**J.P. Morgan Securities LLC**
Ben Ramsey (1-212) 834-4308
benjamin.h.ramsey@jpmorgan.com



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**Economic Research Note**

# Colombia's election: A closer look at Petro's proposals

- **Gustavo Petro, the left-wing frontrunner in May/June elections, has unveiled a sweepingly ambitious policy platform**
- **The end-goals are laudable, but the means imply a much more state-centric focus than Colombia's current model**
- **...which, despite some pledges for gradualism, could imply institutional tension and a challenge for the fiscal rule**

Colombians will go to the polls on May 29 to select their next president. A June 19 runoff would be required if, as seems likely, no candidate attains more than 50% in round one. Left-wing Senator Gustavo Petro, the runner-up in 2018, has consistently led polls in this election cycle, and seems guaranteed a spot in the second round. While polls so far suggest a very close run-off, Petro as of today is the front-runner. Should he win, his would be the first decidedly leftist/anti-establishment administration in memory, although unlike some other new leaders in the region he so far has said he embraces Colombia's existing 1991 constitution.

At the end of March, Petro and his running mate, the progressive activist Francia Marquez, unveiled their government program. More than a specific plan of action, we see the policy program, as published, as a set of broad ideals and objectives. Overall, the document is sweepingly ambitious, combining laudable goals for environmental protection, gender equality and social equity with a much more state-centric economic focus than Colombia has attempted in generations (if not ever).

Petro's plan intends to carry out a significant 5.5% of GDP increase in revenue to pay for a broad set of social plans, though the specific costs of the latter are not laid out. Following the March 13 legislative elections, it's clear that Petro would only be able to construct the majorities needed to approve his agenda on an ad-hoc basis, and much of his plan would likely be challenged. Still, more spending is always politically attractive, and should realize outlays outstrip ideas for new revenue, Colombia's Fiscal Rule could be challenged, notwithstanding better oil income at least in the early going. Despite the embrace of the 1991 Constitution, Petro contends that that document's spirit needs to be better honored. Should his agenda be blocked, we note that his policy platform contains some not-so-veiled challenges to Colombia's robust set of checks and balances via a goal to "democratize" institutions.

Amid a wide array of proposals ranging from the social and environmental to the economy, we highlight in this report Petro's proposals on the following key themes: tax reform, international trade, pensions, extractive industries, the labor market, and finally some of his remarks that touch upon the institutional framework. We conclude by reviewing the outcome of the March 13 legislative elections, as well as some remarks on political economy.

## Energy and extractive industry policy

***"Our government will lay the foundation of [energy] transition via a gradual de-escalation … guarantying the reliability and stability of the energy system, including its sources of employment and economic resources."*** **(pg. 16 of the program)**

***"…the exploration and exploitation of non-conventional oil reserves will be forbidden; pilot fracking studies will be halted as well as off-shore developments. No new hydrocarbon exploration licenses will be granted, and open-air mining projects will not be allowed."*** **(pg. 17)**

Petro's proposals for the oil and extractive industries have garnered perhaps the most attention and questions, as the goals to fast-track energy transition towards renewables have suggested a rapid shift in the current business model of state oil company Ecopetrol. The program corroborates Petro's prior public comments that as president he would halt "new" oil exploration activities and introduce a ban on fracking. Moreover, his economic program mentions that the oil produced will be destined to supply domestic fuel demand, and that there would be a tax on the commercialization of carbon intensive products. Nevertheless, this is framed under the label of energy transition and is coupled with a greater emphasis on wind and solar energy sources and in using Eco petrol to lead the energy transition. Additional aspects of this energy transition plan include a ban on new hydroelectric dams, the creation of a national institute for clean energies. Another proposal is the creation of state-fund for clean energies to be financed through the elimination of tax benefits to the oil & gas sector and the redirection of royalties (that currently go to regional governments under certain parameters). Lastly, the program also mentions how environmental, labor, and fiscal regulations will be strengthened on existing mining projects.

Petro's economic advisors have emphasized that the candidate's stance on transforming the sector has been exaggerated, seeking to reinforce the *gradual, responsible and predictable* nature of plans to reduce the dependency on oil. Ecopetrol (according to the program) would be able and required to provide the oil-based fuel the economy needs for the next 15 years.

## Tax reform

***"The country's fiscal space will be augmented by 5.5% GDP, which will guarantee the financing of this government plan".* (pg. 43)**

Regarding a possible tax reform, Petro has emphasized the need for tax reform to finance a large social expenditure package and reduce income inequality. In line with his numerous public comments on the campaign trail, his reform would seek to fund social programs with of a mixture of new taxes, higher tax rates, and a greater emphasis on progressive taxation. In particular, he has discussed his intention to increase tax revenue with a greater burden on higher income individuals and large firms. For starters, he would repeal Duque's 2019 tax reform (which among other measures continued to lower corporate taxes). Petro's plan intends to eliminate a number of tax exemptions and benefits; increase taxes on dividends and to bring capital gains tax rates to similar levels of personal income taxes; mandate that firms pay "close to 70%" of profits in dividends, and close loopholes to avoid taxes on profit distribution; introduce a presumptive wealth tax holdings in tax haven jurisdictions; and increase property taxes on "large unproductive agricultural estates" (more on the latter below). Overall, with the tax reform Petro's program mentions that the fiscal income would improve by around 5.5 % GDP (also including changes to the pension regime), a significant level considering that tax revenue for the central government reached 13.8% GDP in 2021 (See "Growth sets fiscal on a better track, but eventual adjustment still key"; Feb 8, 2022 ).

Some of Petro's key economic advisors have emphasized that the tax reform will mostly seek to discontinue already existing tax benefits rather than seek blanket increases of tax rates, and would mostly affect higher income individuals. They contend that their focus would be to replace corporate income taxes with profit taxes Moreover, their idea is to avoid having to submit a new partial tax reform nearly every year and thus generate some tax stability. Overall, some of Petro's advisors think they need at least 1.2% of GDP in improvement in the country's fiscal stance in order to maintain emergency social transfers since the pandemic (*ingreso solidario*) and comply with the country's Fiscal Rule. Of note, however, Petro's program itself makes no reference at all to the Fiscal Rule.

## Land reform

***"As a strategic instrument of an agrarian reform, we will establish the multipurpose land survey which will disincentivize large unproductive agricultural estates through taxes." (pg. 19)***

Contained within the tax reform, the proposal of raising taxes on landowners seeks to force the brake-up of large agricultural estates into smaller parcels. This is a longstanding feature of Petro's agenda, including in his 2018 failed bid. The discussion is framed under the lenses of an agrarian reform and seeks to bolster land ownership by small and local cooperatives. Interestingly, the reform includes an update of the national land registry using geo-location tagging and a multipurpose land survey mechanism (catastro multipropósito), proposals that were included in Carrasquilla's failed tax reform from a year ago, and watered down in the first version of the tax reform FinMin Restrepo submitted to Congress (where it was eventually rejected). Petro has been consistently indicated that his plans would not amount to expropriation, and his advisors have even suggested that his land reform would allow the market to more efficiently "right size" landholdings to be more productive. However, critics point out the likely lack of buyers for highly taxed land, and the likely role of the state in acquiring and re-appropriating land.

## Industrial policy and import substitution

***"We will create a policy of smart import tariffs on agricultural inputs and goods […] we will renegotiate free trade deals [...] with special attention to investor protection clauses that are a threat to domestic employment, productivity, and the environment."* (pg. 22)**

***"The measure of efficacy of import tariffs will be domestic job-creation."* (pg. 23)**

In addition to the tax reform, Petro has been emphatic on using import tariffs as industrial policy instruments and import substitution to protect domestic producers. He has proposed to ramp up import tariffs in a wide range of goods, both consumer and intermediate, especially on light manufactured goods such as clothing and food imports. According to his program, the efficacy of tariffs will be evaluated by how much domestic jobs they help to create. This however is at odds with the Government's recently commissioned expert-led mission on international trade which has found the need for a different approach, focused more on export-promotion rather than import substitution. The economic advisors to Petro have reiterated that tariffs will be used as a tool of industrial policy rather than as a policy objective in-and-of itself, and are critical in the context of a country that needs to escape lingering Dutch disease and move away from hydrocarbon extraction.

## Pension reform

***"We will transit toward a unified, mainly public, complementary and non-competitive system of pensions… freeing***

***up COP13trn of current budget transfers to [PAYG] Colpensiones ... organized via non-contributiary, contributory, and complementary pillars, combining the [PAYG] and capitalization regimes."* (pg. 40)**

There is ample consensus across the political spectrum that Colombia's pension system is in need of reform, owing to low coverage, regressivity and related inefficient implied subsidies. Petro's pension reform seeks to transform Colombia's mixed pension system into a mostly public pay as you go regime. Currently, Colombia has two parallel mandatory systems for formal workers: a public PAYG defined-benefit arrangement and a private defined-contribution scheme. Affiliates may periodically switch between the two within certain constraints. Both systems have the same mandatory contributions (a fixed percentage of the workers' wage), but in terms of payouts the government budget finances the shortfall in the public PAYG system, a dynamic that is exacerbated when workers switch from the private system to the PAYG close to retirement age. Indeed, the relatively generous replacement rate in the public system means higher income individuals benefit the most from public subsidies. Petro thus proposes a system of complementary pillars whereby all individuals contribute to the public pension system below the (relatively high) income threshold of 4 legal minimum wages, above which they would be free to contribute to private pension funds. Petro's program states that they will respect all existing pensions, and they will not modify the retirement age or adjust other current acquired rights. Petro's plan would indeed augment the contributions received by the public system thus lowering in the short-term the government's transfers to the pension system and freeing up budgetary resources. However, the proposal to reinforce the public system has been questioned by multiple economists, academics, business associations, and think-tanks mainly due to adverse fiscal implications in the medium and long-term, alongside much debate as to whether the plan would actually resolve acknowledged structural shortcomings of the current system.

## Basic income and "guaranteed work"

***"The State will act as an employer of last-instance offering jobs … the counter-cyclical application of the program will create a sector in the labor market which will vary according to the needs of the economic cycle … maintaining a stock of workers to maintain the economy close to full employment without compromising price stability."* (pg. 26)**

Petro's program does not explicitly address current direct social transfers (*ingreso solidario*). Rather, they propose a basic income based on a permanent guaranteed public employment program for those who cannot find work, which will be financed through general taxation. According to the document, the program would offer jobs to those currently unemployed, and the number of placements will be "counter cyclical" which the government would calibrate in accordance with the business cycle. The administration would look to recognize and remunerate caregivers as part of this program. No details are disclosed on the estimated fiscal cost or size of the program, nor are there specifics on how it would be administered.

## Coordination with monetary policy

**"*We will promote the adequate coordination of macroeconomic and monetary policy not only as a function of growth but also employment.... seeking macroeconomic stability at the service of citizens, where employment, the distribution and sources of growth have the same importance as the payment of debt and control over inflation" (pg. 20)***

Petro's program says it will be in "permanent dialogue" with BanRep, while "respecting its real independence." The characteristics of this "dialogue" in the recent past has been concerning, since candidate Petro has been urging BanRep to directly finance the government as a valid policy practice. To be sure, BanRep legally may only directly finance the government in the context of a unanimous vote from the Board. Its maneuvering around the channeling of the IMF SDR expansion (and perhaps the FCL use) spoke to its sensitivity to the optics and precedent. Petro has repeatedly called for BanRep, beyond its inflation target, to incorporate employment and domestic production in its decision making, and the program makes reference to a 1999 constitutional court ruling that indeed suggests that inflation is the primary mandate but the board can't be indifferent to goals of employment or equitable development.

More recently, Petro has been highly critical of BanRep's Board composition, describing it as not-independent and being captured by the outgoing government (which due to resignations has been able to name the entire board, less the governor, who is elected by the board itself). Petro has mentioned that BanRep's board should include representation of civil society and the productive sector, harkening back to some historical iterations of the first part of the 20th century.

Nonetheless, Petro and his economic advisors contend that they have no interest in changing the 1991 constitution, and which in any case would be an arduous process that would burn political capital, and they acknowledge the outgoing board will maintain a majority even after Petro has a chance to change two directors midway through his hypothetical term. Petro's advisors have also recognized the value and capacity of technical staff both at BanRep and the Finance Ministry, in a sign that they recognize the need for continuity in management, as well as the value and importance of market access.

## Expansion of subsidized credit

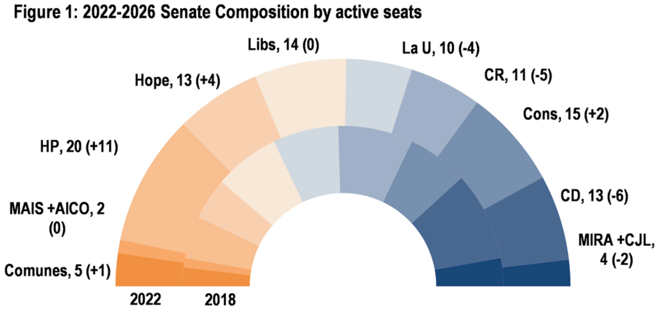
***"The State will prioritize the increase of the capacity of small and medium enterprises […] through credit access programs with low interest rates or condonable loans."* (pg. 26)**

Additional proposals that could have potential economic and/or fiscal effects are: the expansion of social expenditure and the issuance of preferential credit to small and medium enterprises. The published program details a number of social programs aligned with the Historical Pact's development aims; however, it is not entirely clear this fiscal cost, financing sources nor potential economic effects (through either distorting markets, failing to solve market failures, enabling government failures, or being inefficient public policies versus other alternatives). Regarding the subsidized credit, the document also details how the government will look to establish a financial holding to group all of the State's various financial entities enabling the offering of multi-bank services.

## Reality check: Can this program be implemented?

Now, the question remains, should Petro win the presidency, which of these proposals would he be able to implement? Overall, most of the proposals, especially the ones that effect the greatest amount of changes (e.g.: tax or pensions reform), would need to pass through congress. Some others could be accomplished through executive action after being approved by internal agencies (e.g.: import tariffs), and some others would require Petro to align many State agencies to his vision (e.g.: the granting of environmental licenses by the ANLA to mining projects). Some however, such as those that touch on BanRep, would require a constitutional reform which Petro has acknowledged would be difficult to achieve under the current political landscape. Nevertheless, a source of concern would remain the ability of Petro to use his presidential prerogative of appointments to different branches and agencies of Government.

**Figure 1: 2022-2026 Senate Composition by active seats**




Source: Registraduría, Congreso Visible
Notes: - Net change vs the previous active seats in 2018´s congress in parentheses
- Results are preliminary with 97% of votes counted, the official composition is yet to be announced.
- The 108th seat is given to the presidential candidate who reaches 2nd place

To be sure, Petro would not enjoy a congressional majority and would need to form ad-hoc coalitions with more traditional parties, potentially diluting the chances or Petro passing through congress some of his most radical proposals. Figure 1 shows the preliminary breakdown of the upper chamber. Adding together the Historical Pact, Comunes, and the two indigenous parties, Petro would only control 27 seats of the 55 required for a majority. Adding together the Hope Coalition's seats and the Liberal Party Petro would reach 54 seats on the clock. It is yet to be determined if the Hope Coalition will vote in block supporting Petro, and the position the Liberal Party will take as well is yet to be known. Moreover, none of these parties may end up voting in perfect unison, depending on the issue at hand.

In the face of potential obstacles, we have highlighted Petro's stated intention to declare a State of Economic Emergency to address what he had described as a hunger crisis. This constitutional tool (based on Article 215 of the constitution) was used extensively by the Duque administration to nimbly react to the pandemic. The Emergency allows for the president, for up to 90 days, to issue decrees with the force of law to effect changes related to the crisis at hand, including temporary changes to taxes. While even the premise of a hunger emergency could be challenged by courts, and Petro's advisors have been trying to play down the gravity of what they suggest might be narrow use of these constitutionally sanctioned powers, they do not rule out the use of this tool. In our view this is an area to watch given the difficulty Petro may have in Congress. Moreover, in the context of Colombia's robust system of checks and balances, we highlight the ample discourse in published program related to the need to "democratize the state and eradicate corruption", including the intention to "defeat the mafias that have coopted public institutions" (page 46). In this section the program broadly suggests that instructions ranging from courts, the attorney general, the controller, the electoral authorities have been "coopted" and need to be reformed to ensure their "democratic independence." This section could foretell institutional tension to come should Petro find that his agenda is struggling to advance.

**Summary of economic proposals in Petro's policy program**

| | |
|---|---|
| **Tax Reform** | |
| - | Gradually eliminate various tax benefits and exemptions that do not meet "economic and social" criteria, benefit the oil and mining sectors, or benefit higher income individuals |
| - | Unify income source (e.g.: Labor income, dividends, capital gains) tax categories into a single tax category to homogenize tax rates across income sources |
| - | Increase taxes on dividends and make it mandatory for firms to hand out dividends for at least 70% of profits. |
| - | Due to the unification of income categories into one, dividends will be taxed at a similar rate to personal income taxes |
| - | Increase the progressiveness of the income wealth tax |
| - | Taxes on the commercialization of carbon-intensive products |
| - | Allow cities to introduce congestion charges for vehicles |
| - | Raise taxes on "large unproductive agricultural estates" |
| - | No VAT on food nor "basic family consumption basket" |
| - | Taxes on unhealthy foods |
| **Oil, Mining, and Energy Sector** | |
| - | Prohibit the exploration of non-conventional oil reserves |
| - | Halt fracking pilot studies and the development of offshore oil facilities |
| - | Cease the granting of new oil exploration licenses |
| - | Forbid open-air mining projects |
| - | No more hydroelectric dams will be built |
| - | The extraction of current fossil fuel reserves will be destined for domestic consumption under social criteria |
| - | Tighten environmental, labor, and tax regulations on current mining projects |
| **International Trade** | |
| - | Tariffs on agro-industrial goods and inputs |
| - | Renegotiate free trade deals |
| - | Gradual reduction of tariffs on imports that bolster the value-added of domestic industry |
| - | Increase import tariffs on sectors where imports affect the value-added of domestic industries |
| - | The efficacy of import tariffs will be measured by the number of domestic jobs they help to create |
| **Monetary Policy and the Financial System** | |
| - | Coordination of macroeconomic and monetary policy as a function not only of growth but also employment |
| - | Maintain a permanent dialogue with BanRep respecting its "real independence" seeking an inclusive monetary policy |
| - | Create a Financial Holding to group together the State's financial institutions |
| **Fiscal Policy/Debt** | |
| - | Employment, income distribution, and sources of economic growth have the same level of importance as debt payments and inflation |
| **Pension Reform** | |
| - | Transform the dual system into a "tiered-system" in which the first tier will be a PAYG fixed-benefits system into which formal workers will contribute their first 4 legal minimum wages. The second tier will allow workers with salaries above the threshold of 4 legal minimum wages to contribute to private pension funds. Existing pension fund savings will not be touched, and the system will guarantee a minimum pension payment to low-income pensioners |
| **Industrial Policy** | |
| - | Creation of the Ministry of Industry |
| - | The government's public purchases will be limited to products of domestic production giving priority to small and local business to supply the State |
| - | Offer subsidized loans to small and medium firms |
| - | The State will act as an employer of last resort offering jobs to those unemployed. The counter-cyclical application of the program will create a sector in the labor market which will vary according to the needs of the economic cycle maintaining a stock of workers to bring the economy close to full employment without compromising price stability |

Source: Gustavo Petro's campaign website, "Colombia Potencia Mundial de la Vida: Programa de Gobierno 2022-2026."

**Correction details:** Corrected reference to advisors on page 4.

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