

## **The Economic Impact of the 2016 Colombian Peace Treaty**

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### **Abstract**

The Colombian government signed a peace agreement with Colombia's largest rebel group, the Revolutionary Armed Forces of Colombia (FARC) in 2016. The objective of this study is to study the impact of the 2016 peace accords on the Colombian economy. Specifically, the paper explores the historical background of the country, starting with the Colombian Civil War of 1948 to the evolution of the peace truce between FARC and the Colombian government. The Colombian economy has always been presumed to be heavily reliant on traditional commodities like coal, coffee, and oil, however; the qualitative and quantitative data gathered through interviews from the Colombian government officials show some stylized facts that the peace treaty has led to a diversification in new industries like tourism, trade, and foreign direct investment (FDI).

**Keywords: Peace treaty, Economic consequences, Colombia**

### **1 Introduction**

Colombia's economic growth has fluctuated drastically throughout the years because of the political and social instability in the country. The civil wars have negatively impacted the Colombian economy and have stifled the overall development and diversification of the economy. To stabilize the country, the Colombian government signed a peace agreement with Colombia's largest rebel group, the Revolutionary Armed Forces of Colombia (FARC)<sup>1</sup> in 2016. This peace truce has changed the economic landscape of the country positively.

The studies so far have focused on Colombia's over-reliance on the traditional commodity markets like oil and coal, ignoring the growth of new industries like tourism and Foreign Direct Industry (FDI) that have started to bloom after the peace accords<sup>1</sup>. These peace accords have not only impacted the traditional commodity industry in the country positively but also improved the growth of other industries. We bridge this gap in the literature by conducting interviews with the Colombian officials, analyzing industry-level data, and presenting some stylized facts that show that after the peace accords were signed, Colombia's economy has diversified leading to the growth of tourism and communication industry and an increase in the FDI for the economy.

To analyze the impact of the peace agreement on the Colombian economy, Section 2 provides a literature review that addresses the gap in the literature, followed by a historical overview of the political and social scheme of the country starting 1950 and leading up to the peace accord in 2016 in section 3. The framework of political research provides a sense of the underlying problems behind the peace agreements, which is fundamental in understanding how the truce between FARC and the Colombian government impacts the country's economy. Section 4 provides the names of the Colombian officials used to conduct the interviews and the data sources used in the study. Section 5 presents the results of the interviews and quantitative data from the World Bank and Colombia's main stock market index (COLCAP) to provide evidence of diversification of the Colombian economy after the peace accords. The overall conclusion follows in section 6.

## 2 Literature review

An economy's dependence solely on a select few commodities is often associated with slow economic growth<sup>2</sup>. Volatility in the commodity prices bring about fluctuations in the Gross Domestic Product (GDP) and negatively impacts the growth of an economy<sup>3</sup>. Commodity dependence is evident in Latin American countries, especially Colombia. Colombia's economy has always been dependent on the commodity market. According to the CIA World Fact Book<sup>4</sup>, there are four primary commodities - oil, coal, coffee, and flowers that impact Colombia's growth. Figure 1 shows a positive correlation between Colombia's GDP growth rate (%) with oil and coal rents as a percentage of GDP, highlighting a dependence on the commodity market.

In addition to commodity dependence, Colombia faces another challenge in the form of civil unrest that makes situations even worse from the trade perspective. Political uncertainty in the economy further leads to a decline in FDI. So far, the research has only focused on the history of Colombia's civil unrest, the process of peace negotiations, and its impact on the private sector of the economy, ignoring the impact of these peace accords on the overall levels of FDI and impact on emerging industries in the economy<sup>5</sup>. However, there is evidence that the peace process not only generates economic benefits; it also generates an overall positive impact on the emerging industries of the economy like tourism<sup>6</sup>. "The peace-through-tourism idea is rapidly gaining ground among policymakers and industry representatives. The UN World Tourism Organization (UNWTO), the UN specialized agency dealing with tourism, is one of its staunchest propagators<sup>7</sup>". Therefore, it becomes essential to analyze the changing political landscape of Colombia and its impact on both the traditional commodity markets and emerging industries.

To understand the economic impact of the peace accords, section 2 presents a historical overview of the political and social scheme of the country starting 1950 and leading up to the signing of the peace treaty in 2016.

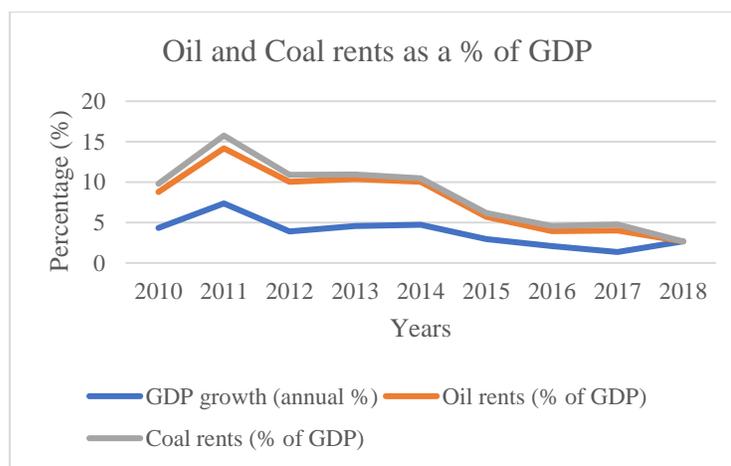


Figure 1. Colombia's GDP growth (annual %) 2010-2018 and Oil and Coal rents as a percentage of GDP. Source: World Bank

## 3 History of the Colombian Civil War

Protectionism shielded Colombia's economy against crises like the Great Depression, World War I, and World War II, which affected most of the world negatively. During the '30s and '40s, Colombia was able to implement social and economic reforms that translated into accelerated economic growth. However, after World War II, Colombia entered a decade of bipartisanship violence<sup>7</sup>. This period is known as La Violencia, and historians look at it as the failure of the Colombian democratic system<sup>1</sup>. Fast forward, a century later, the country is still trying to resolve some of the political turmoil with peace agreements and put the country on the path to economic growth and stability.

From 1948 until 1958, the nation underwent an undeclared civil war, where around 2,000,000 people died. In 1948, President Mariano Ospina Perez took charge and decided to reduce the participation of the Liberal party in political activities. As a result, the Liberal party did not participate in the elections of 1950<sup>1</sup>.

During 1960, many revolutionary organizations were created under the ideals of communism. In 1964, the National Liberation Army (Ejército de Liberación Nacional--ELN) was formed by students who wanted to protest the political coalition formed by the Conservative and Liberal party. In 1966, the Revolutionary Armed Forces of Colombia (Fuerzas Armadas Revolucionarias de Colombia--FARC) began operating. In 1968, the Popular Liberation Army (Ejército Popular de Liberación—EPL) also started working as the armed branch of the Communist Party of Colombia. In 1972, the 19th of April Movement (Movimiento 19 de Abril--M-19) was established, and it was the fourth active guerrilla in the Colombian territory<sup>1</sup>.

FARC-EP (Fuerzas Armadas Revolucionarias de Colombia- Ejército del Pueblo) was a revolutionary movement founded in 1964 in Marquetalia, Tolima. FARC's first members were farmers and students who were trying to achieve political equality<sup>7</sup>. The insurgent guerrilla was created after a period of political instability and chaos. Unfair agricultural reforms, which benefited only the political elites of the country, were a key factor for the formation of FARC. Moreover, the widespread violence in rural villages finally triggered the foundation of this communist guerrilla.

Led by Manuel Marulanda Velez and Jacobo Arenas, FARC grew by spreading the communist ideals that were at peak during the cold war. In response to this expanding movement, the Colombian military, with the support of the United States, implemented the plan Latin American Security Operation (LASO). Alongside the U.S., Colombia fought fiercely throughout the years against FARC, trying to remove the communist ideologies that were spreading in the Colombian population.

In 1982 President Belisario Betancur started the first negotiations with FARC to reincorporate its members to the civil life<sup>8</sup>. This initiative was furthered by President Cesar Gaviria (1990-1994); however, FARC continued growing, and just a few of FARC's members reincorporated to civilian life. In 1998, with the election of President Andres Pastrana, new negotiations started; this time, the president was determined to bring peace to the Colombian people, who had suffered from several terrorist attacks. Regardless of the efforts made by President Pastrana (1998-2002) in negotiating an end to the armed conflict, Manuel Marulanda Velez – FARC founder – never showed up to El Caguan, a place where the negotiations were supposed to take place. The incident was known as “La Silla Vacía”<sup>8</sup>.

Up to this point, FARC had not only expanded but had also started using drug trafficking as a way to strengthen itself economically. In 2002, President-elect Alvaro Uribe Velez decided to stop all political attempts of negotiating with FARC. Instead, he focused on developing military attacks that, he thought, would end the violence once and for all<sup>3</sup>.

In 2006, President Uribe was reelected and continued the military plan to end the armed conflict. “Operación Jaque,” “Operación Libertad Uno,” and “Operación Camaleón” were some of the operations executed during his presidential period; these efforts accomplished the weakening of FARC<sup>9</sup>. The government successfully killed some of FARC's principal leaders and stopped them from developing more terrorist attacks. Nevertheless, FARC continued operating once Uribe's presidential period ended.

In 2010 President Juan Manuel Santos was elected. He initiated a strategy that differentiated from Uribe's strategy in several ways. Instead of continuing military attacks to suppress FARC, Santos decided to start dialogues with the communist group seeking an agreement that could end the 50-yearlong internal conflict. Santos was reelected in 2014, and after several negotiations in La Habana, Cuba, the peace treaty was finally signed on the 26<sup>th</sup> of September 2016<sup>10</sup>.

According to the treaty, FARC is currently not an armed guerrilla. The agreement forced FARC to turn over the weapons and stop committing illegal activities. The treaty establishes that the government is now responsible for reincorporating FARC members to civilian life and giving the ex-guerrilla political participation. FARC was given five seats in the Senate and the representatives' chamber<sup>10</sup>. Colombian officials estimate that a peace deal may bolster economic growth by almost 2 percent in 2018 and bring stability to the country<sup>1</sup>. The next section attempts to analyze these estimations using quantitative and qualitative data to explain the economic impact of the treaty efforts on the economy.

#### **4 Data Sources and Methodology**

To determine the cost-benefit from the peace agreements, we interviewed high-level officials from the Central Bank of Colombia (Banco de la República) and used these interviews as a primary source of information. The officials interviewed were:

- Dr. Hernan Rincon, Principal Investigator of the Colombian Federal Bank<sup>11</sup>
- Dr. Jose Antonio Ocampo, Co-Director and Board of Trustees member of the Colombian Federal Bank<sup>12</sup>

Furthermore, we also gained access to the medium-term fiscal framework provided by the Government of Colombia each year. Based on this data, we examine Colombia's most recent economic performance. To understand the economic impact of the peace treaty on the economy and substantiate the claims made in the qualitative data, we analyze the data from the World Bank and Colombia's main stock market index (COLCAP). COLCAP groups the 20 most liquid publicly traded companies in Colombia. The companies in this index mainly represent financial services, construction, transportation, and food industries and include only two companies that work with oil and gas; it is, therefore, a good indicator of diversification in the Colombian economy<sup>6</sup>.

We analyze FDI levels for tourism, financial services, communication, and oil industries. This basket of industries represents a traditional and modern mix of industries. The peace negotiations started in 2010 and ended with an agreement in 2016; therefore, we analyze data for the year starting 2008 (two years before to the peace negotiations) to the year 2018 to see the full impact of the accords on the industries. In the next subsection, we interpret the qualitative data with the economic indicators of the country to present some stylized facts.

## 5 Results

Dr. Rincon, in his interview, argues that the country has been able to stabilize its economy successfully because of diversification. He explains that historically, the country's economy has depended mainly on the mining and energy sector, but since 2014, the economy is more reliant on the agriculture, manufacturing, technology, and financing industries. Dr. Rincon explains that because of diversification, Colombia has been one of the three countries in Latin America to have economic growth of 2% or more. He also mentions that lesser dependence on commodity prices has strengthened the Colombian market that is evident from the data using the Colombian Stock market<sup>11</sup>. A year after the initiation of the peace agreement in 2012, COLCAP's growth started trending upwards (see Figure 2). This trend indicates that companies in several industries are growing.

Dr. Ocampo supports Dr. Rincon's hypothesis, as he argues that diversification is the best thing that can happen to the Colombian economy. He mentions that several markets in Colombia, like Ecotourism and African Palm export, have the potential to grow. Dr. Ocampo mentions that agriculturally, Colombia has an immense potential that has not been fully developed in the previous years. Dr. Ocampo indicates that while other markets might fluctuate, agriculture and tourism are markets that will continue growing and impacting the economy positively.

After interviewing two of the most important officials of the Central Bank of Colombia, both Dr. Ocampo and Dr. Rincon agree that in the short run, the peace agreements will create more economic costs than benefits. The government declared that the peace agreements generated a transition cost of around 43 million dollars (129 billion Colombian pesos), which will be allocated over the next 15 years. However, both the experts agree that the peace agreements will be beneficial for Colombia's economy in the long run.

Dr. Rincon emphasizes that since the peace agreements started, diversification has increased, which further has the potential to increase the foreign direct investment (FDI). Before 2014, the mining and energy sector represented around 50% of Colombia's FDI. Since 2014, this behavior has been shifting, and the mining and energy sector only represents 20% of the FDI<sup>11</sup>.

Dr. Ocampo highlights the importance of the peace agreements, by emphasizing on the tourism and agricultural potential of the country. He states that the agrarian reform that the peace agreements ought to implement will help the small rural entrepreneurs in Colombia. Also, private national investors will be more eager to invest in Colombia's rural areas, as there is less risk involved. Dr. Ocampo believes that the relationship between big sized firms and small entrepreneurs will improve, and this will benefit Colombia's industries<sup>12</sup>.

On the other hand, Dr. Ocampo explains that tourism is set to increase exponentially. He explains that people from other nations have always seen Colombia as a desirable destination, and now that they can enjoy the country risk-free, they will not hesitate when visiting Colombia<sup>12</sup>.

Figure 3 shows that FDI related to oil has decreased since 2012, while FDI associated with the financial service, communication, and tourism industries has increased since then. In 2016, the financial service industry brought more FDI to Colombia than the oil industry. Tourism is also catching up; this industry brought almost the same FDI levels as the financial services and communication/transportation industries in 2018. The data reveals that several industries have grown since 2010 and continued to grow through 2012 (the beginning of the peace accords) including, FDI.

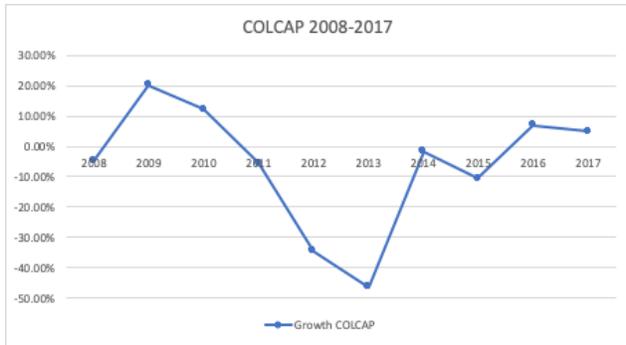


Figure 2. Colombia's major stock index yearly percent growth

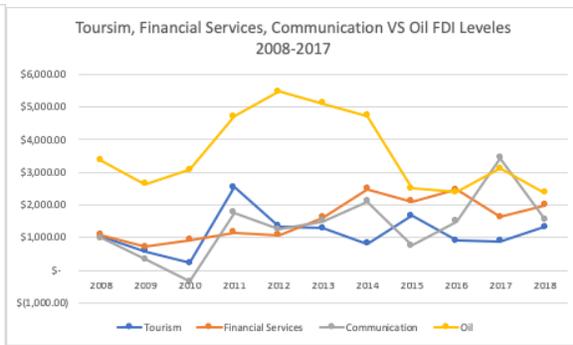


Figure 3. FDI levels by industry

Ex-President Santos' administration tried to quantify the potential economic growth that the peace agreements could give Colombia (see Figure 4). They calculated that the end of hostilities would provide an additional 0.3% growth to the economy every year. In 2018, the economy was projected to grow faster. Taking into account the 0.3% further economic growth, the Federal Bank of Colombia has estimated a possible GDP growth range. At maximum, it will grow at 6%, and at a minimum, it will grow by 2%. More likely, Colombia's economy in 2018 will grow at around 3.5% (see Figure 5). It would be interesting to see how the Colombian economy performs given the changing political landscape of the country.



Figure 4. Real GDP growth both with or without peace (Source: Colombia's medium term fiscal framework)

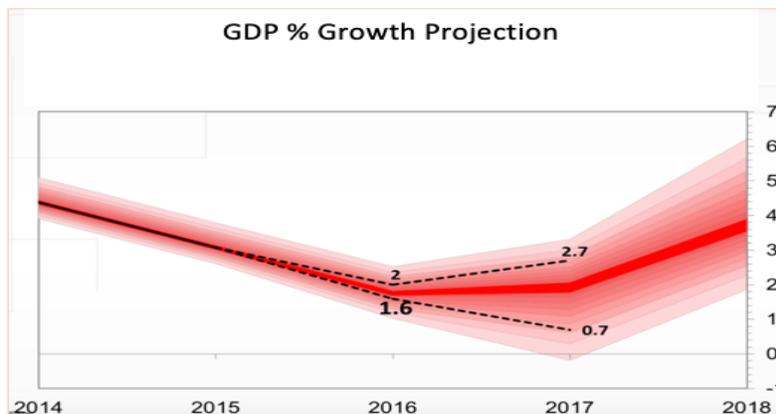


Figure 5. Federal Bank of Colombia GDP estimate growth (Source: Dr. Hernan Rincon's data)

Analyzing the interviews along with the data from the COLCAP and the Colombian Government, we infer that the Colombian Government officials foresee the potential positive impact of the peace agreement on industries like tourism and financial services. The positive impact manifests in the form of industry indices that show a declining reliance on the traditional oil industry and increasing FDI levels in the new and upcoming industries like tourism. We highlight the results of the study through following stylized facts –

- The peace agreement has contributed positively to the FDI inflow in other industries like – Tourism and Communication
- Diversification in industries has further reduced the reliance on traditional commodities like – Coal and oil
- Colombian Government forecasts a positive impact of the peace agreements on the economy despite huge costs attached with the accords

## 6 Conclusion

The peace agreements have been controversial ever since the negotiation between the government and FARC started. However, the Colombian government believes that peace agreements have diversified the economy and have the potential to benefit the country in the long run. The most important contribution of the peace agreements so far is the development of several industries like communication, financial services, and tourism. Several markets that could not expand properly because of political risk earlier are now able to develop. With the weakening of hostilities, there is a possibility of a further increase in FDI<sup>14</sup>. This study provides evidence that the peace accords have helped the Colombian economy to achieve diversification to some extent and reducing the over-reliance on traditional commodities like coal, oil, and coffee.

However, there are some limitations to the study. Our results are presented as stylized facts and do not establish any causation because it is too early to obtain economic data that quantifies the impact of peace accords on different industries to establish any causation using regression analysis.

The government, however, now has an opportunity to implement public policies that can help Colombia's development, considering that the FARC does not occupy several territories of the country. Without having to use fiscal budget towards war efforts, the government should have a better budget to invest in other priorities. Investments towards education and infrastructure in rural areas could help people that have historically live in poverty move towards a better style of living<sup>13</sup>. Moreover, the growth of different industries can create jobs, especially in rural areas that were historically warzones. Increased FDI levels can allow for the development of regions like the south of Colombia, which traditionally have lived in poverty. In theory, people in rural areas could move into the middle class, as new industrial capitals emerge, and more education becomes accessible. In other words, the peace agreements have the potential to give growth and stability to the Colombian economy.

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