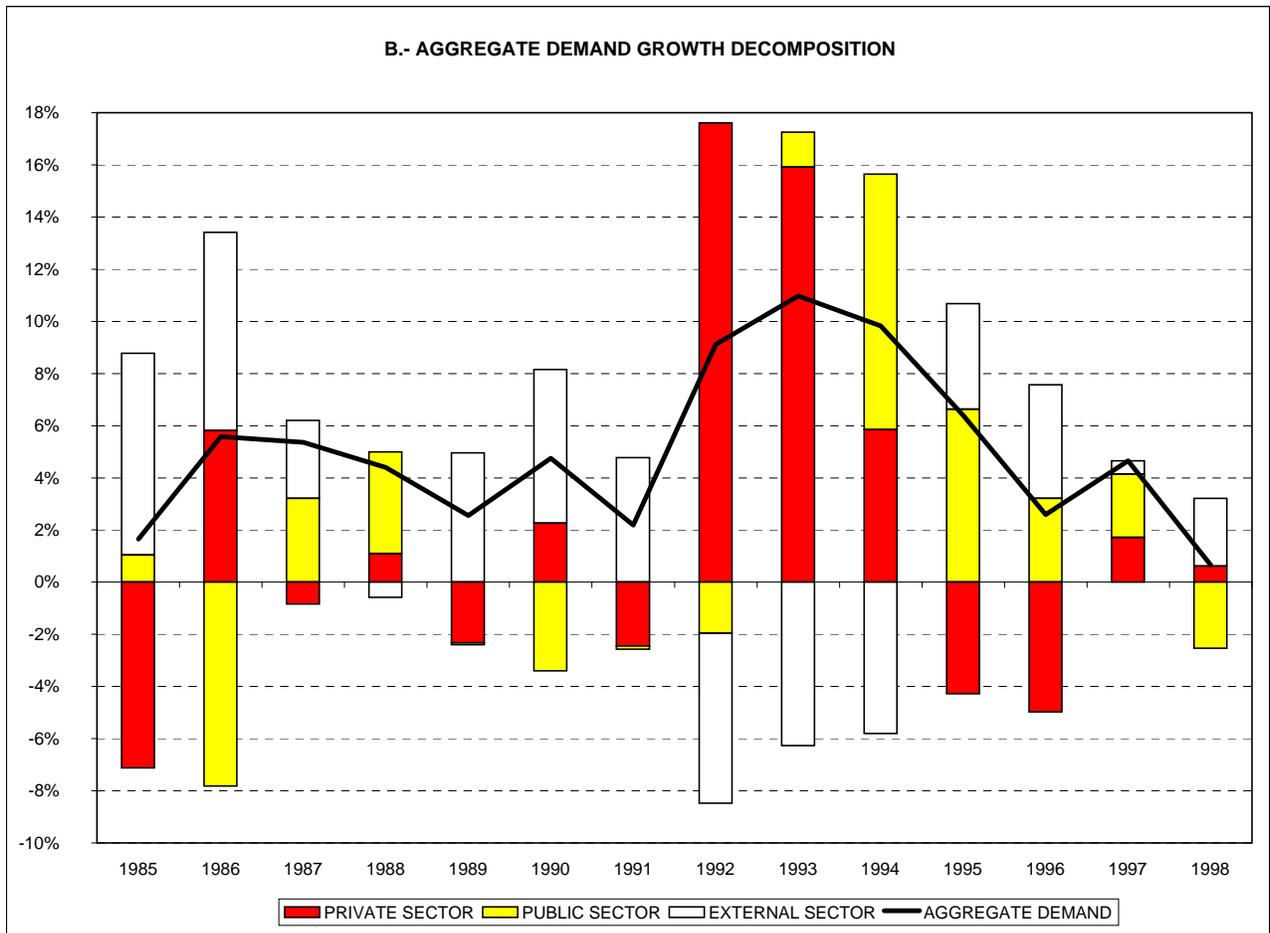**AGGREGATE DEMAND SOURCES OF GROWTH, 1985-1998**

A.- DOMESTIC DEMAND vs. GDP

GDP — — Domestic demand

B.- AGGREGATE DEMAND GROWTH DECOMPOSITION

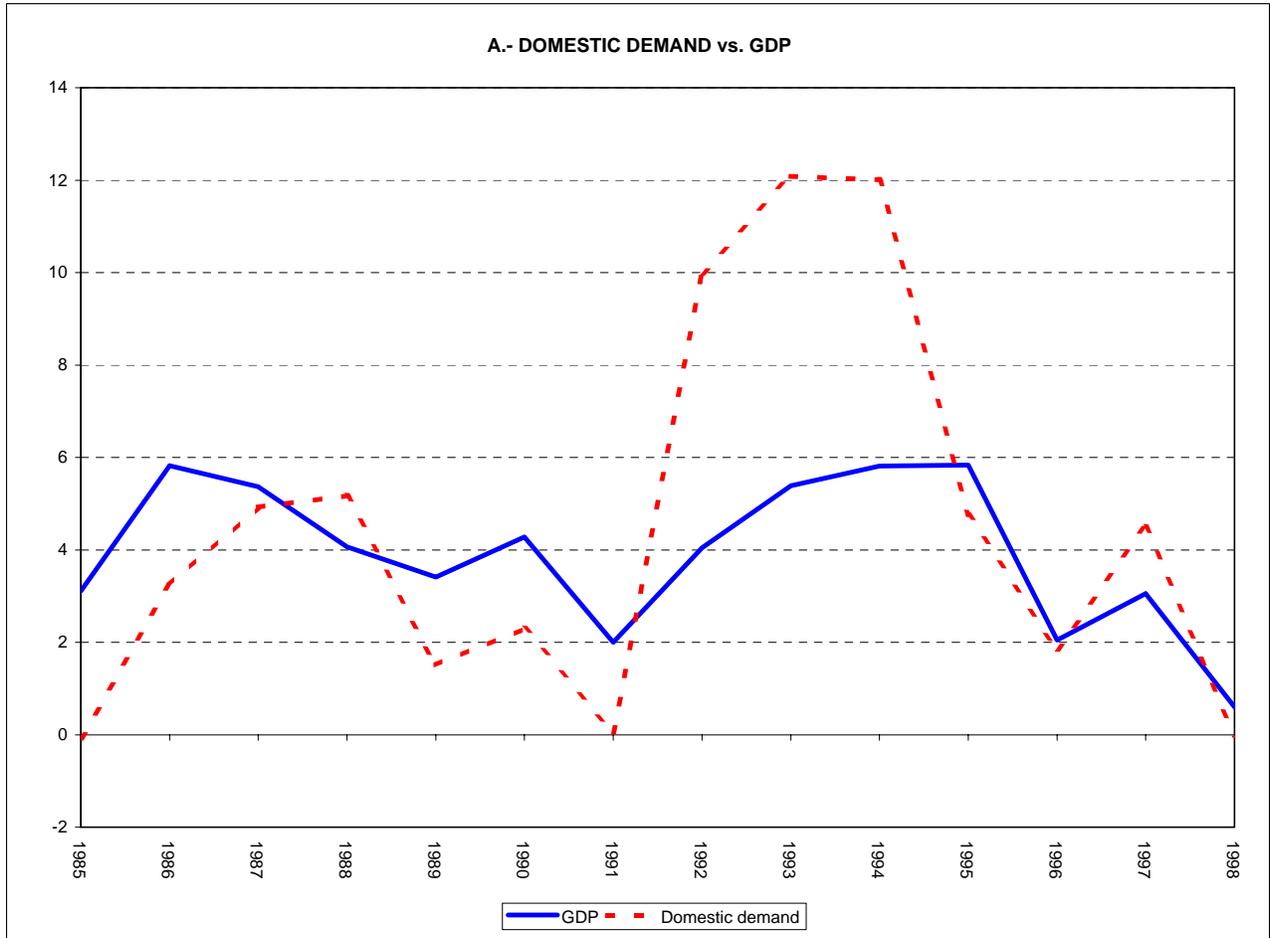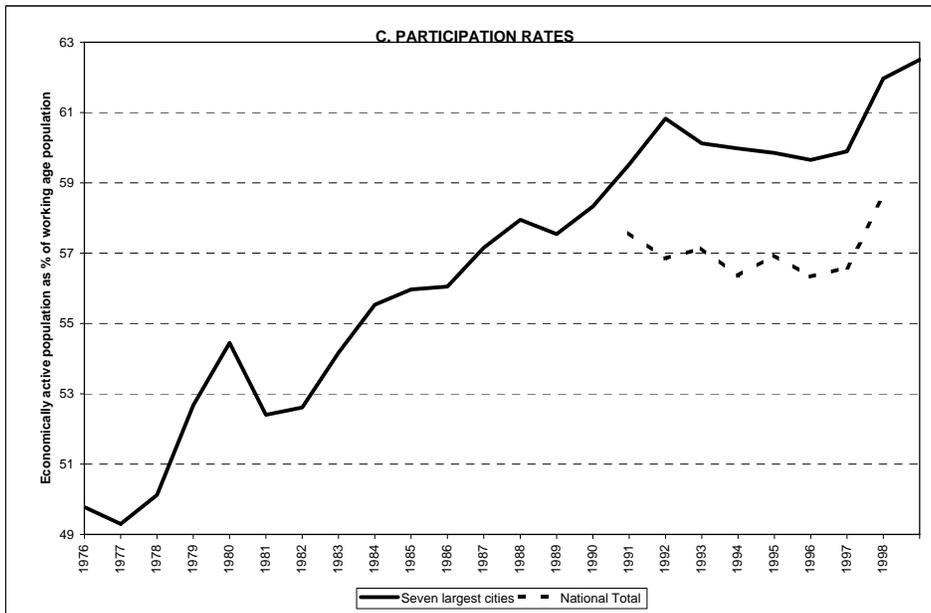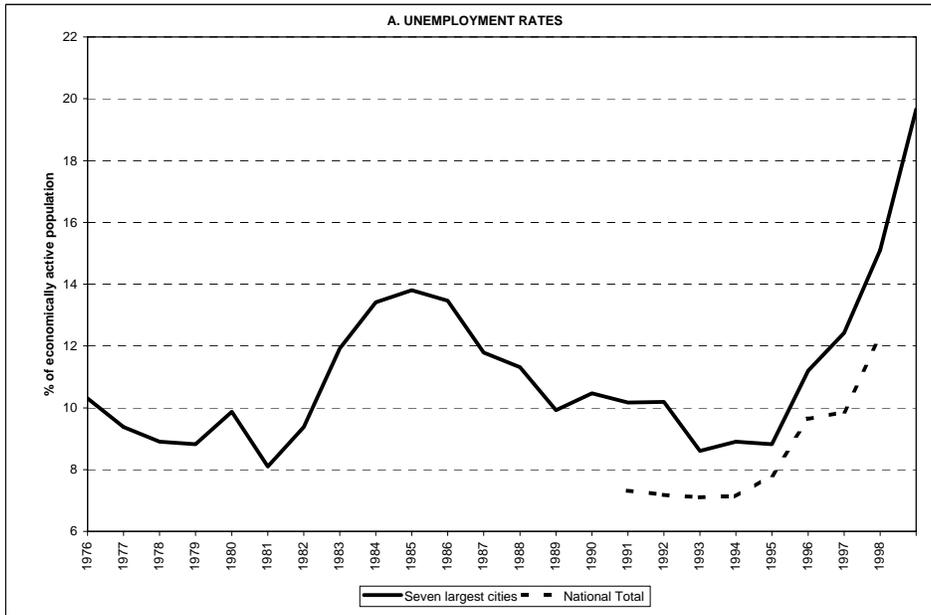PRIVATE SECTOR PUBLIC SECTOR EXTERNAL SECTOR AGGREGATE DEMAND

Source: DANE

FIGURE 2

LABOR MARKET INDICATORS, NATIONAL AND MAJOR URBAN AREAS

A. UNEMPLOYMENT RATES

B. EMPLOYMENT RATES

C. PARTICIPATION RATES

Source: DANE

FIGURE 3

SOCIAL SPENDING
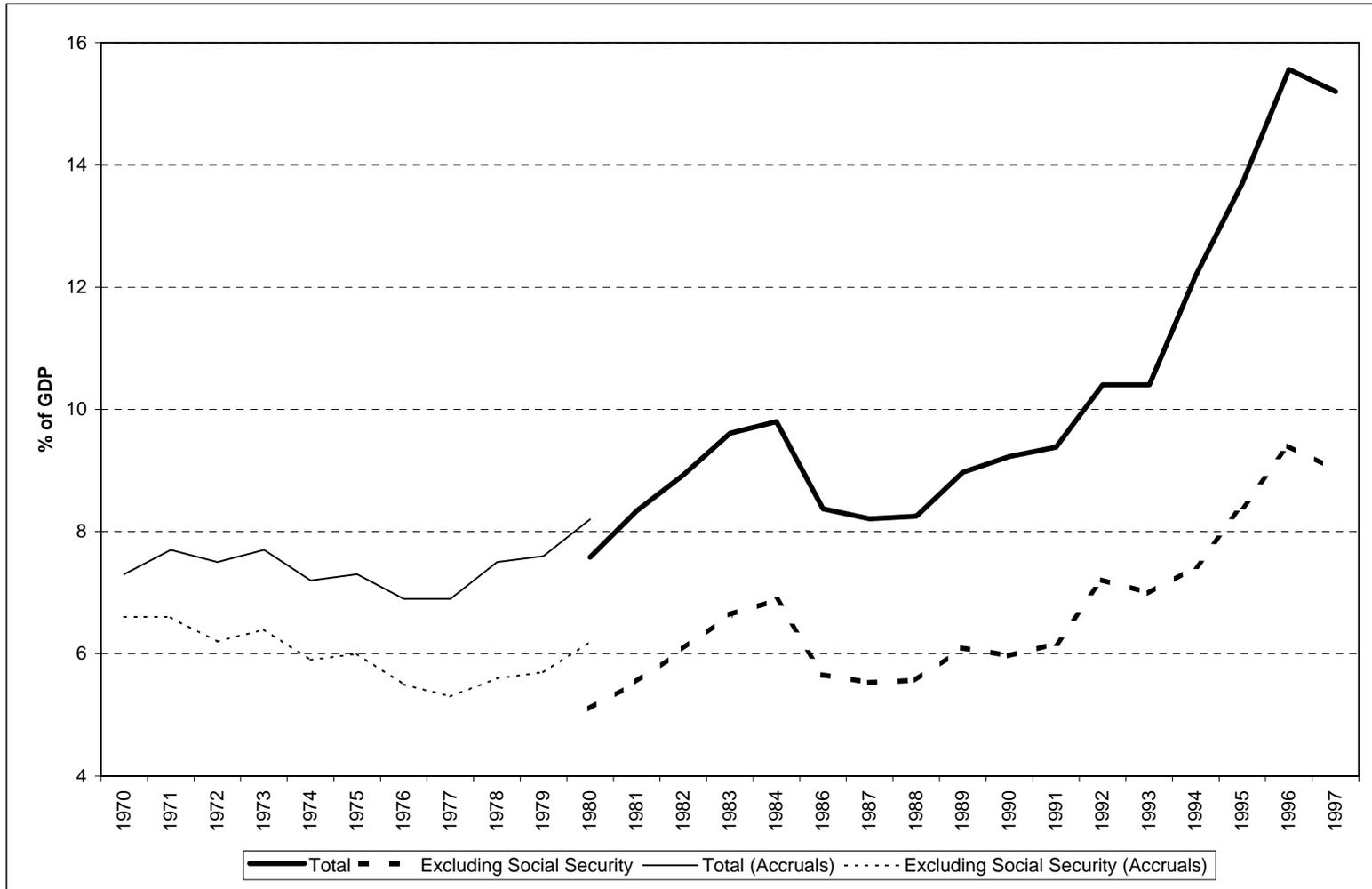
Source: DNP

FIGURE 4

INCOME DISTRIBUTION AND POVERTY IN SEVEN LARGEST CITIES

(4 quarters moving average)

A. HOUSEHOLDS PER CAPITA GINI COEFFICIENTS
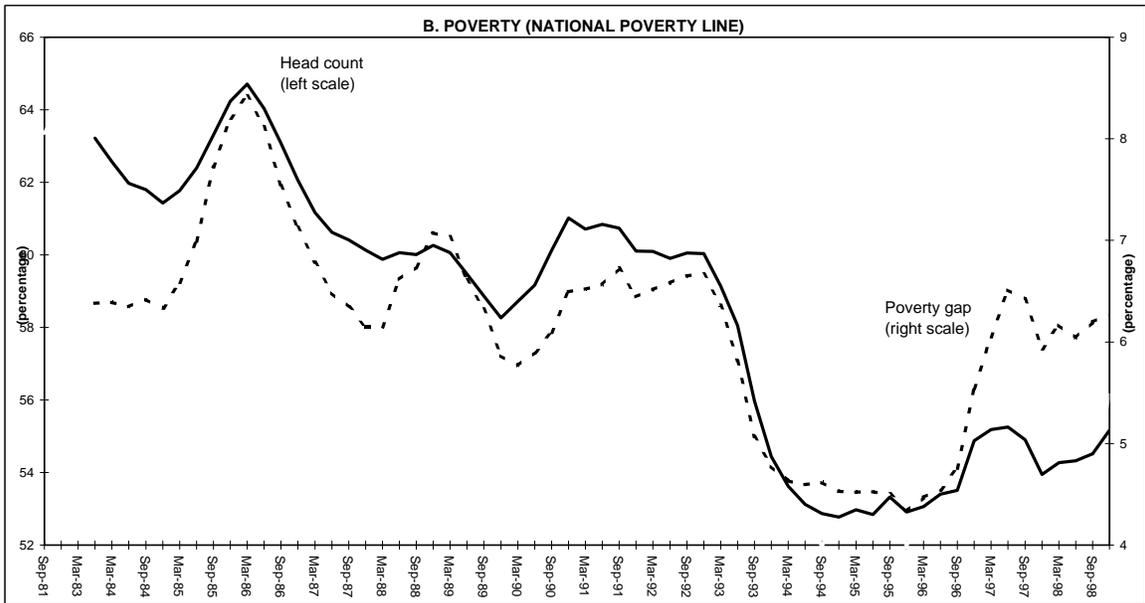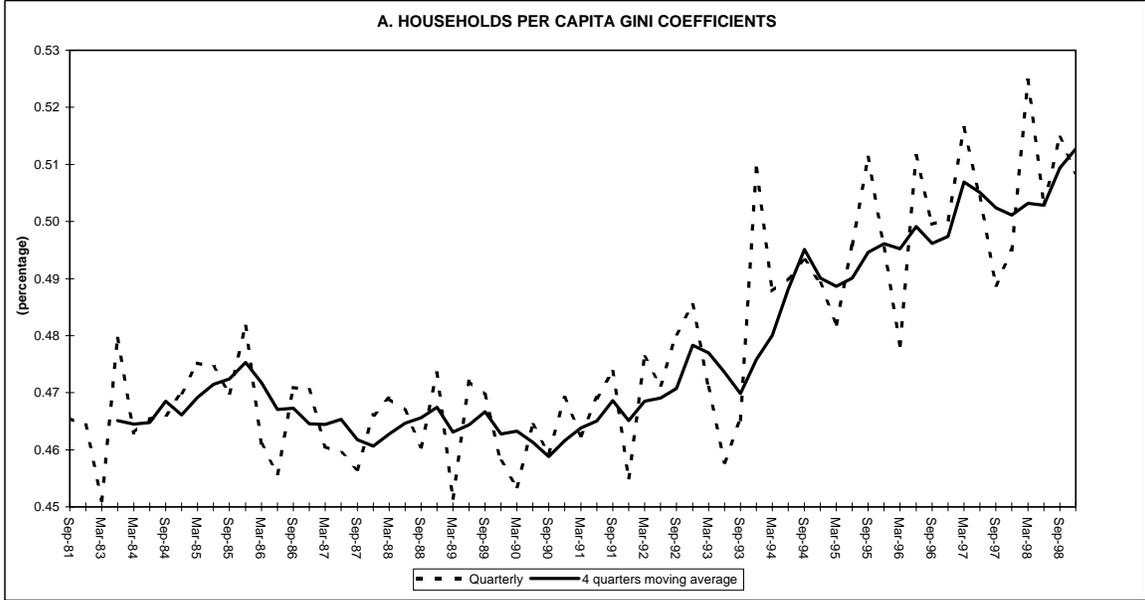

B. POVERTY (NATIONAL POVERTY LINE)

FIGURE 5

RELATIVE WAGES BY EDUCATIONAL ATTAINMENT, LARGEST CITIES
(Index, December 1988 = 100)

UNIVERSITY vs. PRIMARY ATTAINMENT

······ Quarterly ——— 4 quarters moving average

UNIVERSITY vs. SECONDARY ATTAINMENT

······ Quarterly ——— 4 quarters moving average

SECONDARY vs. PRIMARY ATTAINMENT

······ Quarterly ——— 4 quarters moving average