

Investing for peace? On the use of resource revenues to finance an eventual post-conflict process in Colombia*

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Abstract

The national government of Colombia and the Farc guerrilla started a peace negotiation in late 2012 to terminate a prolonged and devastating armed conflict. Up to date, they have advanced in three of the six main points of the negotiation agenda. While different State agencies have estimated the costs that an eventual post-conflict process entails, the discussion on the sources to finance it is still on going. The Colombian Government has not disclosed a definitive plan to finance the needs of a post-conflict scenario, but it has hinted that the resource rents generated by the extractive sector may be a key source of finance. This paper aims to contribute to the debate of how to finance an eventual peace-building process in Colombia, by discussing the challenges and opportunities of using non-renewable natural resource rents, particularly from royalties.

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Resumen

El Gobierno Nacional de Colombia y la guerrilla de las Farc iniciaron a finales de 2012 una negociación de paz para poner fin a un conflicto armado prolongado y devastador. Hasta la fecha, han avanzado en tres de los seis puntos principales de la agenda de negociación. Si bien los distintos organismos del Estado han estimado los costos que conlleva un eventual proceso de posconflicto, la discusión sobre las fuentes para financiar aún está en marcha. El gobierno colombiano no ha dado a conocer un plan definitivo para financiar las necesidades de un escenario posconflicto, pero se ha dado a entender que las rentas de los recursos generados por el sector extractivo pueden ser una importante fuente de financiación. Este trabajo pretende contribuir al debate de cómo financiar un eventual proceso de consolidación de la paz en Colombia, al discutir los retos y oportunidades de la utilización de las rentas de recursos naturales no renovables, en particular de las regalías.

Palabras clave: gasto público, justicia transicional, proceso de posconflicto, regalías, rentas de los recursos, sector extractivo.

1. Introduction

After a prolonged and devastating armed conflict, Colombia is currently seeking to terminate it through negotiation. A peace process between the national government and the Farc guerrilla¹ started by the end of 2012 and advanced in three of the six main points of the negotiation agenda: rural development, political and citizen participation, and illegal drug trafficking. Three arduous points are still under negotiation: i) victims; ii) disarmament, demobilization and reinsertion (DDR); and, iii) conditions for the counter-signature, implementation and verification of the agreements.

This is a crucial moment to devise how Colombia may manage the post-conflict, particularly how to finance it. An eventual post-conflict process in Colombia would entail a myriad of challenges and opportunities that require well planned and implemented policies.² Among them, tackling how to finance these policies and programmes is one of the

1 The Revolutionary Armed Forces of Colombia, in Spanish *Fuerzas Armadas Revolucionarias de Colombia* (Farc).

2 It could be argued that some features of a post-conflict scenario may have already started in Colombia, such as the implementation of transitional justice mechanisms (Justice and Peace Law in 2005 and Victim's Law of 2011). Moreover, a 2012 national survey suggested that processes of reconciliation between victims and perpetrators had already started in Colombia (Rettberg, 2014, p. 252). However, the Colombian armed conflict has not terminated and produces victims on a daily basis. Moreover, most of the conflict's victims are still waiting for the restitution of

biggest difficulties that the Colombian society must face. While the State has relatively good data to approximate the cost of such interventions, government officials have not been very assertive on how to finance peace-building policies.

In September 2014, when the national budget for 2015 was being discussed in Congress, President Santos informed that the government was evaluating different possibilities to finance the “costs of peace”, which included the possibility of creating new taxes.³ Moreover, in October 2014 the Minister of Finance announced that the International Monetary Fund (IMF) agreed to setup a task force to assess different sources of finance.⁴ More recently, the High Commissioner of Peace, Sergio Jaramillo, argued that the private sector should have a pivotal role in future peace-building, but that the economic burden could not be carried solely by companies.⁵

Even though the Government has not yet disclosed a definitive plan to finance an eventual post-conflict, it seems that non-renewable resource rents may play an important role in its funding. Indeed, policy documents⁶ and frequent public interventions by President Juan Manuel Santos⁷ have pointed at the oil, gas and mineral companies as a pivotal sector to finance a post-conflict scenario.

Colombia is relatively resource-rich and has relied on non-renewable resources for exporting in the last decades.⁸ Moreover, as explained in section 3 of this paper, a significant share of the national government and the subnational governments’ income is derived from taxes, dividends⁹ and royalties¹⁰ paid by the extractive sector.

their land, other forms of economic reparation, and the installment of a system that guarantees their rights to truth and justice (DNP 2014b). Hence, in this article I will assume that the post-conflict may eventually start if peace negotiations are successfully closed.

3 See: “Financiamiento de la paz en debate”, published by *Portafolio* on September 10, 2014. Retrieved on 01/06/2015: <http://www.portafolio.co/economia/financiamiento-paz-colombia-septiembre-2014>.

4 See “IMF to study how to finance peace in Colombia”, published by *Colombia Reports* on October 14, 2014. Retrieved on 11/06/2015: <http://colombiareports.com/imf-explore-mechanisms-financing-peace-agreement/>.

5 See, for example: “Hay que coger el toro por los cuernos: Comisionado de Paz”, published by *El Espectador* on April 22, 2015. Retrieved on 10/06/2015: <http://www.elespectador.com/noticias/politica/hay-coger-el-toro-los-cuernos-comisionado-de-paz-articulo-556552>.

6 Such as CONPES document N° 3712 of 2011.

7 See, for example, Bermúdez (2015).

8 The weight of hydrocarbons’ exports in the total national exports was above 25% during almost all the 2000s and reached a peak of 49% in 2011 (Bonet and Urrego, 2014). In 2014, oil exports represented 52.4% of total exports (MHCP, 2015, p. 11). Moreover, almost a third of the foreign direct investment in 2014 was destined for the hydrocarbon’s sector (MHCP, 2015, p. 11). The IMF (2007) defines a country as resource-abundant when its non-renewable resource revenues represent 25% or more of its total fiscal revenues and/or if its non-renewable exports are equal or exceeds 25% of the total exports.

9 Dividends transferred by Colombia’s state-owned oil company, Ecopetrol.

10 Companies or individuals pay royalties to the Colombian State in exchange for the right of extracting minerals and hydrocarbons (Article 360 of the Colombian Constitution of 1991). As it will be explained in the third section

This paper aims to contribute to the debate of how to finance an eventual post-conflict process in Colombia, by discussing the risks and opportunities of using non-renewable natural resource rents, particularly from royalties. To do so, the paper is divided in five sections, including this brief introduction. The second section explains the context of the armed conflict and the costs that the State may face in a post-conflict scenario. The third segment presents the context of the Colombian public finances and focuses on the system for the management of revenues from royalties. Subsequently, the fourth section balances the challenges and the opportunities of using non-renewable natural resources to finance a post-conflict scenario in Colombia, and the last one summarizes the conclusions of the paper. Finally, the conclusion section outlines some alternatives to avoid over-reliance on resource rents and suggestions to avoid the problems related to the use of royalties to finance post-conflict programmes.

This document does not aim to cover the broader discussion of the extractive sector in the Colombian post-conflict, nor the socio-economic and environmental challenges that financing development projects with resource revenues entails (Arisi and González, 2014). These issues are very important, but go beyond the scope of this paper.

2. The context: the conflict and the post-conflict's costs

Over a period of 50 years the Colombian armed conflict has produced more than seven million victims, around 15 per cent of the country's inhabitants (MHCP, 2015, p. 89). Furthermore, the Colombian State estimated that until 2011 the armed conflict generated 830,000 "victimization acts": almost three quarters of them included forced displacement and the rest involved homicide¹¹, forced disappearance, kidnap, torture, recruitment of children, physical injuries, and sexual abuse.¹² In terms of the amount of people that State has planned to treat, this is the biggest reparation program in the World (MHCP, 2015, p. 89).

Based on the Victims and Land Restitution Law of 2011, the Colombian State calculated that the cost of repairing the conflict's victims between 2012-2021 amounts to USD \$ 21 billion (COP \$ 54,903 billion).¹³ The projected costs of implementing the

of this paper, royalties are collected by the National Government and almost entirely transferred to municipal and departmental governments.

11 According to the Colombian National Centre for Historic Memory, between the years 1985-2013, at least 220,000 died due to armed violence (81.5% of them non combatants) and 4,744,046 people were displaced due to the armed conflict (Arias et al., 2014, pp. 25-26).

12 See, CONPES document N° 3712 of 2011 and CONPES document N° 3726 of 2012.

13 The right to remedy was calculated with the standards established by the Victims and Land Restitution Law (Law 1448 of 2011). The costs included five types of expenditures: i) assistance (e.g. education, health, legal advisory, ID expedition); ii) attention (e.g. humanitarian aid, food supply, accommodation, resettlement, attention centres); iii)

individual and collective reparation programmes in these 10 years are equivalent to almost 6% of GDP in 2014. Moreover, the expenditures projected solely for 2015 amount to 1.2% of GDP in 2014 (MHCP, 2015, p. 89).

Even if these costs were accurately calculated, the public expenditures that the Colombian post-conflict scenario requires are bigger.¹⁴ Besides direct victims, the conflict also affected people that lived in conflict areas, especially children. For example, people that lived in conflict areas tended to receive less and lower quality education and health services; furthermore, children were more prone to be affected by specific health problems (Arias, Camacho, Ibáñez, Mejía and Rodríguez, 2014). Moreover, the conflict reduced the productivity of agricultural activities, decreased private investment and weakened the state's capacity (Arias et al., 2014). In this vein, the National Development Plan for the years 2014-2018, that adopted "peace" as one of its three main pillars, and acknowledged that the post-conflict requires making structural changes to "consolidate peace and open the doors of modernity for the country" (DNP, 2014b, p. 4).¹⁵

In addition to repairing victims and reconstructing the shattered infrastructure, it is necessary to restore the "constructive and productive social relations among all members of the society" (Retteberg, 2014, p. 221). Therefore, the costs of reconciliation ("re-building trust among citizens and with state institutions") must also be taken into account for post-conflict scenario (Rettberg, 2014, p. 221).¹⁶

reparation (e.g. land-restitution, housing-restitution, housing subsidies, administrative indemnification, employment and income generation, debt assistance, satisfaction and guarantees of non-repetition); iv) strengthening the state agencies in-charge of implementing the Victims's Law; and v) other costs (e.g. additional state building costs, collective indemnification to ethnic groups).

14 The initial calculations of repairing the victims of the armed conflict in Colombia were much larger. Almost a decade ago, Richards (2006) quantified the financial resources required to repair the victims of the Colombian conflict in accordance with the Justice and Peace Law (Law 975 of 2005). The law established transitional justice mechanisms to incentive the demobilization and reintegration of "illegal armed groups", covering both guerilla and paramilitary members. The law included a judicial procedure that allowed victims to request full compensation for the damage caused by the conflict. Richards (2006, p. 3) estimated that the costs of repairing all people directly damaged by the conflict between 1964 and 2005 was equivalent to a value between 19% and 33% of GDP of 2005. The lower financial cost of repairing victims under the Victims and Land Restitution Law (Law 1448 of 2011) is a consequence of two issues. First, this law limits the reparation to those damages caused after the year 1985, in spite that the conflict started at least two decades before. Second, the law gives the victims the option of obtaining limited administrative reparation if they accept to withdraw or refrain from starting judicial claims for full indemnification.

15 Three objectives are derived from the peace pillar: i) to strengthen the conditions for a peace-building process and guarantee its sustainability (e.g. promoting citizen participation); ii) to integrate the territory and its communities (e.g. improve transport infrastructure and public utilities) and; iii) to reduce the social and territorial inequalities between the rural and urban municipalities.

16 However, a recent national survey of urban inhabitants suggests that the process of "reconciliation" has already started and that due the characteristics of the Colombian conflict its costs are note particularly high (Rettberg, 2014).

In sum, re-constructing the human, social and physical capital shattered by the conflict implies a huge investment for Colombia. But post-conflict entails more needs than the ones explained above. This is the case of the implementation of DDR policies that will also require a considerable effort from the Colombian State. Due to previous experience with individual and collective demobilization of guerrilla and paramilitary combatants it is possible to estimate the cost of implementing a DDR programme in an eventual post-conflict process. A recent report by the General Comptroller's Office on the implementation of DDR policies found that between 2003 and the first semester of 2014 a total of 56,939 people had demobilized and that 30,203 of them were still being treated by the Colombian Reintegration Agency (CGR, 2014, p. 18). Moreover, the General Comptroller's Office found that between 2010 and the first semester of 2014 the implementation of the DDR policies costed a total of USD \$ 255 million (CGR, 2014, p. 34). Based on these figures, the General Comptroller's Office concluded that an eventual DDR programme for Farc guerrilla members would cost between USD \$ 754 million and US \$1.1 billion (equivalent to 0,2% to 0,3% of GDP in 2014, respectively).¹⁷

However, using previous experience with DDR programmes to predict the cost of future DDR implementation for Farc has limitations. As pointed out by Schulhofer-Wohl and Sambanis (2010), DDR programmes are quite heterogeneous across countries and even within-programmes. These programmes may vary from one another on different aspects, such as the entities in charge of implementation, the programming of different phases of intervention, degree of government participation in their administration and funding, the financial resources of the programme, and its comprehensiveness (Schulhofer-Wohl and Sambanis, 2010, p. 37). Hence, it may be the case that the initial calculations of the General Comptroller's Office, based on previous DDR programmes, underestimate the costs of future DDR implementation in Colombia.

The importance of the effectiveness of the DDR policies for preventing the re-initiation of the armed conflict or the generation of new sources of violence related to organized crime cannot be overstated. Villa, Restrepo and Moscoso (2014) warn that if the Colombian economy is not capable of absorbing the demobilized combatants (and part of the Colombian army), the country may face the so-called "peace paradox": the end of the armed conflict, but a subsequent increase in criminal activities. According to them, "an increase of delinquent activity may appear in the country, if the comparative advantage of ex-combatants in the use of fire weapons allows them to enter the delinquent sector more easily" (2014: 206). Unfortunately, the experience with the demobilization of paramilitary groups in the last decade shows that this scenario is likely.

Finally, the implementation of the Havana agreements between the National Government and Farc will also require substantive investment of resources. The documents of

¹⁷ Currently, Farc has between 8,000 to 10,000 combatants (Arias et al., 2014, p. 23).

the three agreements on an “integral rural reform”, “the solution to the problem of illegal drugs”, and “opening political participation” do not quantify the costs of implementation. Yet, the ambitious policies and interventions proposed in the agreements indicate that its implementation would entail a significant financial effort by the State, both at the national and local levels.¹⁸

In sum, the finalization of the armed conflict will bring significant financial costs for the Colombian society and the State. Which sources of financing are available for that purpose? This topic is discussed in the next section. Nevertheless, before revising Colombia’s public finances, it is pertinent to note that peace may also render monetary and non-monetary benefits. Different studies since the late 1990s and until recent times have attempted to estimate the economic and social costs of the conflict.

There is consensus on the negative impact of the conflict on economic growth but the conclusions on the size of the impact vary. The calculations of the negative effect in terms of annual GDP (gross domestic product) growth fluctuate between 0.3 to 4.5 percentage points (Arias et al., 2014, p. 26).¹⁹ A very recent work by Villa, Restrepo and Moscoso (2014) aimed at estimating the so-called “peace dividend”, the economic benefits that can be derived through the end of the conflict through a negotiated process. According to their econometric estimation, if the armed conflict were reduced to a 100%, *ceteris paribus*, the departments’ annual GDP growth would increase on average 4.4 percentage points (Villa, Restrepo and Moscoso, 2014, p. 206).

3. Colombian public finances

To frame the discussion on the possible sources of funds to finance the post-conflict and the government entities that could be in charge of executing these funds, this section presents an overview of the Colombian public finances. Hence, this section starts by briefly presenting the decentralized structure of the Colombian State and the type of responsibilities that different levels of government have. Subsequently the paper portrays the public finances of the national and subnational governments. Finally, the section explains how the fiscal revenues from the royalties paid by the extractive sector are managed in Colombia after the 2011 constitutional reform.

18 For example, the agreement on the “integral rural reform” proposes, among others, the creation of a Land Fund to redistribute land and specific investments in infrastructure, social development, and support for farmers associations. Villar and Forero (2014), cited by OECD (2015, p. 18), calculate that the implementation of the peace agreement in the agricultural sector would require additional expenditures “of around 1% of GDP per annum for 2015-18”.

19 For a succinct account of the findings of different studies on the costs of the Colombian armed conflict, see also the speech of the former IMF’s Deputy Managing Director, E. Aninat, titled “The Economic Foundations of Peace in Colombia” delivered in Washington DC, on June 20, 2002.

3.1 Unitary and decentralized State

Colombia is a unitary state with a system of three-tier governments: national, department (32) and municipal (1102). Although Colombia's decentralization process may be traced back to the end of the 1960s, it was only until the enactment of the 1991 Constitution that political and fiscal decentralization was deepened (Dillinger and Webb, 1999; Zapata, 2010; OECD, 2014; CEECT, 2015).²⁰ Nowadays the mayors of cities, the governors of departments and the local and regional councils are elected through popular vote and sub-national governments receive substantial resources from the central government.²¹ Due to the high level of resources transferred to subnational governments and their fiscal and political autonomy, Zapata (2010) has argued that Colombia is closer to a federal fiscal level. Additionally, local governments currently manage 70% of public investment in Colombia (OECD, 2014, p. 114).²²

Furthermore, the political and fiscal decentralization is coupled with diverse accountabilities in regards to service delivery and provision of public goods. More specifically, since 1986, municipalities have responsibilities on the provision of education, health, water, sewage and sanitation services and infrastructure such as urban transport facilities and tertiary roads (Dillinger and Webb, 1999). Yet, the allocation of competences in Colombia is complex, and municipalities share some of the listed functions with the national government and with departments' governorates (OECD, 2014).

Decentralization is not just about tax sharing or the assignment of funds to subnational governments, but also about expenditure autonomy (Dillinger and Webb, 1999). The autonomy to spend of local governments in Colombia is relative due to the prevalence of earmarked national transfers and low own-source generation.²³ Indeed, Colombia is one

20 The economic decentralization came first in 1968, with the amendments to the 1886 constitution, when municipalities and departments were assigned fixed sums of national revenues and shares of national taxes to spend in health and education (Dillinger and Webb, 1999). In the following years the economic decentralization was strengthened, but political decentralization did not come into play until the mid-80s. The first election of city and municipal mayors took place in 1988 after a legal reform in 1986. The political decentralization was coupled with more functions and funds to municipalities (Dillinger and Webb, 1999).

21 Around thirty percent of the Colombian national revenues are transferred from the national government to the municipal and department governments, a high percentage by international standards (Zapata, 2010; OECD, 2015, p. 22). Most local governments depend on national transfers since they do not raise sufficient own-source funds. In 2013, on average, less than 40% of municipal budget's came from local taxes and less than 22% of department's budgets were levied locally (DNP, 2014a). Furthermore, 41 municipalities (out of 1098) raised 80% of municipalities' own funds and 6 departments (out of 32) raised 70% of departments' own funds (DNP, 2014a). Additionally, the city of Bogotá accrues 35% of the total local revenues collected by municipalities in Colombia (CEECT, 2015, p. 38).

22 In contrast, in 2014 around 81% of the central government's budget was destined to current expenditures, while only 19% was used for capital expenditures (IMF, 2015, p. 45).

23 The Constitution and laws earmark most of the resources provided by the national government to subnational governments. However, according to Dillinger and Webb (1999) the strings attached to the resources, in the case of

of Latin America's countries with the largest percentage of earmarked public spending (Cárdenas, Mejía and Olivera, 2009, p. 107).

This feature is key for the discussion of how the post-conflict policies may be financed and may partially explain why the national government has considered the resource revenues system to circumvent Colombia's fiscal rigidity. Indeed, the 2011 royalties' reform allowed almost all departments and municipalities to access funds that are not earmarked by the law. The royalties may be used to fund local capital investments in the sectors that local governments consider more pertinent for the development of their regions. In this sense, the 2011 reform increased the autonomy of mayors and governors to decide where to invest local public investments.

3.2 National government finances

In 2014, 86% of the national government income came from taxation and around 12% from capital resources (such as the dividends paid by state-owned oil company, Ecopetrol) (MHCP, 2015, p. 56). From the total tax revenues received by the national government in 2014, 46% corresponded to income taxes, 26% to value-added taxes, 15% foreign-sourced taxes (e.g. duties), and 13% other taxes (such as a wealth tax) (MHCP, 2015, p. 58). The Ministry of Finance projected that the national government's fiscal deficit would grow in for 2015, amounting to 3.0% of GDP (0.6 percentage points above 2014), due to the reduction on oil-related revenues and the lower growth of the economy (MHCP, 2015, p. 54).

Despite that the national government claims that Colombia's economy is not dependent on hydrocarbons, the first issue discussed in the Ministry of Finance's Medium-Term Fiscal Framework 2015-2018 (MTEF) was the plummeting prices of oil (MHCP, 2015, p. 11).²⁴ Oil prices are currently 40% below the market prices in June 2014 and the Ministry of Finance recognized that the main challenges posed by this situation are fiscal (MHCP, 2015, p. 14). Resource rents are a significant source of income for the national and subnational governments in Colombia. These rents include income taxes paid by extractive firms, dividends transferred by Ecopetrol and royalties paid by oil and mining companies.²⁵

municipalities, have not been restrictive in practice due to the flexible interpretation given to local governments to the conditions established by the laws.

24 The optimism of the Ministry of Finance it is also reflected on the fact that the MTEF 2015-2018 assumes that the prices of oil will recover significantly and that Colombian crude production will grow, despite different structural conditions that make both assumptions unlikely. See OECD (2015), Kalmanovitz (2015) and Ahumada (2015).

25 The weight of resource revenues in Colombian public finances grew in the last quarter of the century. During the period 1990-2003 the fiscal income from mining and hydrocarbons activities in Colombia represented on average

In the last three years, the rents derived from income taxes paid by hydrocarbons companies plus the dividends paid by Ecopetrol represented, on average, 17% of the national government's income (MHCP, 2015, p. 13).²⁶ Moreover, revenues from royalties, mostly destined for subnational governments, were equivalent to 1.4% of Colombia's GDP in 2012 (OECD, 2014, p. 95).²⁷ Additionally, a significant number of subnational governments are resource-dependent.²⁸ Indeed, in 151 municipalities royalties represented more than 25% of total capital investment income and in 51 municipalities royalties accounted for more than 50% of total capital investment income.²⁹

To curb the fiscal deficit, the government decided to postpone expenditures in 2015 equivalent to 0.7% of GDP (0.4% associated with investment) (MHCP, 2015, p. 55). Furthermore, in December 2014 Congress approved a tax reform "designed as a short-term tool to offset scheduled revenue declines" (IMF, 2015, pp. 2). However, these efforts fell short in regards to the fiscal needs of the Colombian State.³⁰ Besides improving tax management and curbing evasion, Colombia needs to find additional resources to fund future social programmes and to shorten the country's infrastructure gap (CEECT, 2015; IMF, 2015; MHCP, 2015; OECD, 2015). In this vein, the OECD very recently suggested that it was critical for Colombia to raise "revenues in an efficient and fair way" and recommended to "[u]ndertake a comprehensive reform of the tax system to increase fairness, growth and revenues" (2015, pp. 6, 18).

11.3% of the total fiscal income of the country, while in the period 2004-2009 they represented on average 16.3% of the total fiscal income (Altomonte et al., 2013, pp. 33 and 62).

- 26 Moreover, in 2013 11.2% of the central government's total revenues (equivalent to 1.9% of GDP) came from Ecopetrol's dividends (OECD, 2015, p. 17). In recent years, the sum of Ecopetrol's dividends transferred to the national government and income taxes amounted to 15% of national income (CEECT, 2015, p. 17).
- 27 The weight of royalties paid by extractive companies to the Colombian State grew in the last decade. In 2002, these revenues represented 0.6% of the country's gross domestic product in 2002 (Bonet and Urrego, 2014, p. 1).
- 28 In 2013, royalties represented a sum that was equivalent to approximately 86% of all the local taxes levied at the department level (DNP, 2014a, pp. 56-57). At the municipal level, the royalty funds represented a sum that was equivalent to approximately 28% of the income derived from local taxes levied by municipalities (DNP, 2014a, pp. 64-65). Finally, in 2013 royalties represented on average 8% and 25% of the total income of municipalities and departments, respectively (DNP, 2014a, pp. 56, 64).
- 29 Colombia has a total of 1,102 municipalities. Calculations based on data from DNP (2014a).
- 30 A recent report by OECD (2015, p. 17) argued: "Colombia has important spending needs. Public infrastructure investment will be critical to economic development and is expected to rise after 2020. Indeed, currently planned infrastructure investment may prove insufficient to address bottlenecks in transportation and energy (Clavijo, Vera and Vera, 2013a). Spending pressures also arise from already planned expansions of social policies and a potential peace deal with armed groups. For example, expanding non-contributory pensions, increasing the quality of education and the coverage of early childcare programmes, and planned additional health care expenditures would cost around 1.7% of GDP."

In February of 2015 the national government established an expert commission to find ways for mobilizing additional revenue (IMF, 2015).³¹ The first report presented by the commission after three months of work consisted on a diagnostic of the Colombian tax system's problems. The commission concluded that despite of Colombia's high nominal tax rates, in comparison with international standards, it has one of the lowest tax collection rates (CEEECT, 2015, p. 13). Besides concluding that Colombia's tax system does not generate sufficient income, the commission also concluded that the system is not progressive and that it is inefficient (CEEECT, 2015).

Bearing in mind the adverse fiscal situation of the Colombia State it is quite outstanding that the national government increased in 4,3% (real terms) the budget for the victim's programmes between 2014 and 2015 (MHCP, 2015, p. 89). Moreover, besides the specific reparation programmes, the national government has also aimed at targeting its public expenditures to the victims population, which will represent in 2015 approximately 7% of the total national government expenditures (MHCP, 2015, p. 89). Additionally, the investment in "social inclusion and reconciliation"³² will account for 22% of national government total capital expenditures in 2015 (MHCP, 2015, p. 61). The latter is consistent with the MTEF 2015-2018,³³ which contains the expenditure projections, both current and capital, for each sector that is part of the national budget. Indeed, the first objective mentioned in this MTEF is the necessity to maintain the social expenditures related to the implementation of the Victims and Land Restitution Law (1448).

Nevertheless, aside from the latter, neither the MTEF 2015-2018 nor the approved 2015 national budget include explicit and significant provisions for future implementation of post-conflict programmes. The fact that the 2015 national budget did not include specific provisions for post-conflict did not pass unnoticed and Congress members, from government and opposition parties, criticized that shortcoming.³⁴

31 The Commission of Experts for Fiscal Equity and Competitiveness was setup by the national government through the Decree N° 327 of February 25, 2015.

32 Includes financing the programme for early childhood, *Familias en Acción* (conditional cash transfer programme), and other programmes for low income, vulnerable, displaced and victims population.

33 The Medium-Term Expenditure Framework (MTEF) is prepared in a yearly basis by the Ministry of Finance and the National Planning Unit (DNP). The MTEF is the main input used by the National Government for the formulation of the annual national budget. In the case of the Medium-Term Expenditure Framework 2015-2018, it was approved in document CONPES N° 3813 of 2014.

34 See, for example: "Financiamiento de la paz en debate", published by *Portafolio* on September 10, 2014. Retrieved on 01/06/2015: <http://www.portafolio.co/economia/financiamiento-paz-colombia-septiembre-2014>.

3.3 Local government finances and the management of revenues from royalties

The three main sources of subnational governments' income in Colombia are inter-governmental transfers, revenues from royalty payments, and local taxes.³⁵ Local governments are dependent on the first two types of income: in 2013 inter-governmental transfers represented almost half of local governments' income and royalties represented 8% and 25% of the total income of municipalities and departments, respectively (DNP, 2014, pp. 56, 64).³⁶

The essential difference between inter-governmental transfers and non-renewable resource rents is their destination. On one hand, inter-governmental transfers from the national government to the local governments have strings attached. Indeed, 80% of the intergovernmental transfers are earmarked for health and education (OECD, 2014, p. 195).³⁷ On the other hand, the current royalty system gives local governments more autonomy to decide how to invest the resource rents they access.³⁸ These resources are not earmarked but may be invested by local governments in their preferred sectors (e.g. transport, housing, education, etc.), as long as they formulate investment projects that are approved by multi-tier government directorates. Let us revise how resource revenues are currently managed in Colombia.

Colombia's 1991 Constitution established that the exploitation of non-renewable natural resources generate an obligation to pay a royalty in favour of the State.³⁹ The original rule of the 1991 Constitution mandated that royalties had to be distributed mainly among the municipalities and departments where such exploitation took place or where

35 While local governments' expenditures accounted in 2011 for 33.2% of the total government expenditures, the taxes levied by subnational governments only represented 18% of total government tax revenues (OECD, 2014, p. 197).

36 National transfers represented 46% of the municipalities' total income in 2013 (DNP, 2014a, p. 64) and 40.1% of the departments' total income in 2013 (DNP, 2014a, p. 58). Additionally, around a quarter of the funds available for capital investments at the department level come from mineral royalties (DNP, 2014a).

37 National transfers include earmarked resources of the "general system of participations" (SGP), funding for social security pensions of teachers and other state employees, and other payments such as contributions to public universities (Echeverry, Navas and Clavijo, 2009). In 2006, the social security transfers and the SGP funds amounted to 44% and 45% -respectively- of the total national government's transfers to local governments (Echeverry, Navas and Clavijo, 2009, p. 243). The constitution and the law strictly regulate the destination of SGP funds. Currently, the resources must be allocated to the following expenditures: 58.5% to education, 24.5% to health, 11.6% to potable water and basic sanitation, and only 5.4% for other purposes. Bonet, Gerson and Ayala (2014). In Colombia, most of the resources used to increase the scope and quality of public health and education come from the national government's transfers to local governments (Galvis, 2014). In sum, local governments use national transfers to fund both current expenses (e.g. wages and social security) and investment expenses (e.g. investment projects to increase quality, scope and efficiency) particularly related to health, education and basic sanitation services.

38 Yet, the use of these resources is restricted to capital investments, not current expenditures.

39 See article 360 of the Constitution of 1991. "The royalty is the price that the owner of a natural resource charges for the right to develop the resource. ... The royalty rate applied depends on the kind of product, and on the volume of the production." (OECD, 2014, p. 95).

these resources or their derivatives were transported. Hence, these “producing” municipalities and departments received “direct royalties” commensurate to oil, gas or mineral production while the rest of the municipalities where these commodities were transported received “indirect royalties”. Between 1995-2011 direct royalties represented – on average – 86% of total royalties (OECD, 2014, p. 103).⁴⁰ Additionally, the destination of royalties before the 2011 reform was heavily regulated and earmarked towards specific type of investments.⁴¹

In July 2010 the Colombian government presented a constitutional amendment to modify the royalties system in Colombia and after one year of debate in Congress the reform was approved. The 2011 royalties’ reform (effective from January 2012 onwards) created the *General System of Royalties* (GRS) that included major changes in regards to resource allocation among local governments and the assessment, approval, and destination of investment projects funded by these resources.⁴²

The first key new rule of the GRS is that it decoupled the allocation of royalties from the geographic location and size of mineral and hydrocarbon production. The GRS established five funds that benefit all municipalities and departments and left just one fund destined exclusively for “producing” regions, that from 2015 onwards represents only 10% of the total royalty funds.⁴³

The two main consequences of the new resource allocation rules of the GRS were a steep reduction in the concentration of royalties’ distribution and a significant re-shuffle of resources among subnational governments. Firstly, as a result of the amendment, all the municipalities and departments in Colombia may benefit from royalty revenues. Thus, while around 42% of the municipalities did not have access to any royalties in 2011, 89% of the municipalities accessed and started executing royalty resources in 2013.⁴⁴

40 Hence, in the 1990s and 2000s most of the royalties were allocated to a few resource-rich municipalities and departments, inhabited by approximately 14% of the Colombian population (Bonet and Urrego, 2014).

41 For example, for municipalities that received “direct royalties” had to destine 90% of the royalties to local investment projects “for environmental sanitation, potable water, sewage systems and other basic public services” (Armenta et al., 2014, p. 15).

42 Before the reform, local governments accessed royalties almost directly and were subject to flexible rules in terms of the planning, procurement and implementation of investment projects. The reform created a complex system of funds and rules to access such funds. Particularly, each investment project requires the approval by a kind of board of directors integrated by subnational (mayors and governors) and national authorities (ministers of the cabinet or their representatives).

43 The rest of the resource rents are allocated in the following funds: i) 10% for pension savings fund; ii) up to 30% for a savings and stabilization fund; iii) 10% for a science, technology and innovation fund; iv) after 2015, 24% for a regional compensation fund that allocates resources to the poorest municipalities and departments; and, v) after 2015, 16% for a regional development fund that allocates resources to all subnational governments based on population and socio-economic variables.

44 Own calculations based on data from DNP (2014a). The fact that in 2012 and 2013 there were municipalities that did not execute royalties is due to their failure to obtain approval for specific investment projects, not because they lack

Secondly, the shift in resources also increased the resources available for certain regions and decreased the resources for a few regions, mainly those that produce hydrocarbons.⁴⁵ However, while the reform reduced significantly the concentration of resources allocated to the departments, the reduction in the concentration of resources allocated to the municipalities was small. Indeed, the Herfindahl-Hirschman Index shifted from 1,472 to 659 from the period 2010-11 to the period 2012-13 in regards to the departments' resources, while the index shifted from 655 to 599 in the same periods in regards to the municipalities' resources.⁴⁶

Furthermore, the amendment shifted more resources to departments and consequently decreased the amount of resources available for individual municipalities.⁴⁷ Hence, the resources executed by municipalities between the period 2010-11 and the period 2012-13 increased in 22 percentage points while the resources executed by departments in the same periods increased in 48 percentage points.⁴⁸ As a result, in the period 2012-2013 departments accessed 62% of the total royalties while municipalities accessed 38%.⁴⁹ Furthermore, in 2013 the department investments funded with royalties presented a nine-fold increase with respect the investments in 2012 (DGAP, 2014, p. 22). The shift of resources from municipalities to departments and the new system of prior approval of investment projects to access such resources may have changed the gravity of power at a subnational government level. In short, the new rules made municipalities and their mayors more dependent to the governors of their respective department to receive and execute royalty funds.

The third key new set of rules included by the 2011 royalties' reform is related to the destination of the royalties by municipalities and departments. In the GRS, the resources have to be used for investment purposes (hence, not current expenses), but are not earmarked for specific sectorial uses. Thus, the mayors and governors have more discretion than before to choose how to allocate the royalties.⁵⁰ The autonomy for investing these

a royalty funded budget. Up to date DGAP (2014) considers that the difficulties in budget execution by subnational governments are an important challenge for development.

45 For example, the Department of Meta accessed 31% of the total royalties of the country in the period 2010-11, while in the period 2012-13 it only accessed 14% of total royalties. Own calculations based on data from DNP (2014a).

46 Own calculations based on data from DNP (2014a). For the calculation of the HHI for municipalities I grouped the municipalities in their respective department. Hence, if I had calculated the HHI using the municipalities as the unit of measurement, the HHI would be considerably smaller.

47 Colombia has 32 departments that aggregate a total 1102 municipalities and cities. Although for public accounting purposes, Bogota city is treated as a department, not as a city.

48 Own calculations based on data from DNP (2014a).

49 Own calculations based on data from DNP (2014a).

50 This change may explain why the use of royalty resources has shifted from education, health and public services to other destinies. Indeed, up to date, according to DNP (2015) around 32.9% of the resources have been invested in transport projects, 14.3% in housing and urban infrastructure, 13.9% in education, 11.1% in science in technology, 3.79% in health and social security services.

resources is limited because each investment project requires technical approval by DNP and political approval from a collegiate body conformed by representatives from the three different tiers of the government called “Órganos Colegiados de Administración y Decisión – OCAD”. In this sort of “board of directors”, each tier of government (national, department and municipal) has an equal voting right and decisions are taken by qualified majority of voting (2 out of 3). Therefore, for example, if the representatives from the municipal and department agree to approve a project, the national government cannot veto the decision. The OCAD’s assess, evaluate, prioritize, and approve the investment projects presented by the local governments (OECD, 2014).

4. Risks and challenges of using resource revenues to finance post-conflict needs

Juan Gossain (Journalist): “From where are you going to raise the money for post conflict if dollar is at \$2,600 Colombian pesos and petroleum at USD \$ 60 per barrel?”

Humberto de la Calle (Chief Colombian government negotiator for peace talks with Farc): “Farc should have signed the peace accord two or three years ago when petroleum was at USD 110.”⁵¹

Colombia is one of the Latin America’s countries that most benefitted from the last commodity price boom (Gómez-Sabañi and Morán, 2014, p. 25). This cycle started around 2003 and reached its peak in mid 2008 when the prices dropped due to the global financial crisis. The growth trend resumed in 2009, and commodity prices remained high until 2011 (Altomonte et al., 2013; Gómez-Sabañi and Morán, 2014). Yet, the prices of mineral and non-mineral commodities minerals started declining in 2011, and the prices of oil plummeted since June 2014.⁵²

51 “Proceso de paz con Farc está en su peor momento”: Humberto de la Calle”, interview published by *El Espectador* on July 5, 2015. Retrieved on 09/07/2015: <http://www.elespectador.com/noticias/politica/proceso-de-paz-farc-esta-su-peor-momento-humberto-de-ca-articulo-570406>

52 The prices of oil halved between June 2014 and February 2014, but in the last months have partially recovered and are currently 43% below the prices of mid 2014.

The “super-cycle” seems to be over and the fiscal revenues from the exploitation of non-renewable resources have decreased substantially in oil exporting countries like Colombia. The shortage of resource revenues has uncovered the limitations of the Colombian tax system. As a result, the national government promoted a tax reform, approved by Congress in December 2014, among others, to cover the fiscal deficit generated by the drop in the prices of oil. Additionally, the government reduced its planned expenditures for 2015 by an amount equivalent to 0,7% of GDP. The cuts will affect central government’s public investment, but seem to exclude “education and compensation of civil victims of the conflict” (IMF, 2015, p. 10).

Fedesarrollo estimated that if Colombia does not amend its tax system, the total government’s income would be reduced from 16.9% of GDP in 2013 to 13.8% of GDP in 2020 (CEEECT, 2015, p. 18). The fiscal challenge currently faced by the Colombian government is not limited to finding additional resources to deliver public goods, implement social programmes, and execute key investments in areas such as infrastructure, but also to raise additional funds for the post-conflict (CEEECT, 2015, p. 7).

Bearing in mind the above said, should the Colombian State rely on resource revenues to finance post-conflict needs? My answer to the question is quite straightforward: the Colombian State should not depend solely on resource revenues to finance post-conflict needs. Yet, I argue that this does not mean that resource rents should not be used for this purpose, or that these revenues should not have an important role in financing the post-conflict’s expenditures. This section analyses the opportunities and the risks faced by the Colombian government if non-renewable natural resource rents, particularly from royalties, are used to finance an eventual post-conflict process.

4.1 Resource rents are a significant source of income but also volatile, decreasing and insufficient to finance post-conflict’s policies

Revenues from the extractive sector constitute a significant share of Colombian national and sub-national governments public income. Resource revenues from the extractive sector represented, on average, an annual income of approximately 3.5% of GDP for the Colombian State. Despite that these resources are a significant source of income that will very likely be required to finance the post-conflict, more and different sources of income will be required. There are at least four reasons to justify this claim.

First, the revenues from royalties are simply not sufficient to cover the expenditures required. As explained before, the Colombian public finances are already under significant pressure due to the significant reduction of oil prices (OECD, 2015). According to Fedesarrollo, the fiscal income from the extractive sector “decreased from 3.5% of GDP in 2013 to 1.2% of GDP in 2015 and will be situated below 1% of GDP in the next years” (CEEECT, 2015, p. 17). Furthermore, unless different technical, social, and envi-

ronmental related to the exploitation of oil by Ecopetrol issues are solved, a future decline in production is very likely (OECD, 2015, p. 17; MHCP, 2015, p. 21). Additionally, the production of the mining sector also contracted in 2014 for the first time in nine years (MHCP, 2015, p. 21).

Second, due to the GRS rules on the destination of royalties, less than two thirds of the funds would be available for investment for post-conflict purposes. The GRS consists of five funds that benefit all municipalities and departments and one fund destined exclusively for “producing” regions. The rents from royalty payments are allocated in the following funds: i) 10% for pension savings fund; ii) up to 30% for a savings and stabilization fund; iii) 10% for a science, technology and innovation fund; iv) after 2015, 24% for a regional compensation fund that allocates resources to the poorest municipalities and departments; v) after 2015, 16% for a regional development fund that allocates resources to all subnational governments based on population and socio-economic variables; and, vi) the direct royalties fund for producing regions that represented, from 2015 onwards, 10% of total royalties.

Consequently, 40% of the royalty funds are earmarked for expenditures that cannot be used for post-conflict purposes, and 10% of the funds may be linked to post-conflict effort only if the projects are related to innovation. Thus, strictly speaking, only half of the royalties’ budget may be used directly to finance post-conflict policies.

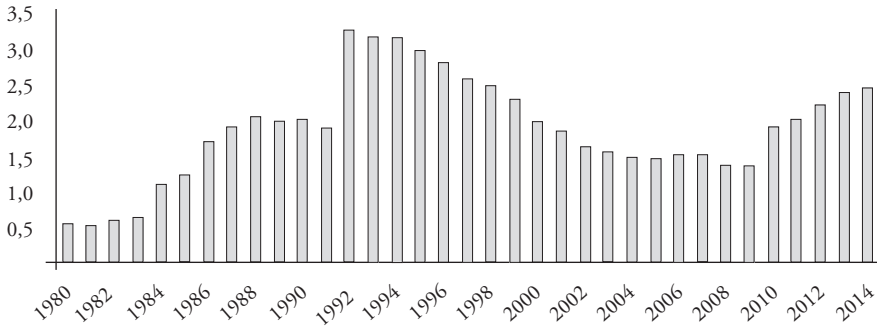
Moreover, the revenues from royalties can only be used for capital expenditures and only exceptionally for current expenditures such as formulating projects or initial operation of the project. Other sources of income are needed to finance the operation costs of schools or hospitals that may be built with royalties or to finance victims’ reparation. As a benchmark, to estimate the ratio between capital and current expenditures in the implementation of post-conflict projects, we can take into account the structure costs of expenditures devoted to Colombian victims in the recent years. On average, between 2012-2015, 39% of the budget destined for victims has been used in investment expenditures, 25% in education and 21% in health, 9% in indemnification and 6% in other current expenditures (MHCP, 2015, p. 90).

However, even if the resource rents were currently sufficient to finance post-conflict policies, it would be very risk to rely on them for the future. There are two main reasons for the latter: volatility of public revenues due to the price cycle of commodities, and the future exhaustion of resources (Gómez-Sabañi and Morán, 2014). Indeed, the prices of commodities, particularly oil, are more volatile than other goods traded in World markets (Sinnott et al., 2010; van der Ploeg, 2011; van der Ploeg and Venables, 2012).⁵³

53 In 2012, “[o]il extraction generated 73% of royalty revenues an coal and gas generated 16% and 6% respectively” (OECD, 2014, p. 95).

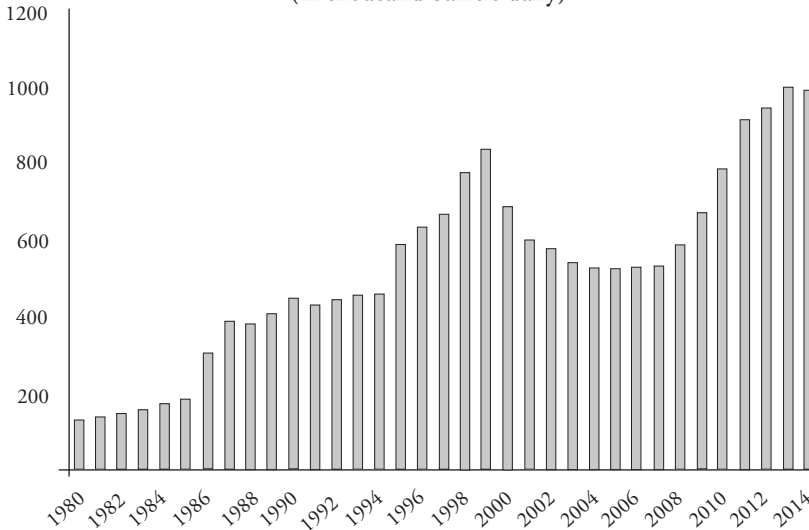
Finally, although Colombia has managed to increase its oil reserves in the last four years, its production has increased at a faster pace. Due the lower pace in the discovery of new oil fields and higher rate of production, the years of reserves fell for the first time in seven years (Ahumada, 2015). The following two graphs show these trends.

Total proved oil in Colombia, 1980-2014
(in thousand barrels barrels)



Source: BP Statistical Review of World Energy, June 2015.

Total oil production in Colombia, 1980-2014
(in thousand barrels daily)



Source: BP Statistical Review of World Energy, June 2015.

In conclusion, resource rents are a significant source of income but also volatile, decreasing and insufficient to finance post-conflict's policies. A more diversified basket of sources of income is required to ensure a steady and sufficient flow of resources for the long-term programmes that post-conflict requires.

4.2 The system for investing royalties allows tailoring region-specific post-conflict programmes, but the low implementation capacity curtails subnational governments' autonomy

In repeated occasions both the national government representatives and Farc negotiators have claimed that the implementation of the peace agreements, and in general the implementation of post-conflict policies, will require a territorial approach. The three Havana agreements constantly appeal to empowering the regions. It is likely that both municipal and department governments will be in charge of managing the bulk of the resources devoted to the post-conflict processes.

Decentralization implies that decisions are taken at local level, closer to the citizens; consequently, in theory, local governments are expected to be more sensitive to preferences of citizens (Zapata, 2010). The work of Faguet (2012), that studied the effects of decentralization in Bolivia, shows that there are empirical grounds for greater responsiveness of subnational governments to local needs.

Hence, the use of local governments' own-income sources, such as royalty revenues, appears to be a good match for the necessity of a territorial implementation of post-conflict. Moreover, Colombian regions are very heterogeneous,⁵⁴ highly unequal⁵⁵ and have been exposed to the armed conflict in different degrees. Thus, the GRS may offer the flexibility on the destination of the resources required to tailor the post-conflict programmes to the specific necessities of each region.

However, the capacity of the Colombian local administrations to invest resource rents, on average, is very low.⁵⁶ According to OECD, "[t]he evidence is that the system to manage royalty payments between 1994 and 2011 was not able to promote inclusive growth in Colombia's resource-rich departments (2014, p. 97)." Indeed, there are at

54 OECD describes Colombia as "a large country, whose topography, climate, regional accessibility, industrial specialisation, the legacy of the armed conflict and illegal activities, and also wide variations in sub-national governments' capacities, have generated a 'mega-diversity' of regional economies" (2014, p. 11).

55 "Regional inequalities are not only 42 times higher than in Australia and more than 5 times higher than in Canada or the United States, but also higher than in most neighbouring Latin American countries" (OECD, 2014, p. 16).

56 According to OECD, "[w]ith some exceptions, many local and departmental governments lack the adequate technical, managerial and even political capacity to lead the [investment] development process. This is one of the main factors suppressing the level of investment implemented in connection with the funds allocated by the new system of royalties, and also the quality of the territorial projects" (2014, p. 115).

least a dozen studies concluding that the hydrocarbon and mineral booms in Colombia have had a sub-optimal effect at a subnational level, in terms of the impact of royalties on economic growth, poverty reduction, efficiency of public spending or provision of public goods (Benavides et al., 2000; Viloria, 2002; Sánchez, Mejía and Herrera, 2005; Candelo et al., 2008; MME, 2011; Armenta et al., 2012; Tamayo, 2012; EU and CNC, 2012; Rojas, 2014; Moyano and Wright, 2015). Moreover, this lack of capacity to invest, particularly in small and remote municipalities, curtails local governments' autonomy that is essential for post-conflict implementation (OECD, 2014).

The poor record on the investment of royalty revenues by municipalities and departments poses a big challenge for the future of local management of post-conflict programmes. Namely, the necessity to improve significantly the technical and political capacity of subnational governments to formulate, implement, monitor and evaluate public investments. In this vein, the National Development Plan for years 2014-2018 explicitly reckons the need of building the capacity of investment in local governments (DNP, 2014b, p. 9). Additionally, it is necessary to increase transparency and accountability of local governments to curtail the high levels of corruption (OECD, 2014).

In conclusion, the system for investing royalties gives space for territorial tailoring of post-conflict programmes, but low implementation capacity at the local level curtails subnational governments' autonomy.

4.3 The transparency of resource rents investment has increased, but the process requires more citizen engagement

The agreements from the Havana peace processes underscore the importance of boosting citizen participation in Colombia to strengthen democracy. Additionally, citizen participation during different stages of public investment processes is key to ensure that governments are responsive to local needs and to prevent corruption and mismanagement of resources. In this vein, the National Development Plan for years 2014-2018 and the three Havana agreements between the national government and the guerrilla, emphasize that post-conflict's programmes require a territorial implementation with close citizen participation.

Are the investment processes of resource revenues in Colombia transparent and open to citizen participation? The availability of information about the processes and the investments certainly has improved in the recent years. Finding and accessing such information before 2010 was a daunting task even for national government officials (Viloria, 2002; Arisi and González, 2014). The information was highly dispersed and its accessibility varied among different subnational governments. This situation changed when the Colombian national government decided to introduce transparency standards in its extractive sector, and prepare to apply for a candidacy to be part of the Extractive Industries

Transparency Initiative (EITI).⁵⁷ EITI is just one of the different initiatives in the global drive towards greater transparency and accountability in the extractive industries (Arisi and González, 2014).

In the last years the quality and quantity of information about the use of resource revenues has increased substantially (Arisi and González, 2014). For example, since 2013 the information about royalty revenues received by each local government, the destination of the funds, the contractor selected to execute the project and the progress of implementation is publicly available through an internet platform managed by the National Planning Unit called *Mapa de Regalías* (Royalties Map).⁵⁸ Colombia was accepted as candidate country for EITI in October 2014 and this commitment obliges the national government to be fully transparent on the revenues from oil, gas and mining activities (EITI, 2014). Moreover, complying the EITI standard also entails that the government must work with the business sector and civil society organisations to ensure an “informed debate” on the use of those resources, and to address other key issues such the environmental impacts of the extractive industries (EITI, 2014).

Moreover, in theory the multi-level bodies that assess and approve the investment projects formulated by local governments were designed as a “triangle of good governance whose purpose is to prevent fraud and improve efficiency and effectiveness in the use of resources” (Arisi and González, 2014, p. 283). The OCAD’s decision-making meetings may include the participation of “committees of consult” that are composed by representatives from civil society groups, business associations, may audit the OCAD’s and ethnic groups, among other stakeholders. Additionally, Arisi and González (2014) report that diverse actors from the civil society have been recently empowered at the local level to oversight the investment processes of resource rents. The mechanisms that empower the citizen participation, such as accountability hearings on the management of resource rents may “open windows of opportunity” for dialogue for greater accountability (Arisi and González, 2014).

Yet, although there are some specific initiatives of civil society groups, extractive sector companies and associations and NGOs to participate closely in the oversight of royalty funds investments at the local level, citizen participation is not a common feature in most of the regions. Due to the centralization legacy and the armed conflict “many peripheral areas do not have the civic associations and groups that would allow civil society to assist in the [projects’] development process” (OECD, 2014, p. 115). Hence, the SGR

57 The EITI define itself as “a global Standard to promote open and accountable management of natural resources. It seeks to strengthen government and company systems, inform public debate, and enhance trust. In each implementing country it is supported by a coalition of governments, companies and civil society working together.” See information on EITI here: <https://eiti.org/eiti>.

58 The Royalties Map can be accessed here: <http://maparegalias.sgr.gov.co>.

processes require to be upgraded with “an extensive consultation process involving sub-national entities, business and citizen organisations” (OECD, 2014, p. 115).

Finally, increasing citizen’s participation to make governments more accountable for their management of public resources requires avoiding the *rentier-state* type of incentives generated by natural resource revenues. This notion, first developed in the early 1970s by scholars that studied oil-rich Middle-East countries, contended: “when governments gain most of their revenues from external sources, such as resource rents or foreign assistance, they are freed from the need to levy domestic taxes and become less accountable to the societies they govern” (Ross, 1999, p. 312). In this vein, Karl (1997, p. 16) argued that fiscal dependence on oil revenues eventually led to a *rentier-state* that is eager to spend without having the capacity to invest, that “encourages the political distribution of rents”, and where “officials become habituated to relying on the progressive substitution of public spending for statecraft, thereby further weakening state capacity.”

How to avoid *rentier-state* incentives? Besides devising mechanisms to make citizen participation more effective in the investment processes of resource rents, the straightforward way is diversifying the sources of public income and strengthening the tax sources over resource rents.

In conclusion, the transparency of resource rents investment has increased, but the management of these resources requires more citizen engagement to make local governments accountable.

4.4 Criminal groups may target point-source revenues, increasing the probability of relapsing in an armed conflict

The Colombian extractive sector has been closely related to the armed conflict. Many of the conflict zones coincide with the presence of non-renewable resources (Massé, 2012). Furthermore, the presence of extractive companies in these regions made them a political and economic target for armed groups. There are multiple cases in which these groups financed by extorting these companies, and there are also allegations of companies voluntarily financing these groups in exchange of “services”, particularly paramilitary groups (Dube and Vargas, 2006, 2013; Massé, 2012, 2013).

Different econometric studies have shown a positive relation between the amount of royalties in municipalities and the incidence of the armed conflict. Sánchez and Palau (2006, p. 29) found evidence according to which “the presence of local resources such as royalties and taxes triggers violence against politicians.” Moreover, Dube and Vargas (2006, 2013) found a direct and significant correlation between oil price (positive) shocks and the number of paramilitary attacks in municipalities (e.g. political kidnappings or massacres) where crude is produced and/or transported.

Moreover, Dube and Vargas interpreted “that a rise in petrol prices motivates armed groups to escalate activity in oil-rich areas, with the aim of extracting these resources” (2013, p. 1406). They argued that increased prices made oil-rich municipalities more attractive for armed groups; this is the particular case of paramilitary groups that “have operated disproportionately in oil areas and used explicit strategies to intervene in elections” (Carreri and Dube, 2014, p. 10). According to Carreri and Dube (2014), armed groups had incentives to intervene in elections in order to install mayors that would give them access to resource revenues, for example through the allocation of public contracts. Finally, Carreri and Dube (2014) argued that their econometric evidence showed how the prices of oil had influenced the electoral outcome in Colombian municipalities. Using data on oil price shocks, Carreri and Dube concluded:

Exploiting oil price shocks, we found that increases in oil value lead to the increased election of legislators affiliated with right-wing pro-paramilitary parties in more oil dependent municipalities. We document that these effects are larger in conflict locations, and correspond to the increased presence of armed groups in oil rich regions. We also found that these price shocks reduce electoral competition, as reflected in fewer candidates running for office and higher vote margins of winners.

Our results suggest that where armed groups predate on natural resources, and are positioned to intervene in elections forcefully, resource rents will undermine institutions as these groups act to constrict political participation. As such, the combined effect of conflict and the presence of natural resources may prove particularly inimical to local democracy. (2014, p. 20).

Both guerrilla and paramilitary groups have found different ways of benefitting from royalty revenues. According to Sánchez and Palau (2006, p. 34) the management of public funds at the local level has been restrained “by pressure of armed groups and ‘armed clientelism’ (using violence to appropriate State resources).” Revenue predation is shaped in different forms but occurred either as a consequence of extortion or through collusion with local politicians (Dube and Vargas, 2006, 2013; Massé, 2012, 2013; Carreri and Dube, 2014).

There were cases where armed groups pressured local governments on how to use royalties and as well as cases of local governments co-opted by armed groups that deviated royalties and other sources of public income to finance armed activities (Viloria, 2002; Dube and Vargas, 2006, 2013; Massé, 2012, 2013; Arisi and González, 2014; Carreri and Dube, 2014). There are reports of such situations in petroleum regions (Dube and Vargas, 2006, 2013; Massé, 2012, 2013), gold mining regions (Massé, 2012; Franco, 2013), nickel mining regions (EU and CNC, 2012), and coal mining regions (Sánchez, Mejía and Herrera, 2005; Gutiérrez and Celis, 2014).

This problem was not merely an issue of criminal enforcement, since the illegal appropriation of resource revenues by armed groups was the result of their political strategy too. As explained by Massé (2013), for example, in crude producing regions paramilitary and neo-paramilitary groups financed politicians' electoral campaigns, and then the elected politicians paid back through the award of contracts financed by royalties.

In conclusion, criminal groups may target point-source revenues, increasing the probability of relapsing in an armed conflict. Consequently, preventing the illegal appropriation of revenues from royalties by criminal organizations in the post-conflict will certainly be a very big challenge for the Colombian State. However, it is worth mentioning that Massé (2013) reported that the new GRS system might have reduced the illegal groups capacity to appropriate the revenues from royalties.

5. Conclusions

This paper aimed to discuss the risks and opportunities of using non-renewable natural resource rents, particularly from royalties, to finance post-conflict policies and programmes. I argued that resource rents may play an important role in financing the post-conflict's expenditures, but that such use has some pitfalls that the national and subnational governments must tackle.

Additionally, in the previous section, I presented four main conclusions about the use of resource rents to finance the policies required in a post-conflict:

1. Resource rents are a significant source of income but also volatile, decreasing and insufficient to finance post-conflict's policies.
2. The system for investing royalties gives a margin for tailoring post-conflict programmes for each region, but low investment capacity of level subnational governments reduces their autonomy to design and implement these programmes.
3. The transparency of resource rents investment has increased, but the process requires more citizen engagement to make local governments accountable.
4. Criminal groups may target point-source revenues, increasing the probability of relapsing in an armed conflict.

Hence, it is necessary to consider a more diversified basket of sources of income to hedge against income volatility and to ensure the continuous flow of resources required for the long-term maintenance of post-conflict programmes.⁵⁹ The question of how to

⁵⁹ The challenge of diversifying is certainly not exclusive of Colombia, but of most of the Latin America's resource rich countries. In this sense, Gómez-Sabañi and Morán (2014, p. 75) suggest that tax reform proposals should aim, among others, to "[r]educer income volatility and dependence on income from natural resource exploitation in countries that

raise resources for post-conflict is not very different from the more general issue of how to mobilize additional resources for the operation and investments of the Colombian State. This broader question goes beyond the scope of this paper.

However, it is worth mentioning that the additional post-conflict sources of income suggested in the past by IMF (Aninat, 2002), such as privatisations and foreign aid, seem to be less feasible now a days.⁶⁰ The investments required for peace building in Colombia will require increasing tax revenues at the domestic level. As claimed recently by Ibáñez (2015), if Colombians want to benefit from peace in the long-term, the payment of additional taxes almost everyone will be unavoidable.

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specialize in these commodities to avoid possible negative effects on the financing of public spending in the face of changes in international market prices.”

60 The attempts of the current government to sell ISAGEN, a state-owned company that generates and commercialises electric energy and natural gas, have been stalled by judicial litigation. Moreover, even if the national government sells ISAGEN, the proceeds would be used for infrastructure projects, not for post-conflict specific programmes (IME, 2015). More recently, the national government increased its efforts to obtain foreign aid. Moreover, the President of the European Council recently announced in mid 2015 the setup of a European Union’s Trust Fund to support post-conflict activities. It is highly probable that the National Government will be able to obtain foreign aid, but being a middle-income country it is not likely that foreign countries will accept carrying the bulk of the responsibility to finance post-conflict.

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