

**PRESENTATION OF COLOMBIA TO THE
INTERNATIONAL COMMUNITY**

**COLOMBIA
AN INTRODUCTION**

September 1993

CHAPTER 1

COLOMBIA: AN INTRODUCTION

1.1 THE COUNTRY AND ITS PEOPLE

1.1.1 Geography

Colombia is located on the north-western corner of South America. It covers a territory of 1.147.748 square kilometers. Its neighboring countries are Panama to the north-west, Venezuela and Brazil to the east, and Perú and Ecuador to the south. It has a 1600 kilometer long coastline on the Caribbean and 1300 kilometers of coast on the Pacific Ocean. Colombia's territorial waters, within the 200 mile limit, cover 933.000 km², with 515.000 km² in the Caribbean and 418.000 km² in the Pacific.

Colombia's territory is composed of a mountainous region in the west, dominated by the Andes mountain range, and vast plains in the east, reaching the Orinoco and Amazon basins. The peaks of the Andes are as high as 5.000 meters above sea-level, with an average of close to 3.000 meters. The variety of altitudes is responsible for a diversity of climates, an important factor in the country's agricultural wealth. All of Colombia's industrial production, coffee cultivation, and a major part of agricultural production, are located in the western region. The location of production centers in the midst of mountainous areas, with considerable transport difficulties, was a major reason for production being oriented towards the domestic market. Hence, the issue of transportation is one of the crucial subjects of the current trade liberalization process.

Colombia has a great abundance of water resources (it is the third richest country in the world in availability of water), with swift-flowing rivers emptying into the Caribbean and the Pacific oceans, as well as into the Orinoco and the Amazon rivers.

The country has 53 million hectares of woodland. Unfortunately, there has been a great deal of deforestation, as much as 600.000 hectares annually. Squatter-type settlements are the principal cause of the problem. A reforestation effort was initiated recently through the "Forestry Action Plan for Colombia", headed by the National Coffee Growers Federation. Among other objectives, it aims to increase forestry participation in the economy, protect the ecosystem and biological variety, and decontaminate the waters.

1.1.1.1 Colombia's Ecological Wealth¹

One of the most important changes to have taken place in the environmental community over the past decade has been the rise of concern over preserving bio-diversity, which is to say the diversity of plant and animal species, to the forefront of conservation goals. In other words, efforts have shifted to the conservation of entire ecosystems instead of just a few well-known system. As a result, Colombia is beginning to come into the spotlight, for it is a true environmental treasure trove for humanity.

Colombia is the second most bio-diverse country in the world after Brazil. It also ranks first in bio-diversity in proportion to surface area. Colombia has more species of birds, orchids and frogs and toads than any other country in the world, including 20% of the known species of frogs and toads in the world, 15 % of the known species of orchids and 10% of the planet's known species of plants and animals.

Most of the country's ecological wealth is centered around its two major rain forests, the Amazon Jungle in the South and the Chocó region in the north-west coast, although there are other rich ecosystems like the tropical cloud forest and the Páramo, the latter of which is unique to Colombia, Venezuela, Ecuador and Costa Rica. The Amazon, which Colombia shares with countries like Brazil, Ecuador and Peru, is the world's largest (2/3 of the world total) and most bio-diverse tropical rain forest, which makes it by far the planet's single most bio-diverse region. The Chocó region, in turn, holds the record for the greatest amount of different plant species ever found within a single hectare of land. In fact, more different plant species can be found in one hectare of the Chocó jungle than in the whole of temperate North America.

As has been the case in almost every other with tropical rain forests, the environment has suffered alot in Colombia in the process of the country's development, including substantial amounts of deforestation. Now, however, things are changing and a new consciousness is on the rise, both in government and among the people, that preserving our environmental resources is one of the

¹ See also: The Colombian Cloud Forest. Cristina Uribe Editores. Banco de Occidente. Bogota, 1992.

"The Other Group of Seven." The Economist. June 4, 1988. London, U.K.

Stevens, William K. "Shamans and Scientists Seek Cures in Plants". The New York Times. Tuesday, January 28, 1992.

most important things we can do in safeguarding the future of our country, and the world. The rain forest's many riches, such as its trove of discovered and undiscovered medicines and other chemicals, are coming into the light, and people are coming to understand that preserving the environment is in fact a much better economic decision than destroying it. As a recent **New York Times** article put it: "The solution is to emphasize the value of the forest as a long-term, sustainable economic resource, and to give local people an economic stake in its preservation."

Some of the Government's conservation efforts will be discussed in Chapter 5, while some investment opportunities in the new area of Eco-Tourism will be dealt with in Chapter 6.

1.1.2 The People

Colombia's 33.4 million people (1992 estimate) come from a wide variety of backgrounds, both ethnically and culturally. The official language, spoken by almost 100% of the population, is Spanish, though English is commonly used in conducting international business. While catholicism is the most popular religion, there is complete freedom of religious belief and practice, as well as complete separation between the church and the state.

The annual demographic growth rate has been approximately 1.7% in recent years. 67.4% of the population live in cities and 32.6% in rural areas. The past decades have been characterized by significant migration to the country's five largest cities: Bogota (5.0 Million), Medellin (1.6 M), Cali (1.6 M), Barranquilla (1.0 M) and Cartagena (0.7 M) (Numbers indicate total population).

1.1.2.1 Education

Colombia has a competitive and educated work force. By constitutional law, primary education is universal and compulsory, and, while the goal of universal coverage has not yet been met, due to both economic and geographic difficulties, recent efforts aimed at increasing access to education have borne fruit. A survey made by Fedesarrollo in 1992 indicated that over 86% of children between the ages of 6 and 12 attend school, and Colombia has achieved a literacy rate of 87%, up from 73% 25 years ago, high within the regional context and, especially, within the group of developing countries as a whole (see below, and Table 1.1).

With regards to country's work force, the government has an apprenticeship service, SENA, which provides technical and capacitation training and is considered the most advanced of its kind in Latin America. It aims to help workers adapt to changing

technologies and market structures, allowing them to adapt their skills to those demanded by the productive sector. Furthermore, its 115 training centers were recently restructured, giving them more autonomy and allowing for the greater participation of the private sector. These changes seek to improve the way in which the service adapts to changing market structures and demanded skills, to the advantage of the workers who receive training and the employers who demand skilled labor.

With regards to higher education, it is of excellent quality, though limited in coverage. In fact, the quality of Colombia's managerial class is high enough that Colombia has "exported" professional talent to other countries in Latin America.

The goals for the coming decades, with regards to education as a whole, are to expand the coverage of both primary and secondary education and to make overall improvements to the educational system.

1.1.3 Political and Social Overview

Politically, Colombia is divided into 32 partially autonomous regional entities, known as departments, each governed by a democratically elected governor and departmental council. The departments are in turn sub-divided into a total of 1,024 municipal districts, each governed by a democratically elected mayor and city council. Bogota is the capital, the seat of the government, and the principal center of industry, trade and culture. Next in importance both in terms of industry and of population are Medellin, in the north, and Cali, in the west, followed by Barranquilla and Cartagena in the Atlantic coast.

1.1.3.1 The Government: Democratic Tradition and Political Parties

Colombia's political system does not fit into the conventional stereotype for Latin America, which is known for its long history of dictatorships and authoritarian regimes maintained almost constantly since the 19th century and which experienced a transition into democracy only in the past decade. This description may be valid in many cases but not in that of Colombia.

Colombia has maintained a presidential regime with free elections since 1821. There have been only a few brief military dictatorships. The last of these occurred between 1953 and 1957, and one of its main consequences was to persuade the armed forces that governing the country's destiny was not their vocation.

The President of the Republic is the Commander-in-Chief of the Military Forces and it is usually he who decides any changes in the

command of the forces. There have been no authoritarian States nor autonomous bureaucracies in Colombia comparable to those which have existed in other Latin American countries that have maintained non-democratic governments. Congress operates in accordance with the Constitution and maintains a strong power of veto over the President's actions. There is a free press which habitually expresses open criticisms of government officials at every level, including the President, regardless the party they may belong to.

Two traditional political parties, the Liberal and the Conservative, have fought for power since the beginning of the Republic. Although other parties have emerged periodically in the past decades, none have ever succeeded in establishing a permanent place for themselves in the country's political scene. Even though some have achieved considerable popularity at a given time, none has ever won the presidency and with time they disappeared altogether or joined the traditional parties.

At present, however, the two-party system is opening up to a larger number of political parties. The new Constitution issued last July changed the political "rules of the game", favoring the emergence of independent movements. It is foreseeable that in the 1994 elections candidates of several of these new movements will be serious contenders for the presidency.

While one cannot claim that Colombia is free of problems, its open political system must be stressed. The latter's strength is evidenced by the strong institutional transformation now taking place, which has included the drafting of a new Political Constitution with the participation of all political forces that wished to be heard, including representatives of former guerrilla groups, that had returned to civilian life only a few months before and now have a major political following.

The new Constitution paved the way for citizens' greater participation in the country's political life. As in more advanced democracies, the new Constitution provides a comprehensive bill of rights, broader in scope than those considered by any previous charter. The recent process also introduced the possibility that the initiative to reform the constitution come from the people, rather than just from congress, and new mechanisms were established for citizen participation, such as the plebiscite and the referendum, among other fundamental changes.

1.1.3.2 Causes of Violence

The principal problems in Colombia's social and political environment over the course of the last decade were the recrudescence of guerrilla actions and a sharp escalation in drug

trafficking and traffic-related crimes. These two factors were responsible for the tremendous rise in national violence and for the unfavorable international image Colombia has accrued with respect to its institutional stability.

The increased violence in Colombia is not due to any of the simplistic explanations which have been put forward by the international media. Present violence in this country cannot be explained as a response to a repressive political regime since, as mentioned above, democracy does work in this country, and there is complete freedom of expression and of movement. Nor is the increased violence due to any deterioration in the population's quality of life since, as we will see below, Colombia has shown positive, acceptable rates of growth in per capita income and in the principal social indicators during the last decades. Moreover, recent studies indicate that the inequalities of income distribution have been decreasing at a particularly rapid rate compared to other countries in a similar state of development.

The escalation of violence in Colombia during the 80's was caused by other factors. In the case of guerrilla groups, the rise in their violent actions was due to their goal of extending their areas of influence in the countryside and their desire to mobilize the low-income population with an aim at seizing power. Popular response, however, has been negative. In recent years, those guerrilla groups that returned to civilian life were rewarded with electoral support greater than any ever received by the traditional left throughout its history. The groups still active in guerrilla warfare, on the other hand, are being openly rejected. In a number of Colombian towns located in areas of guerrilla activity, there have been massive popular demonstrations against guerrilla violence throughout 1991 and 1992.

If guerrilla organizations were successful in recruiting young people, this was not the result of a worsening in their living conditions or closing of opportunities, but to the speed of social transformations in Colombia. Forty years ago, Colombia was a rural country, but it has rapidly become fundamentally urban. The children of the small farmers or "campesinos" who migrated into the cities during the 50's, have become the high school and university students of the 70's and 80's. Their higher level of education greatly increased not only their horizons but also their ambitions, which Colombia could not satisfy in the short term. Although their financial and social status was clearly better than that of their parents, in comparing themselves with the upper strata of the population and with the international, industrialized world standards revealed by the media, they felt a deterioration in their relative standard of living. Hence, guerrilla group's recruiting capacity focused on the young "campesinos" who wished to leave

home, and on middle and lower-class students in their first years of college.

Parallely, the escalated violence linked with the drug traffic was a result of drug traffickers avowed purpose of intimidating the civilian population for the specific purpose of consolidating their economic power and creating their own political space. Drug traffic organizations, or cartels, declared war on the State, persuaded that they could force the authorities into submission by assassinating their leaders and threatening those responsible for administering justice.

Finally, there has also been a major increase in general delinquency over the past decade, which has placed Colombia among the countries with the highest rate of violent deaths relative to population. The increase in this type of violence was favored by the general climate of hostility which dominated the period, in addition to a rise in illegal gun running, all during a time when the authorities had to devote all their efforts to fighting the guerrilla and drug traffic problems. This development is concentrated in specific areas of the country, particularly in Medellín, which shows high rates of juvenile unemployment and has been the city most affected by the drug traffic and drug terrorism.

1.1.3.3 Solutions to the Violence

At this stage, Colombia's prospects in combatting these types of violence may be viewed with optimism. The political system has shown an extraordinary capacity to deal with diverse circumstances and to test strategies by submitting them to a trial and error process until the right solutions are found.

Starting in the early 80's, various peace initiatives and negotiations were attempted between the Government and guerrilla organizations. This process, full of ups-and-downs and broken truce agreements, culminated with the return, in 1990 and 1991, of several guerrilla groups to civilian life. Close to 800 members of the M-19 movement laid down their weapons in March of 1990, followed by 2,400 members of the People's Liberation Army (EPL), the native-Indian "Quintín Lame" movement, and the Revolutionary Workers' Party (PRT). This process, however, has not come to an end yet, since the two oldest and most important guerrilla organizations in this country, the National Liberation Army (ELN) and the Revolutionary Armed Forces of Colombia (FARC), have yet to return to civilian life.

One factor that has served to stimulate the demobilization of guerrilla groups is the electoral success of the M-19 Movement, the first group to lay down arms and become a legal political movement.

The M-19 discovered in time that there is an important space for a moderate center-left party on the Colombian political scene . Their platforms have left behind the watchwords and slogans of the old leftist parties, which in Colombia never won any significant amount of votes, to dwell on subjects such as socially responsible capitalism, equal opportunity, public sector efficiency, and social justice. In any case, their platform is not very different from that presented by the candidates of the other parties, including the traditional ones.

Negotiations with the FARC and ELN, principal members of the "Coordinadora Guerrillera" (Guerrilla Coordinator), have not gone as desired, however. While the government held negotiations with these two groups for over two years, and even entered into formal talks wit delegates from the "Coordinadora Guerrillera" in Caracas, Venezuela and Tlaxcala, Mexico, the authorities were forced to suspend these towards the end of 1992, because of the violent and terrorist actions which the guerrilla groups engaged in even in the midst of negotiations. The FARC and ELN, which are currently more a multi-million dollar business of extortions, kidnapping and drug trafficking (the news-weekly SEMANA calculates their joint revenues at over US\$ 200 million), continue to perpetrate acts of terrorism against Colombia's resources, in desperate attempts to tire and frustrate their hunters.

Still, the eventual disappearance of the guerrilla movement remains an unquestionable fact; the only unknown is when this will occur. In fact, even these groups' decision to remain in arms had been anticipated by the Government, which complimented its negotiation policy with a strengthening of the armed forces and a change in their strategy in order to effectively deal with the changing situation. For on thing, there has been a change in the criteria on which resources to and within the armed forces. Instead of concentrating on preparing themselves for the possibility of an external conflict, their priority will now be the handling of internal problems. Moreover, for the first time in several decades Colombia, as of 1991, has a civilian Defense Minister. This is conducive to better collaboration between civilians and the military in adapting the armed forces' activities to the priorities determined by the Government. In accordance with this new orientation, the armed forces are being provided with greater support in such areas as intelligence, communications, and equipment.

Perhaps even more importantly, active guerrilla organizations have lost the people's support. As people became aware of the criminal business side of the guerrilla movement, and of their reiterated refusal to embrace peace and negotiation, these groups have vertiginously lost any popular acceptance or understanding

they may have had in the past. In general, the nation has demonstrated and increasing rejection for armed struggles.

The battle against drug traffic, in turn, entered a new phase in mid-1991 when the policy of submission was established. Applicable to the heads of the drug organizations, this policy gives traffickers certain guarantees in exchange for their surrender and abandoning of the illicit drug business. While this process of the drug traffickers' surrender has been criticized both in and outside Colombia, particularly because of the Government's decision not to extradite offenders to the United States and the escape of Pablo Escobar, head of the self-denominated "Medellín Cartel", the fact is that this policy has brought about the surrender of the principal drug barons, and, except for Escobar's activities, the cessation of the narco-terrorist actions. The traffickers' idea of increasing their power through intimidation came up against the Government's firm resolve, forcing them to choose between an indefinite war and a life on the run, and surrendering to Colombian justice.

The new policy does not change the government's resolve to fight any future drug-linked activities. The escape of Pablo Escobar, despite all the criticism it has drawn, does not change the essence or the purpose of this policy. His is just the individual case of a trafficker who, through continued terrorist actions, has all but eliminated any benefits he might have received by surrendering himself to Colombian authorities. Escobar is in fact currently the subject of one of the greatest law-enforcement hunts in history, and organizations from all around the world have offered rewards for his capture totalling over US\$ 14 million.

While Escobar increased his terrorist activities dramatically in the months following his escape, even "founding" a pseudo-guerrilla movement, "Free Antioquia", in an effort to garner popular support and different treatment under the law, his organization has been weakened tremendously in the last several months. Over forty of his most trusted henchmen are either dead or have turned themselves in and become witnesses against him. As a result, his once nearly omni-present organization has been atomized and the kingpin now finds himself more alone than ever. Surrounded on one side by his enemies in the criminal world, many of them his former allies, and on the other by the implacable forces of the government, Escobar's fall is now only a matter of time.

With regards to common delinquency, the Government is taking action in such diverse areas as: restricting the possession of arms, by improving control mechanisms and increasing the fines to those who violate them; strengthening the system of justice to make it more effective and reduce impunity; seeking greater cooperation

between the state and communities, through special programs designed to strengthen family unity and youth recreation and involvement, particularly in those cities which are most affected; and providing members of the police forces with better training and equipment to combat the different types of crime.

In synthesis, after an escalation of violence during the late 80's, Colombia has found ways to move forward on the road towards peace and stability. Threats from drug traffickers and guerrilla groups continue to be a source of uncertainty, but they are being strongly counteracted. A profound political reform has taken place, one that included the enactment in 1991 of a new Constitution that opens the doors to all ideologies and political groups. Furthermore, since mid-1992, President Gaviria has advanced the second phase of his national restructuring policy, designed to complement the political reforms currently in process and counteract the disturbing effects of trade liberalization, an aptly named by him "the social shake-up". The tension prevailing a few years ago has given way to a climate of tolerance, and the center of attention is now the construction of the future Colombia.

1.2 SOCIO-ECONOMIC STRUCTURE AND PERFORMANCE

In the field of economics, the stability and continuity of Colombia's economic performance are noteworthy. It is one of the medium sized economies in Latin America, with a Gross Domestic Product of 47.6 billion dollars in 1991 (at 1980 prices). The economy is smaller than that of Mexico (US\$ 214 billion in the same year), Brazil (US\$ 286 billion), and Venezuela (US\$ 70.7 billion), but larger than Chile's (US\$ 36 billion). Not only did Colombia maintain itself free of the rigors of the foreign debt crisis which affected the economies of other Latin American countries during the 80's, but, according to the Economic Commission for Latin America (ECLA), a body of the United Nations, the Colombian economy showed the region's highest percentual growth in its Gross Domestic Product during the decade of the 1980's.

1.2.1 Main Social Indicators

Regarding social development indicators, Colombia is close to the average for Latin America (Table 1.1). The indicators the countries in this region have achieved notable progress over the past decades. According to World Bank data, life expectancy in Colombia increased from 56.6 to 69 years between 1960 and 1991. Infant mortality dropped from 157 per thousand births to 23. The rate of adult literacy rose from 78% to 87%. The average annual demographic growth rate was 2.5% in the period 1960-1990, and it is estimated that it will drop to 1.7% during 1990-2000. These figures are similar to those covering Latin American countries as a group,

Table 1.1
SOCIAL INDICATORS

	Colombia	Latin America & Caribbean	Developing Countries	Industrialized Countries
Per capita GNP (1991)	1260	1830	1010	21050
% Change Per capita GDP 1980-91 (Ave.)	1.2	-0.3	1	2.3
1992	1.4	0.5		
Population (millions) 1991	32.8			
Demographic Growth Rate				
1960-1990	2.5	2.4	2.3	0.8
1990-2000	1.7	1.7	2	0.5
Life Expectancy at Birth (years)				
1960	56.6	56	46.2	69
1991	69	68	64	77
Infant Mortality Rate (under age 5, per 1,000 births)				
1970	77	82	102	20
1991	23	44	61	8
Adult Literacy Rate				
1970	78	73		
1990	87	84	65	96

Source: World Bank

and are higher than those of developing countries as a group. However, the distance separating Latin America from the industrialized countries is still great. In the latter, life expectancy is 77 years, infant mortality is 15 per thousand births, and adult literacy is 100%.

Apart from maintaining relatively high growth rates within its regional group, Colombia's economy is undergoing, since the middle 80's, a period of structural transformation with profound implications. This change is revealed principally in the modernization of the public sector's accounts, the handling of foreign exchange rates, the relative drop in coffee exports with regards to total exports, and the increase of mining and non-traditional exports.

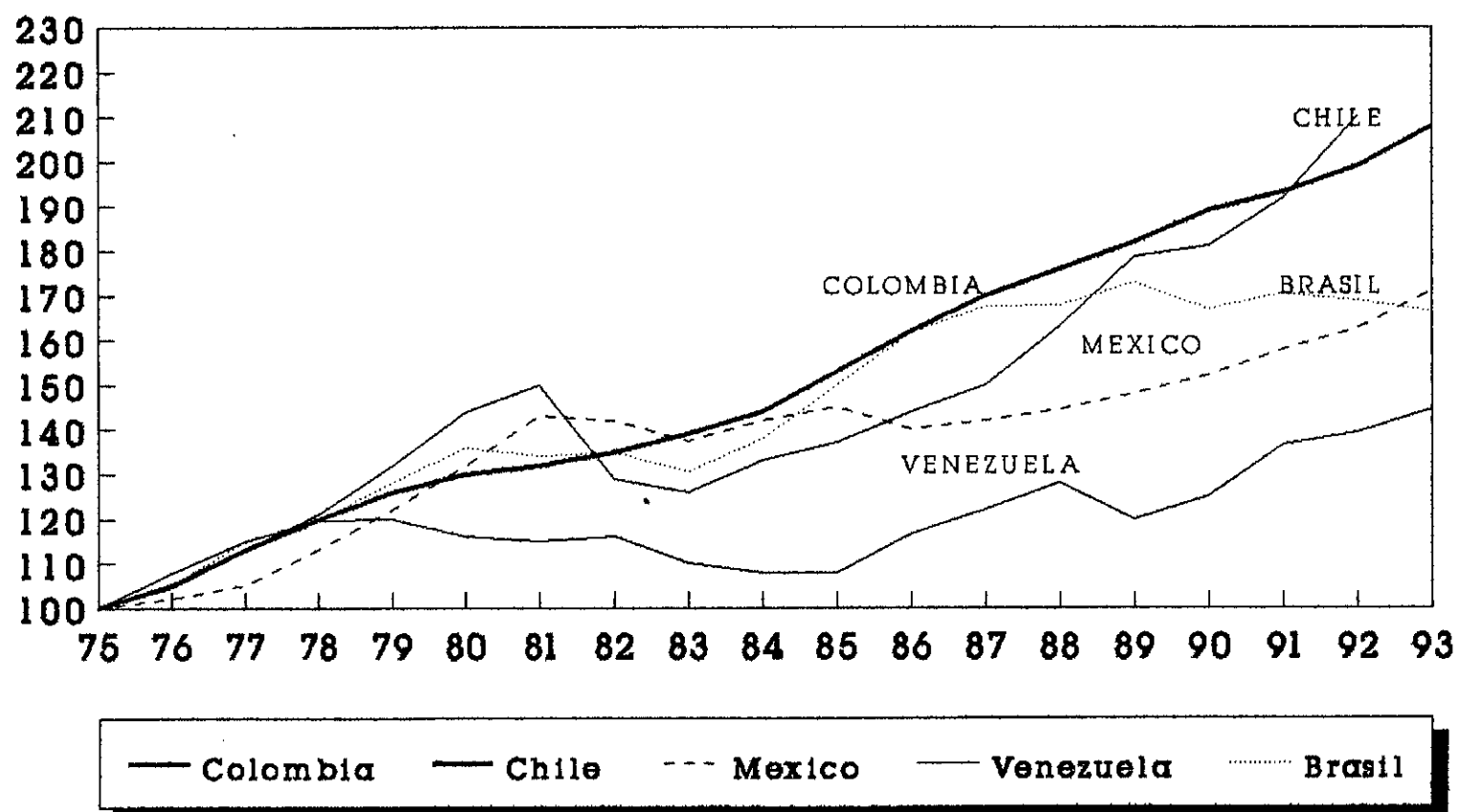
1.2.2 Economic Growth

The behavior of the Colombian economy is really outstanding in the regional context. Colombia has traditionally kept itself on the margin of the great booms and slumps experienced by other neighboring countries. Although its average annual growth rates are relatively modest, it achieved the highest percentage growth in Latin America during the 16-year period between 1975 and 1991. Graph 1.1 shows that Colombia's 1991 GDP is equivalent to 191% GDP in 1975. The growth rates of its neighbors were more rapid during certain periods but later, as a general rule, these fell quite drastically. Colombia does not show, in any of the years under review, an absolute drop in the size of its GDP, as did occur in the others' cases.

The per capita GDP indicator shows the effect of the foreign debt crisis on this group even more clearly. Of the countries included in Graph 1.2, between 1981 and 1992, per capita GDP showed an absolute drop in Brazil, Mexico and Venezuela, and rose only in Chile and in Colombia (25.4% and 19.9%, respectively). Here, again, Colombia's growth was stable, free of any major fluctuations.

The stability in the rates of growth was achieved simultaneously with substantial changes in the economic structure and dynamics of the different sectors (Table 1.2). Between 1975 and 1980, the most dynamic sector of the economy was the area of construction, but throughout the 80's, the growth of mining, specifically in the areas of coal and petroleum, accelerated dramatically. Additionally, agriculture and manufacturing both outpaced construction in the latter half of the eighties, recovering their rate of participation. Thus, there has been a switch in the leading growth rates, from non-tradeable goods to tradeable goods. Agriculture and industry drop behind slightly,

Graph 1.1
GDP GROWTH
Index 1975=100



Source: CEPAL, CEDEAL and ONU/DESD

Table 1.2
COLOMBIA: GDP BY ECONOMIC ACTIVITIES

	Average Annual Growth (%)				
	1975-1980	1980-1985	1985-1992	1975-1992	1980-1992
Agriculture	4.3	1.5	4.0	3.4	3.0
Mining	-0.8	15.6	15.5	10.3	15.5
Manufacturing Industry	4.6	1.2	4.0	3.4	2.8
Construction	5.4	7.8	2.0	4.6	4.3
Retail	4.4	1.3	3.0	2.9	2.3
Total	5.4	2.2	4.0	3.9	3.3

	Participation %			
	1975	1980	1985	1992
Agriculture	23.9	22.7	21.9	15.7
Mining	1.7	1.3	2.3	7.6
Manufacturing Industry	23.2	22.4	21.2	19.8
Construction	3.3	3.3	4.4	5.0
Retail, Restaurants and Hotels	13.3	12.7	12.1	15.4
Total	100.0	100.0	100.0	100.0

Source: DANE (National Statistics Administrative Department)

with their participation in total production dropping during this period.

Table 1.3 shows the annual rates of growth of GDP, by sectors, over the past three years, as well as projections for 1993. Due to adjustment policies designed to combat inflation, and to the acceleration of the trade liberalization process, the years 1991 and 1992 present a lower rate of economic growth. However, it is expected that in the medium term the indicators will regain their dynamism, as the control over the inflation rate is consolidated and the Colombian economy increases its degree of integration to international trade and capital flow.

1.2.3 Inflation

Inflation figures in Colombia also stand out in comparison with most Latin American countries, even though inflation levels are none the less higher than those prevailing in the developed world and in Asia's rapidly industrializing countries.

Between 1970 and 1992, average inflation in Colombia was 22.7%. During this time, in Chile it was 87.7%, in Mexico 39.5%, in Brazil 365.7%, and in Venezuela 18.0%. For most of these countries, the second half of the 80's was a period of rapid acceleration in inflation rates, where three-digit rates became nothing unusual.

In Colombia it has been possible to maintain the annual inflation rate around 25%. The highest rate of inflation throughout the period under review occurred in 1990 (32.4%), and led the economic authorities to make the fight against inflation the central focus of economic policy, giving priority to monetary contraction. This became particularly complicated during 1991 and 1992 with the management of the exchange rate, which involved an unprecedented accumulation of international reserves. While, the government was harshly criticized for a while for failing to achieve the desired reduction in inflation, the counter-inflationary effort is accepted by most people as necessary. During 1991 inflation was 26.8%, while in 1992 the rate was 25.7%. By August, 1993, the monetary authorities had achieved their stated goal by reducing inflation to 20.4%, well under the 22% mark. It should be pointed out that, in Colombia, an inflation of over 30% is considered intolerable and, in consequence, any sacrifice is justified to control it. The same thing did not happen with other countries in the region, as may be appreciated in Graphs 1.3a and 1.3b, which show that inflation rates of well over 70% have been common in the region over last 20 years.

1.2.4 Fiscal Situation and External Debt

Table 1.3
COLOMBIA: ANNUAL GROWTH OF GDP BY ECONOMIC ACTIVITY

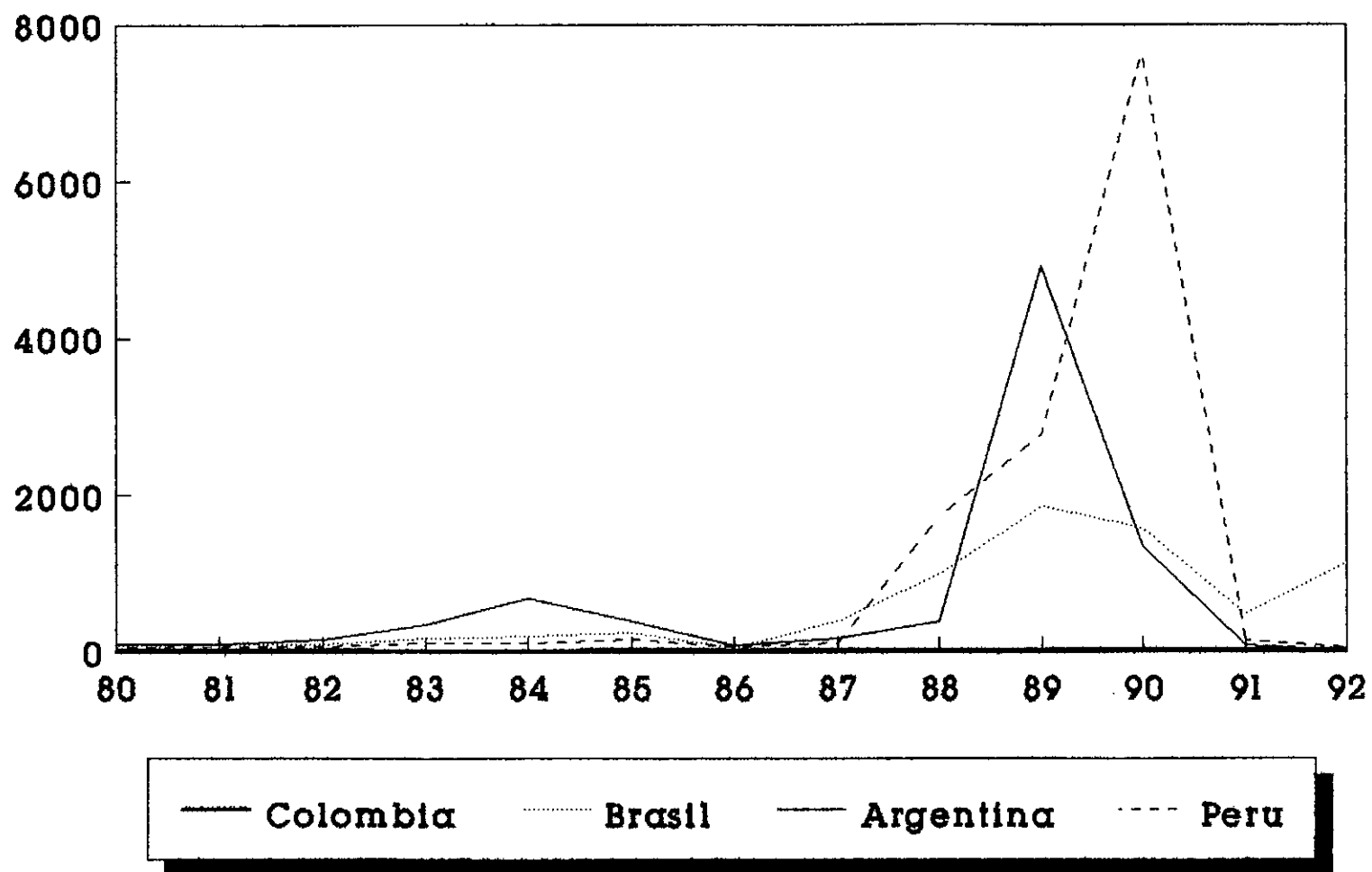
	1990	1991	1992p	1993e Fedesarrollo
Total Agricultural	6.6	4.9	-0.1	2.2
Mining	3.0	0.8	3.9	12.0
Manufacturing	4.3	-0.5	5.1	3.4
Coffee Harrow	20.3	-9.5	24.0	-5.6
Other	2.2	0.8	2.5	5.0
Electricity, Gas and Water	5.2	3.7	-5.0	7.0
Construction	-15.1	4.2	9.8	7.0
Retail	2.8	1.3	3.8	4.0
Transportation	4.3	3.6	2.9	4.3
Financial	2.6	4.5	5.0	6.0
Communal Services	5.5	3.6	5.0	6.0
 Total	 4.1	 2.3	 3.3	 4.4

p = preliminary

e = estimate

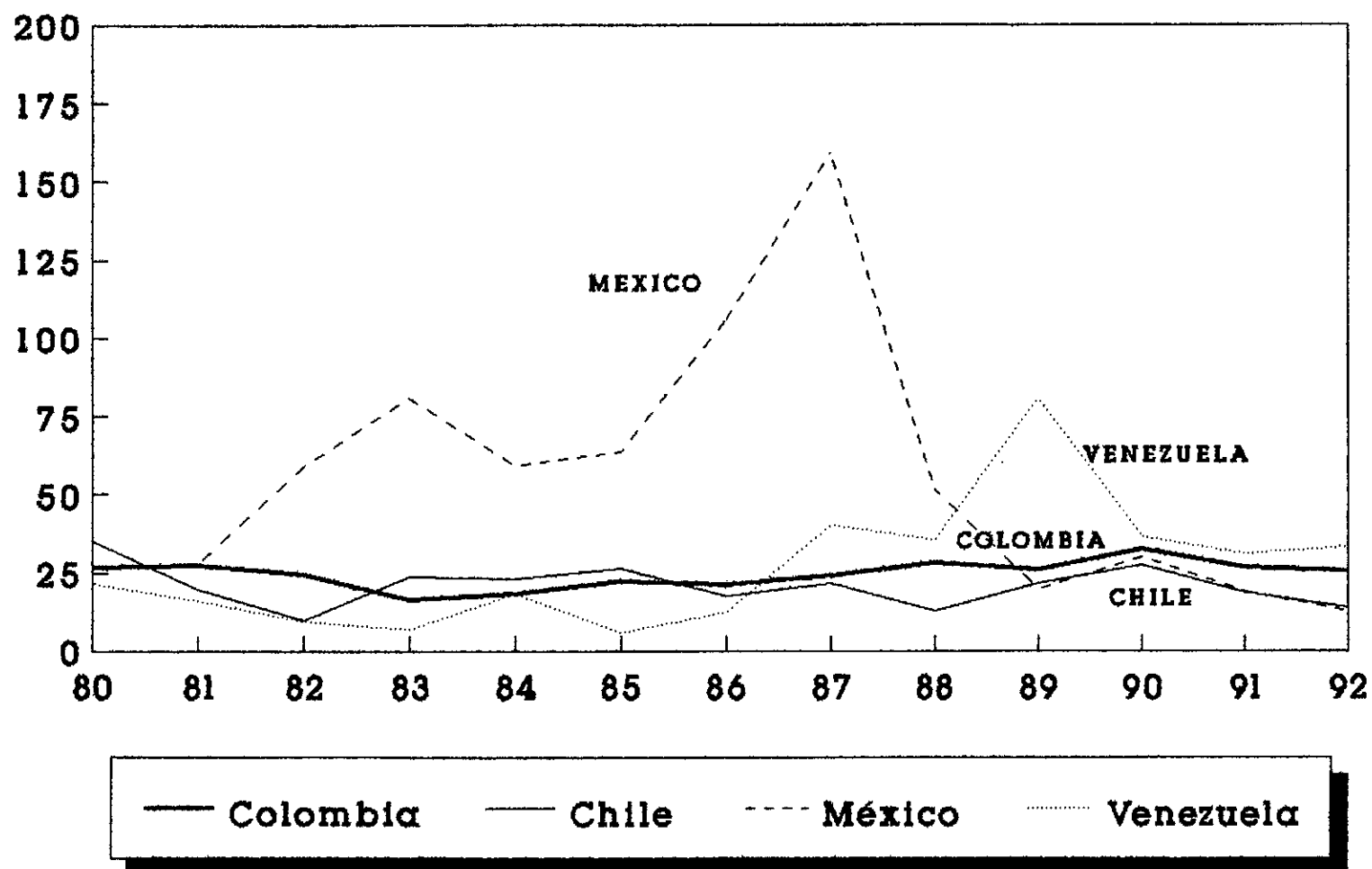
Source: DANE and FEDESARROLLO

Graph 1.3a
Annual Inflation



Source: CEPAL, World Bank

Graph 1.3b
Annual Inflation

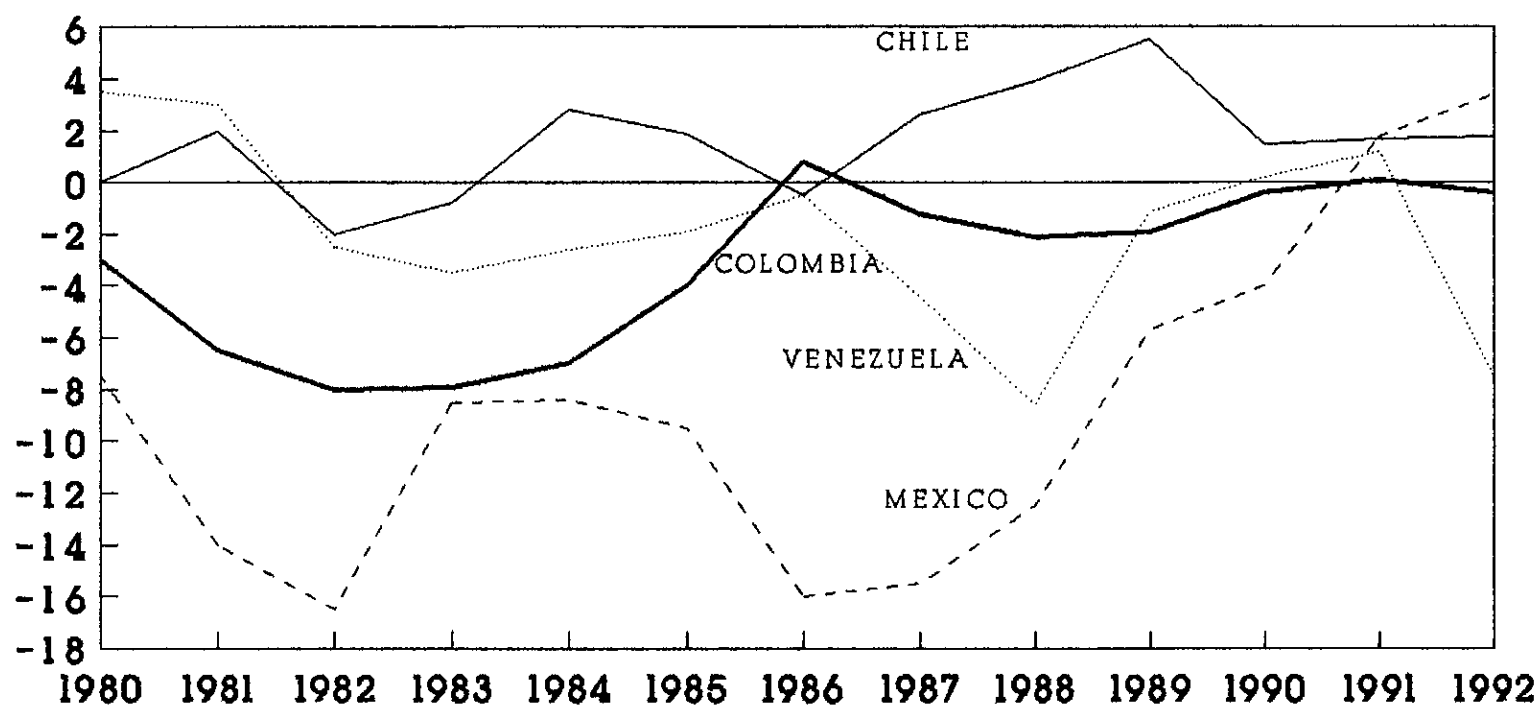


Source: CEPAL, World Bank

As part of the general policy directed at maintaining macro-economic equilibrium, successive Colombian governments have kept a fiscal discipline which also stands out within the Latin American context. In the first half of the 80's, Colombia's fiscal deficit came to represent close to 6% of GDP. As of 1985, the fiscal deficit was rapidly corrected, in 1990 it was equivalent to 0.33% of GDP and in 1991 a surplus of 0.08% was even achieved. These proportions are small in international terms and, in particular, in a Latin American context (Graph 1.4).

Another area in which Colombia stands out in the regional context is that of foreign debt. Thanks in part to the growing strength of the foreign sector, Colombia displays a constant improvement in foreign debt indicators over the past years (table 1.4). The total of Colombia's foreign debt in 1985 was equivalent to 40.8% of GDP, but this percentage has been decreasing steadily in past years, to reach 33.5% in 1992. The total servicing of the debt has increased as a proportion of GDP, but this is due to the fact that the country is making a great effort to amortize previous debt. The rate of new debt accumulation has decreased thanks to the availability of foreign resources, as is reflected in the reduction of payments of interest as a proportion of GDP, which were equivalent to 19.1% of the revenue in the current account in 1985, but dropped to 16.0% in 1992. It should also be mentioned that Colombia was the only Latin American country which did not default on its payments or apply to renegotiate its foreign debt during the 80's. For a more complete treatment of Colombia and foreign debt see Chapter 4, below.

Graph 1.4
Fiscal Deficit
(Percent of GDP)



Source: CEPAL

Table 1.4
COLOMBIA: FOREIGN DEBT INDICATORS

	1985	1987	1989	1990	1991	1992
Foreign Debt (% of GDP)	40.8	46.8	42.7	42.8	40.6	33.5
Debt Servicing/ Exports	6.0	9.5	11.0	9.3	10.5	15.6
Interest on Debt/ Exports	19.1	18.6	17.0	15.4	14.8	16.0

Source: Banco de la Republica, DANE, Contraloria General de la Nacion

PRESENTATION OF COLOMBIA TO THE INTERNATIONAL COMMUNITY

INTERNATIONAL COMMERCE AND TRADE LIBERALIZATION

September 1993

CHAPTER 2

INTERNATIONAL COMMERCE AND TRADE LIBERALIZATION

2.1 THE FOREIGN SECTOR

No area in the Colombian economy has shown as much dynamism and progress in recent years as has the foreign sector. Its transformation during the 80's is noteworthy, particularly in the second half of the decade.

2.1.1 The Balance of Payments

The last line on table 2.1 shows the balance of the country's foreign reserves for certain years. In 1980, Colombia had close to US\$5.4 billion in international reserves, by 1984 this amount dropped to US\$1.8 billion but since then it has risen steadily, to over US\$7.9 billion in 1992, with US\$8.7 billion estimated for 1993.

The manner in which Colombia accumulates international reserves has been the object of great transformations. In 1980, the country's total imports of goods exceeded exports, with the consequent commercial deficit. The balance of services counteracted this situation only in part, so that the balance of payments was negative. It was only the entry of long-term capital, principally through the contracting of debt, that allowed the balance of reserves to be positive.

In past years, the situation has changed drastically. Since the mid-80's, the country has been showing a commercial surplus, with exports growing faster than imports. In 1991, the commercial surplus reached US\$3 billion, close to 6% of GDP. In the meantime, the balance of services remained more or less stable, so that the current account behaved increasingly well. These highly positive results in the external trade area have kept up during 1992 and one can expect them to continue so in 1993. An increase in imports because of the fall in tariffs (described below), however, points to a lower commercial surplus in the short term. This will be offset, however, by a solid capital account due to the massive entry of private capital, chief among which is the flow of foreign investment, estimated at US\$ 800 million for 1993

Table 2.1
COLOMBIA: BALANCE OF PAYMENTS (MILLIONS OF US\$)

	1980	1985	1988	1990	1991	1992	1993
Exports of goods	3724	3782	5343	7064	7507	7203	7462 - 7814
Imports of goods	4148	3673	4515	5108	4548	5749	6759 - 7180
Balance of trade	-424	109	281	1957	2959	1454	634 - 703
Current Account	-174	-1586	-215	532	2347	990	-359 - -452
Capital account	818	2220	938	-93	-782	536	1142 - 1197
Balance of reserves	5416	3194	3809	4598	6573	7920	8610 - 8757

Source: National Planning Department and FEDESARROLLO

2.1.2 Exports

It is worth highlighting the behavior of Colombia's balance of trade. Table 2.2 shows that as recently as 1985, coffee sales accounted for 45% of total goods exported. The remainder was distributed among non-traditional exports (30%), petroleum and its derivatives (11%), coal (3%), ferronickel (2%), and gold (10%). This distribution of the proceeds from exports had prevailed for several decades, with only minor fluctuations, and it meant that the behavior of the entire economy was highly dependent on the fluctuations of international coffee prices. In effect, the cycle of coffee prices had determined the country's fortunes in the economic field up to that time.

In the second half of the 80's, however, some very significant changes suddenly took place in the exports scene. Oil discoveries transformed Colombia, for the first time in many years, into a net exporter of hydrocarbons; exports of coal increased, and a boom in the non-traditional exports (agricultural and industrial) began.

According to 1992 statistics, coffee in that year represented merely 17.1% of total goods exported, while the share of petroleum and its derivatives rose to 18.8%, that of coal to 7.5%, and that of non-traditional exports to 49.9%. The average annual growth in the exports of petroleum and its derivatives was 18.4% from 1985 to 1992, while non-traditional exports showed an average rate of growth of 19.1%.

The growth in the exports of hydrocarbons originated in certain substantial discoveries of crude, which in turn were a direct consequence of the petroleum policy adopted by Colombia since the first half of the 1970's. This growth will probably accelerate in the coming years, as a result of the discovery of Cusiana/Cupiagua (see chapter 6) and other large new fields.

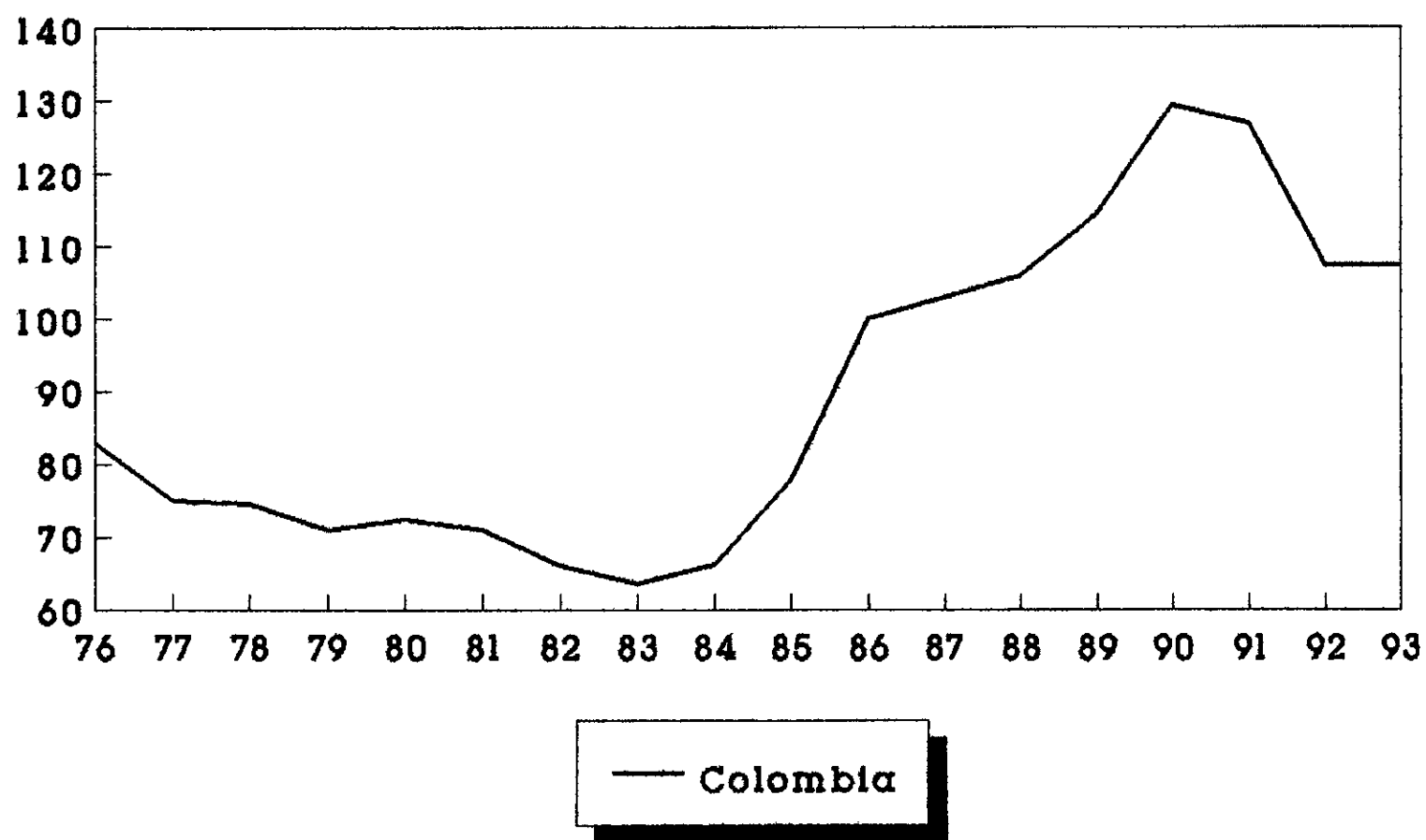
The expansion of the non-traditional exports, on the other hand, had its roots in the stability of economic policies and, in particular, in a sustained favorable real rate of exchange (Graph 2.1). Colombia undertook a drastic adjustment of the rate of exchange in the mid-80's, in order to correct an artificial overvaluation accumulated since the late 70's. Between the end of 1983 and 1986, the real rate of exchange was devalued 65%. Since then, the rate of exchange remained more or less stable, with a real devaluation of 4.5% per annum between 1986 and 1989. Subsequently, between 1989 and 1990, the real rate was again devalued 13.5%. During 1991 and 1992, the stability of the exchange rate has been the subject of considerable economic discussion, due to the Colombian economy's buoyant external trade position. In light of

Table 2.2
COLOMBIA: COMPOSITION OF EXPORTS

	Millions of US\$ - FOB		Share (%)		Annual Average Growth (%)
	1985	1992	1985	1992	1985-1992
Coffee	1702.0	1259	45.0	17.1	-4.2
Petroleum & Derivatives	409.0	1387	10.8	18.8	19.1
Coal	126.0	554	3.3	7.5	23.6
Ferronickel	55.0	125	1.5	1.7	12.4
Gold	365.0	363	9.7	4.9	-0.1
Non-traditional	1125.0	3674	29.7	49.9	18.4
Total	3782.0	7362	100.0	100.0	10.0

Source: General Customs Administration and FEDESARROLLO

Graph 2.1
Real Exchange Rate Index
(1986=100)



Source: Coyuntura Economica

an unprecedented level of international reserves, the real rate of exchange has been revalued 17% since the last months of 1990. Nevertheless, the exchange rate still remains at higher levels than those which prevailed in 1986.

Non-traditional exports have taken advantage of this situation. Although the revaluation of the exchange rate affected their impetus during 1992, they have continued to expand, with the total value of non-traditional exports made between January and May of 1993 having grown 12.5% over that of the corresponding 1992 period. As mentioned above, the average annual growth of these exports has been 18.4% since 1985. As shown in Table 2.3, these exports are quite diversified, with agricultural exports generating only 24.6% of non-traditional exports. The principal non-traditional exports goods are clothing, bananas, flowers, food products, and chemicals.

With regards to foreign markets for Colombian goods (Table 2.4), the United States currently holds first place, purchasing close to 36% of total exports. It is followed by the European Economic Community, with 25.8%, and Latin America, with 20.7%. The distribution of imports by country of origin presents a similar order, although the amounts are slightly different. United States has a 37.2% share of total Colombian imports, the EEC 18.9% and Latin America 17.8%. Japan receives 2.7% of exports and provides 8.3% of imports. In fact, of the five groups, USA, EEC, the Andean Pact, the rest of Latin America and Japan, Japan remains the only one with which Colombia has a trade deficit.

2.1.3 Imports

The composition of imports has also shown relevant changes (Table 2.5). The imports showing the fastest rate of growth are consumer goods and capital goods, especially those directed towards the agriculture and manufacturing industries. The growth of total imports which had been relatively low up until 1991, 3.2% as an annual average between 1985 and 1991, has accelerated rapidly in the past two years, as a result of the trade liberalization policies the Government is committed to, and of the recent real revaluation the peso has undergone in the fight against inflation. Imports grew over 33% between 1991 and 1992, and are expected to grow over 40% in 1993, spurred by imports in the areas of durable consumption goods, capital goods and transportation equipment.

Thus, the external sector changes have had a profound macroeconomic impact on the country. There is much less dependence on coffee, so that the fluctuations in coffee prices no longer have an

Table 2.3

COLOMBIA: NON-TRADITIONAL

AGRICULTURAL AND INDUSTRIAL EXPORTS (1992)

	US\$ Millions	Composition (%)
AGRICULTURAL:	915.8	26.4
Bananas	410.0	11.8
Flowers	341.0	9.8
Crustaceans & Molluscs	57.0	1.6
Cotton	56.0	1.6
Others	51.8	1.5
INDUSTRIAL:	2550.0	73.6
Clothing	311.5	9.0
Yarns & Fabrics	298.8	8.6
Food and Tobacco Products	531.7	15.3
Footwear	103.4	3.0
Leather & Leather Goods	120.8	3.5
Paper and Printed Items	184.1	5.3
Glass and Glass Products	30.1	0.9
Clay, Porcelain and Ceramics	16.4	0.5
Chemicals	410.2	11.8
Machinery & Equipment	190.1	5.5
Metal Industries	112.9	3.3
Non-Metallic Minerals	62.5	1.8
Rubber and Plastics	48.4	1.4
Transportation Materials	52.0	1.5
Wood & Wooden Goods	25.8	0.7
Others	51.3	1.5
TOTAL:	3465.8	100

Note: There are also non-traditional exports in the Petroleum and Mining Sect
Source: DANE and FEDESARROLLO

Table 2.4
COLOMBIA: FOREIGN TRADE BY GEOGRAPHIC AREAS (1991)

	1985		1991		Average Annual Growth 1985-91
	US\$ Millions	Share (%)	US\$ Millions	Share (%)	
EXPORTS:					
LAFTA	308.5	9.3	1554.0	20.7	31.1
Andean Pact	240.3	7.3	773.3	10.3	21.5
Rest of LAFTA	66.2	2.0	780.8	10.4	50.9
U.S.A.	1006.1	30.4	2702.7	36.0	17.9
EEC	1127.3	34.0	1951.9	26.0	9.6
Japan	147.9	4.5	240.2	3.2	8.4
TOTAL	3311.0	100.0	7507.4	100.0	14.6
IMPORTS:					
LAFTA	934.8	19.9	809.5	17.8	-2.4
Andean Pact	489.4	10.4	423.0	9.3	-2.4
Rest of LAFTA	445.4	9.5	388.6	8.5	-2.3
U.S.A.	1524.1	32.5	1691.9	37.2	1.8
EEC	854.2	18.2	859.6	18.9	0.1
Japan	467.3	10.0	377.5	8.3	-3.5
TOTAL	4688.9	100.0	4548.0	100.0	-0.5
BALANCE OF TRADE:					
LAFTA	-628.3		744.5		
Andean Pact	-249.1		350.3		
Rest of LAFTA	-379.2		394.2		
U.S.A.	-518.0		1010.8		
EEC	273.1		1092.4		
Japan	-319.4		-137.2		
TOTAL	-1377.9		2959.4		

Source: National Statistics Department and CEPAL

Table 2.5

COLOMBIA: IMPORTS BY USE OR ECONOMIC DESTINATION
(US\$ Millions of US\$ - CIF)

	(US\$ Millions CIF)		Share (%)		Average Annual Growth (%)
	1985	1992	1985	1992	1985-1992
Consumption Goods	332.7	796.9	8.1	11.9	13.3
Non-Durable	177.6	439.4	4.3	6.6	13.8
Durable	155.1	357.5	3.8	5.4	12.7
Raw Materials & Intermediate Products	2434.1	3583.1	58.9	53.7	5.7
Fuels	481.3	344.3	11.7	5.2	-4.7
Agriculture	173.3	297.2	4.2	4.5	8.0
Mfg. Industry	1779.5	2941.6	43.1	44.1	7.4
Capital Goods	1307.5	2095.6	31.7	31.4	7.0
Construction Materials	256.6	67.4	6.2	1.0	-17.4
Agriculture	15.0	35.7	0.4	0.5	13.2
Mfg. Industry	672.6	1490.5	16.3	22.4	12.0
Transportation Equipment	363.3	502.0	8.8	7.5	4.7
Automobile Assembly		187.8		2.8	
Others*	56.4	5.3	1.4	0.1	
TOTAL	4130.7	6668.7	100.0	100.0	7.1

* Includes Automobile Assembly in 1985

Sources: DANE and Fedesarrollo

excessive effect on the country's balance of trade. At the same time, the diversification of external trade incomes means that the handling of the foreign front becomes much more complicated and difficult to forecast than has been the case in the past.

2.2 THE SCOPE OF TRADE LIBERALIZATION

These changes in the foreign sector of the Colombian economy are the result of what is, without a doubt, the most important building block in Colombia's new economic development model: its international trade strategy. Based upon market liberalization and institutional modernization, this model aims to increase the country's wealth and growth potential through the internationalization of the economy.

In sharp contrast with the development model based upon import substitution which was followed by Colombia and most Latin American economies since the 1930's, the "new" model is outward looking, relies more on market forces, and focuses state-intervention on the protection of clear and fair competition rules, rather than on the administration and enforcement of trade barriers such as quantitative import restrictions and high tariffs.

During the past decade, Colombian leaders and analysts, in both the public and private sectors, came to recognize that the possibilities for a growth model based on protectionism had been exhausted. Such recognition was based upon the following considerations:

1. The relative small size of the Colombian market makes it impossible for Colombians to enjoy higher standards of living and achieve high rates of growth without international trade. Exports are one of the main engines of growth and job creation in the economy, and have been growing faster than other components of production. Without enough export growth, it is impossible to enjoy the benefits brought about by economies of scale and specialization. Therefore, in order to strengthen the Colombian economy, securing and enhancing access to international markets had to become a prime objective on the Government agenda.
2. During the 1980's it became evident that due to the lack of competition and the difficulties involved in importing goods because of protectionist policies, industries (and to some extent, the agricultural sector) had lost their capacity to change and grow efficiently, while great technological setbacks occurred in many branches. Hence, in order to penetrate world markets and guarantee high rates of growth, import policies had to change in creating a more competitive environment.

3. The past two decades have seen the changing nature of international business and the emergence of a truly global economy. Firstly, spurred on by improvements in communications and transportation, and advances in business administration and finance, natural barriers to trade have shrunk throughout the world. Secondly, specialization and intra-industry trade have grown impressively, changing the nature of trade and multinational corporations. Lastly, flows of capital and knowledge are nowadays at least as important as the flow of goods in international exchange. Today, being competitive in the economic game involves attracting both domestic and foreign investors. Colombia could not remain isolated from the forces of global change for much longer and sooner or later would have to face the challenge of adjusting to global competition.

The redirection of Colombian long-term economic policy towards creating a more open economy began to take place in the second half of the 1980's, immediately after a severe macroeconomic adjustment program was implemented. Important steps toward trade liberalization and the internationalization of the economy were taken during the government of Virgilio Barco (1986-1990), though it is under the present Administration that the most radical institutional and trade reforms have been carried out in that direction.

Today, Colombia is at the forefront of regional efforts to liberalize trade. The Government of Colombia is following a five-track strategy in pursuing the benefits of internationalization and trade liberalization, which consists of the following interrelated elements¹:

1. Trade negotiations
2. Import liberalization
3. Export promotion
4. Foreign investment liberalization (promotion)
5. Reform of Government institutions and administration

¹/ This strategy is explained in detail in "Colombia's Foreign Trade Plan: 1990-1994" a document approved in april 1992 by the country's maximum trade policy authority : The Foreign Trade Council. The Council is integrated by the following members: The President of Colombia;The Minister of Foreign Affairs;The Minister of Foreign Trade;The Minister of Development;The Minister of Agriculture;The Minister of Transport;The Minister of Energy and Mining;The General Manager of the Central Bank;The Director of The National Planning Department;The Director of INCOMEX;The President of BANCOLDEX; and two Council Advisors.

2.2.1 Trade Negotiations

Trade negotiations play a key role in Colombia's new Foreign Trade Strategy. It is the Government's view that unilateral import liberalization is not enough to maximize the advantages of international trade and improve Colombia's position as a good place to invest.

In a world of imperfect competition and information, where there are still powerful protectionist forces in many of the biggest markets (especially in the EEC and the USA) and a growing tendency to conform separate trade blocks rather than a multilateral free trade area can be observed, international negotiations are crucial to guarantee increased and stable access to world markets. On the one hand, only international arrangements with clear trading rules can assure durable opportunities for trade and investment, and provide fair and consistent interpretation of international trade legislation. On the other, trade negotiations are needed to penetrate trade blocks and closed economies and thus avoid the dear costs of trade diversion and isolation from such markets.

Colombia has recently adopted a multi-tiered approach to trade negotiations. It has become more active in multilateral negotiations such as the GATT's Uruguay Round, while simultaneously pursuing its objectives through bilateral negotiations with the EEC and the USA as well as signing several regional trade agreements.

The ultimate goal of the latter is to help construct a hemispheric free trade zone, in the same line as the "Enterprise for The Americas Initiative" proposed by the previous US Administration. This strategy is clearly justified by the large share of regional trade in total trade in Colombia. As shown in Table 2.6, more than 60% of Colombian imports come from Latin America and the USA, and more than 65% of the country's exports are destined to those areas.

In fact, it is inter-regional trade that has saved Colombia from suffering the effect which the real revaluation of the peso, necessary to bring down inflation, could have had on the export sector, especially on non-traditional exports. While exports to the U.S., Europe and Japan have dropped slightly over the past several months, both as a result of the real revaluation and of the commercial barriers some countries have set, notably the limits that Europe has set on banana imports, exports to Venezuela, Ecuador and, to a lesser extent,

TABLE 2.6

COLOMBIA'S MAIN TRADE PARTNERS

	USA	EEC	JAPAN	ANDEAN COUNTRIES	REST OF LAMERICA	REST OF THE WORLD	TOTAL
	% SHARE						US\$ Millions
A. EXPORTS							
1988	36.6	27.1	6.2	8.1	12.0	12.0	6026
1989	40.8	26.7	4.4	7.1	13.6	10.2	6740
1990	41.3	30.0	3.8	5.5	15.0	4.4	6765
1991	36.2	26.1	3.2	10.7	16.6	4.7	7276
Jan-Sep 1992	35.6	25.8	2.7	14.2	15.4	6.4	6278
(% Var. 92/91)	(-0.1)	(0.3)	(-19.3)	(38.3)	(-21.8)	(-4.9)	
B. IMPORTS							
1988	36.6	20.0	10.8	6.8	15.3	11.4	6006
1989	35.6	19.3	9.4	7.6	15.4	12.7	6010
1990	36.1	20.8	8.9	9.2	13.6	12.6	6589
1991	38.6	18.7	8.3	10.6	14.5	11.1	4966
Jan-Sep 1992	37.2	18.9	8.3	8.7	15.8	11.2	4844
(% Var. 92/91)	(0.6)	(0.2)	(0.0)	(-1.8)	(1.1)		

Source: DANE (National Department of Statistics).

Mexico, have been extremely dynamic. Notably dynamic areas have been those of beverages, paper, metals and other minerals, fabrics and plastics. These results point to the tremendous benefits that can be reaped from deepening inter-regional trade ties.

Though regional economic integration efforts have always been part of Colombian foreign-trade and international-relations policies, the focus of trade negotiations has changed considerably over the past two years. Colombia has become a leader in Latin America, - and particularly within the members of the Andean Pact (Colombia, Venezuela, Ecuador, Perú and Bolivia)- in breaking with the long-standing tradition of routinely seeking access to foreign markets while trying to continue shielding its own. Years before, regional integration was a mechanism by which Latin American countries tried to protect themselves from foreign economic influences. Today, regional integration is viewed as a strategy towards opening the economy to the rest of the world, according to the principles of a new approach to integration that has been coined under the term "Open Regionalism".

There have also been changes in the scope and content of overall trade negotiations, reflecting changes in trade practices and barriers to trade throughout the world. Thus, Colombia's present trade negotiations not only cover the traditional subject matter of trade negotiations- trade in goods and policies that directly affect that trade- but also trade in services, investment, intellectual property and similar trade-related issues.

With this strategy, Colombia has pressed forward in an effective role toward freer trade in Latin America, while gaining a unique and privileged trade position in the hemisphere and probably in the world:

- Thanks to recognition by the international community of the tremendous costs incurred by Colombia in its fight against narco-terrorism, Colombia has started to enjoy temporary preferential access to the most important world markets: the US and the EEC. Since November 1990 (and until 1996) the vast majority of Colombian products have free access to the European Community market, and since June 1992, and for a 10-year period, nearly all trade barriers were eliminated from 4816 items (more than 78% of Colombian total tariff items) in the US market.

- Since January 1992 Colombia and Venezuela share a free trade area, and were joined by Ecuador and Bolivia in September 1992, thus creating a common market of more than 60 million people.

The combination of these factors will enable Colombia to penetrate approximately 60% of the world market without facing tariff barriers in the coming years, a position that will certainly be envied by most nations- including the NICs, whose products have been excluded from the Generalized System of Preferences (GSP).

Furthermore, if by the end of 1993 Colombia, Venezuela and Mexico reach an agreement to create a free trade area under the framework of G3 negotiations, and negotiations with Chile, Central America and the Caribbean continue to prosper, Colombia's trade position will become even more advantageous. These countries represent a market of more than 200 million people and more than half of Latin Americas GNP and total exports.

A more detailed description of the present state of Colombia's most important trade negotiations will be offered in the following chapter.

2.2.2 Import Liberalization

Colombia's import liberalization strategy has three basic components:

1. Elimination of quantitative controls (quotas). The removal of import quotas began in February 1990, though the licensing system had already been relaxed slightly: about 60% of tariff positions needed import permits. By the end of 1990, quantitative import restrictions were almost completely abolished. Only controls on armament purchases and some drug imports were maintained.

2. Tariff-rate reduction. Although the present Administration was elected on a platform which explicitly included trade reform, from 1990 to mid-1991 there was great debate among policy makers and academics regarding the speed at which tariff reduction should take place. Apart from reducing tariff rates, the reform was aimed at homogenizing the tariff structure which at the time was rather complex: there were over 14 different tariff levels with an average tariff rate of 45%, including a surcharge on all imports which originally amounted to 18%.

At first, the new government authorities considered that the tariff reduction process should be gradual. However, in September

1991 the Government decided to take a major step towards removing trade barriers, and tariff rates were reduced to levels which would have been reached in 1994 according to the initial schedule. Table 2.7 shows the evolution of the tariff structure in Colombia between December 1990 and December 1992. The average tariff in the economy fell from 36% to 11.8%. Tariff reductions were greater in consumer goods sectors, particularly in the automotive industry. At present, there are four basic tariff levels: 5, 10, 15 and 20% ; there are a few exceptional items with 0% tariff rate, and for cars and transport equipment there are two levels : 35% and 40%.

The resulting tariff structure gives greater effective protection to consumer goods (38.2%) followed by raw materials (17.4%) and to a lesser extent capital goods (14.9%), as is shown in Table 2.8.

3. Removal of non-tariff and natural barriers. Though severe transportation bottlenecks still represent a strong natural barrier to trade in Colombia (especially in seaport infrastructure and administration), the present Government has been highly successful in reducing import transaction costs through institutional reforms aimed at reducing red tape, eliminating corruption, and improving overall efficiency in customs and general government administration.

2.2.3 Export Promotion

The dynamism of Colombian exports is not a matter of the last few years alone. Foreign sales have been increasing at an accelerating rate since 1985, from US\$ 3782 Million in that year to US\$ 7623 M in 1991. This is due both to the increase in oil and coal exports and to the development of non-traditional exports. The latter went from US\$ 1125 M in 1985 to US\$ 3730 M in 1991. This progress is the result of an export promotion policy which, aside from trade agreements and the such, has, since 1967, consisted of four basic instruments: (1) a gradual exchange rate devaluation policy (crawling peg), (2) a system of directed lending, (3) a system of duty-free imports of industrial inputs and capital goods, and (4) a system of direct fiscal incentives.

1. Exchange Rate. In Colombia, since 1967, the dollar exchange rate was fixed daily by the "Banco de la Republica", the central bank. Every authorized exchange operation was carried out at this rate, in an effort to maintain the competitiveness of Colombian export products. The real devaluation achieved by this process since 1983 is very significant, for the export business was 102%

TABLE 2.7

TARIFF STRUCTRE (%)

	December		February	
	1989	1990	1991	1992
TOTAL	43.7	35.5	13.5	11.8
CONSUMER GOODS	61.6	49.8	20.4	17.4
Durable	59.1	48.6	20.7	17.7
Non-durable	63.0	50.4	20.2	17.3
INTERMEDIATE GOODS	39.6	30.9	11.8	9.9
Hydrocarbons	31.7	25.4	13.2	8.0
Agriculture	22.4	18.3	12.0	8.9
Industry	40.4	31.5	11.8	10.0
CAPITAL GOODS	39.5	27.2	12.2	10.3
OTHERS	37.6	25.1	12.3	8.6

Source: Ministry of Finance, National Planning Dept.

TABLE 2.8

EFFECTIVE PROTECTION RATES (%)

	December		February
	1990	1991	1992
TOTAL	45.4	14.8	21.6
CONSUMER GOODS	87.7	30.4	37.4
INTERMEDIATE GOODS	38.5	10.7	17.7
CAPITAL GOODS	19.8	8.6	15.0
OTHER	23.5	21.6	13.5

Source: National Planning Department.

more profitable in 1990 than in 1983. This change had an important impact on the afore mentioned evolution of small exports since 1985.

In 1990 the daily mini-devaluation system was modified and the market was given greater importance in determining the exchange rate. On a daily basis, the government continues to set the official exchange rate, at which it buys foreign currency coming into the country with "exchange certificates". These, however, are dollar denominated and have a one year maturity period, so that it is the price at which they can be sold in secondary markets at the moment they are issued which in fact determines the market exchange rate, called the "representative market rate." The discount at which they are sold is equal to the difference between the passive interest rate and the expected rate of devaluation. The Bank intervenes in this market only in order to ensure that this discount does not exceed 12.5% or fall under 5.5%, thus determining the range within which the market rate can oscillate.

The high value, in pesos per dollar, recently reached by the real exchange rate has allowed Colombian authorities to implement a nominal devaluation rate lower than the inflation rate, and even nominal revaluations of the exchange rate, in an effort to reduce inflation. Between 1990 and 1991 the real exchange rate fell 1.9%, and in 1992 it will decrease an additional 5.7%. Never-the-less, non-traditional exports increased 36% in 1991, and have remained stable in 1992.

2.) Directed Lending. Loans directed to the export sector have been the most stable incentive for exports and one of the more effective because they have counteracted the limitations of the Colombian financial system, and have been able to satisfy the sector's high financial demands. Financial support to the export sector has concentrated on short term loans, although there are postshipment lines of credit for buyers and diverse financial structures for investment projects.

Following a tendency general to the Colombian financial system, interest rates for loans to exporters have increased in the last several years, becoming slightly greater than the inflation rate. In this manner, the financial subsidy inherent to these loans has been eliminated, as it was not essential to the efficacy of the instrument. The availability and permanence of the loaned resources, on the other hand, are vital, and these could not be guaranteed if the interest rates continued to be subsidized.

The entity in charge of the export sector's financing policy is BANCOLDEX, previously PROEXPO, which additionally carries out international promotion and commercial assistance. PROEXPO's capital, approximately US\$ 600 million, was transferred to the new Export Import Bank (BANCOLDEX), allowing it to mobilize resources of several times that amount in continuing to support the development of non-traditional Colombian exports, which currently represent over US\$ 3500 Million a year.

3.) Vallejo Plan. This is a system through which raw materials for the production of export goods can enter the country free of duty. This mechanism was very important for certain industrial export sectors, for it protected them from the import controls and high tariff rates of the past.

4.) Direct Fiscal Incentives for Exports. The Tax Refund Certificate (CERT) is a mechanism used in Colombia to pay exporters a percentage of the value of their foreign sales of products different from coffee, oil and coal as a fiscal stimulus. The CERT is a financial instrument which can be used for tax payments or sold at a small discount in secondary markets. The government's economic liberalization and restructuring have decreased the importance of this instrument, which has existed since 1967. It is foreseeable that the government will continue to reduce and simplify the CERT, which will be practically eliminated within a few years.

2.2.4 Foreign Investment Policy

During the last several decades, Colombia has had strict control policies for foreign capital, with strong restrictions on profit remittance and participation percentages. These controls greatly limited foreign investment in the country, except for the large investments made by foreign companies in the oil and mining sectors, which were none-the-less heavily controlled. For these reasons, the reform which took place in 1990 represents a great change for foreign investment in Colombia. The principal elements of the new regulations are:

1) Equal conditions for national and foreign investors. Among other things, this means free access to internal credit and any benefit or support offered to national producers. It also means an equal income tax rate, which according to the new tax law is effectively 35.2%/37.5% until 1997. Foreign investment is admitted into any sector of the economy except defense and national

security, and the processing, disposal and discharge of hazardous waste not produced in the country.

2) Guaranteed stability of conditions for foreign investment: conditions of operation and profit remittance can not be changed for the worst with regards to foreign investment, except in the remote possibility of an exchange crisis which reduced international reserves to an amount below the equivalent of three months worth of imports.

3) Freedom of entry for foreign capital, except in sectors such as public utilities, mining and petroleum, and certain areas of the financial sector, for which it is necessary to obtain authorization from the appropriate entity.

4) Free remittance of profits, without limitation of amount or time. There is also the freedom to totally or partially remit capital at any time.

5) Special surcharge of 12% as of 1993 for dividends or partnership profits received by non-residents and for the remittance of commercial profits of branches of foreign companies or entities. In 1994 the rate will be reduced to 10%, in 1995 to 8% and from 1996 on will be 7%. In the hydrocarbon sector the rate will be 15% from 1993 to 1995, and 12% for the following years.

6) Foreign capital investment funds that invested in portfolios in the Colombian stock exchange were previously subject to two different tax regimes. According to law 49 of 1990, said funds had to pay an income tax. The base was determined according to commercial profit, after the exchange profit and the general rate of 12% had been accounted for. This continued in force until December 31, 1992. Law 6 of 1992 established that said funds do not pay income taxes on profits earned by their activities, unless these correspond to financial earnings or dividends from profits not taxed in the companies generating them. In the latter cases, the rate is 30%. The new system applies as of January 1993.

7) The special conditions for the hydrocarbons sector mean that there is no obligation to bring the currency obtained from the sale of crude in to the country or sell it to the "Banco de la Republica" or the financial system. Conversely, currency for payments abroad can not be bought in the Colombian financial system. Investments in petroleum activities require previous authorization by the Ministry of Mines and Energy. Only mining

projects with investments greater than US\$ 100 million require said authorization.

8) Foreigners may establish and/or operate processing (*maquila*) operations and free zones. These are special entities which produce goods or services for export and only secondarily for the domestic market. They are hence subject to special tax and investment regimes. Among other things, they do not have to pay import duties or sales taxes for raw materials and, in the case of free zones, they are exempt from income, remittance and asset taxes on the proceeds from goods and services exported.²

The causes and consequences of recent capital flows into Colombia, especially direct foreign investment, will be dealt with more fully in Chapter 4 (Foreign Capital and the Foreign Exchange Market).

2.2.5 State Reform and Internationalization

In addition to the establishment of the above policies, and as part of its broader purpose of becoming more modern and efficient, the Colombian government has carried out a number of institutional and administrative reforms aimed at advancing the growth and internationalization of the economy

2.2.5.1 Exchange controls

From 1967 to 1991, legislation regarding exchange transactions had been based upon a system of strict controls over all trade or financial operations. This legislation changed in 1991 as part of the liberalization program. The new exchange regime has the following characteristics:

- 1) The financial system is now in charge of the currency market. The Central Bank, which previously took part in every exchange transaction, is now only a regulator of the market.
- 2) Currency originating from trade of goods or from financial transactions must be negotiated through the financial system, but

² Complete information on all regulations covering foreign investment in Colombia can be found in the Guide to Foreign Investment in Colombia, published by the National Planning Department (DNP).

all the control systems and necessary authorizations which used to complicate exchange transactions have been eliminated.

3) Currency originating from services rendered by Colombians abroad, tourism and donations, can be freely held or negotiated both abroad and in Colombia. This freedom of exchange also applies to all capital held abroad before the new laws were implemented that takes advantage of the fiscal amnesty that has been offered to said capital.

4) Although the law does not establish a mechanism for determining the exchange rate, the mini devaluation system in which the government directly determined the exchange rate was modified in 1990 to allow for a greater influence of market forces in its determination. As was mentioned before, the authorities now set a range along which the exchange rate can freely move, in reaction to such things as the expected exchange rate and the interest rate.

The new exchange policies have created a positive climate, which has in turn fostered the return of a large amount of Colombian capital that had been held abroad. The amount of capital that has come in has been such that authorities have established a temporary mechanism to differ the exchange of these currencies into Colombian pesos for 360 days, through a system of exchange certificates. A withholding rate of 10% on income from abroad was also established, by decree 1085 of July 1992.

2.2.5.2 Transportation Policy

Sea

Sea transportation policies have been changed in accordance with the internationalization of the economy. In another section the matter of privatization of ports, which is part of the more general policy of modernizing and streamlining the transportation of goods within and outside the country, will be dealt with fully. Private ownership will mean that port operators will have to compete among themselves in rates and services in order to attract cargo ships.

Regarding conditions for sea transport, the rule according to which a certain percentage of the different goods that were being exported or imported had to be transported by Colombian ships has been changed. Now, only a criteria of reciprocity will be taken into

account, so that conditions to foreign transport will be set according to the conditions offered by other countries to Colombian ships.

The new policy has also established complete freedom in determining transport charges. Furthermore, routes can be freely determined by transport companies, thus eliminating the exclusive assignment of routes to determined companies.

Air

Within the negotiations of the Andean Pact, there have been agreements of "open skies" with Ecuador and Venezuela so as to allow enterprises from other countries to cover national and international air routes. This will allow greater efficiency in the transportation of passengers and certain type of cargo between the neighboring countries, thus contributing to the integration process. For aerial transportation of cargo, there is also a policy of "open skies" at the international level.

The transformations taking place in the internal transportation infrastructure will be dealt with in Chapter 5 (State Reforms and Privatizations.)

2.2.5.3 Industrial Policy

The government's industrial policy is directed towards correcting the technological backwardness of many of Colombia's industrial sectors, partly caused by the old protectionist strategies. The government knows that simply exposing Colombian firms to international competition will not alone produce greater levels of productivity and competitiveness. Thus, liberalization, which is the main element of current industrial policy, must be complemented by a policy of technological development and of investment promotion. This policy has three basic objectives: the progressive expansion of exports, industrial conversion and modernization, and the promotion of new sectors with high technological development potential. The main elements can be summarized as follows:

1) Credit Policy: its objective is to finance the changes needed by enterprises to adjust to the internationalization of the economy. For this purpose, a reconversion credit line with the World Bank of US\$200 million has been established. The Industrial Promotion Institute, IFI, will play an important role in this process, serving as an investment bank. This entity will emphasize long term loans for new investment projects. Towards this end, a New Investment Projects Fund will be created, using

the resources obtained from the privatization of enterprises in which IFI holds shares. Additionally, Colombia has gained access to the "Cheyson Facility" of the European Economic Community, which supports new investment projects in developing countries. The credit diffusion process will be aided by BANCOLDEX and the Financial Development Corporation, which concentrates on small and medium-sized industries.

2) Technological Development Policy: There has been an administrative restructuring of the government entities that are in charge of supporting the transference, creation and transmission of technology within the industrial sector. This effort will be supported with the availability of resources for the development of Industrial Technology Development Centers, programs for human capital development etc..

3) Deregulation Programs: A process has been initiated to reduce all formalities and simplify the government's systems of control over industrial entities. A special deregulation program has been developed for the automobile industry, which is currently one of the most tightly regulated: many of the existing regulations have been eliminated (limit to the number of models, etc.), a requirement for a national added value has been established, and the positive list system has been eliminated.

4) Anti-monopoly law: Recently, congress was presented with a legislation project that aims to change the laws that have governed monopolistic practices in Colombia since 1959. This legislation does not aim to eliminate all existing monopolies, but to lessen the harmful effects these might have on consumers.

PRESENTATION OF COLOMBIA TO THE INTERNATIONAL COMMUNITY

TRADE NEGOTIATIONS

September 1993

CHAPTER 3

TRADE NEGOTIATIONS

3.1 NEGOTIATIONS WITHIN THE ANDEAN PACT

1992 represents a watershed in the history of Andean Pact negotiations. For the first time, radical steps were taken toward consolidating a free trade area and customs union between its members. In great part, this was possible thanks to redirection of economic policies in the region towards implementing disciplines of debt-restructuring and price-stability, and the adoption of macroeconomic adjustment programs that could sustain economic recovery and adjustment.

After four meetings of the Andean Presidential Council since 1990, the difficult process of negotiating an agreement to create a customs union ended successfully in September 1992. In a crucial meeting held in Lima at the end of the second quarter of 1992, Bolivia and Ecuador joined the free trade area already created by Venezuela and Colombia in January 1992, and the four Countries approved the general structure of a common external tariff that should start to be in force as of January first, 1994.

The agreed tariff structure has four levels: 5%, 10%, 15% and 20%, according to the amount of "added value" (grado de elaboración) of the corresponding product. Though there are still differences between countries regarding the level of protection that should be given to some items¹, in February 1993 officials reached a effective consensus on nearly 95% of the total of tariffed items. Andean Pact Authorities have not legally approved the corresponding decision yet; December 1993 was set as the

¹/ Main differences are with Ecuador, in petrochemical, agricultural, and steel sectors.

deadline before which the four countries must have reached a complete agreement on the external tariff.

It was agreed that Ecuador could enjoy some preferences, on the grounds that this country is still at an earlier stage of industrial development than Venezuela and Colombia. Therefore, until December 1996, tariff rates in Ecuador for 1000 specific products will be 5 percentage points below the common external tariff charged by the other countries.

Due to Peru's difficult present social and economic situation, in particular its large public deficit, it was also agreed that for one year (that is, until the end of 1993), this country would not participate in the free trade area, nor would it have to abide by the rules of the liberalization program and common tariff agreement, though, in the meantime, any of the other four countries could adopt countervailing measures if it wishes to do so.

Other important agreements and steps taken recently by the Andean-Pact authorities towards consolidating free trade in the region are the following:

1. Countries were allowed to negotiate independent free trade agreements with Latin American countries outside the group, such as Mexico, as long as such treaties abide by a group of general rules set out by the Andean-Pact authorities in a framework agreement.
2. A deadline was established to remove all subsidies and fiscal incentives to intra-Andean exports.
3. Countries signed a set of separate agreements to facilitate and liberate transport within the subregion.
4. It was agreed that more formal cooperation mechanisms should be enforced in areas such as education, science and technology transfer, academic interchange, etc.

Andean trade negotiations have been (and will continue to be) of utmost importance for Colombia's present and future trade development and economic performance, as the following figures

clearly illustrate: In 1992, this market represented 14.2% of Colombian total exports (Table 3.1) and more than 22% of its non-traditional exports, while 8.7% of its imports came from Andean countries.

As a result of the progress being made in these negotiations, in 1992 total Andean trade reached the highest level in the 24 year history of the Andean Pact: US\$ 2150 million, increasing almost 20% with respect to 1991 (in the previous 23 years the average annual growth rate of intra-Andean trade had been 14%). As shown in Table 3.2, Colombia is the most important exporter of the group, accounting for nearly 46% of total intra-Andean trade.

3.1.1 Integration with Venezuela

Without any doubt, economic integration between Venezuela and Colombia is the single most important recent event in Colombian and hemispheric trade relations. In January 1992, under the framework of Andean-Pact negotiations, a free trade zone and customs union was created between the two countries². This area represents a trading market of more than 50 million people and US\$ 180 billion worth of economic production.

For Colombia, the Venezuelan market represents almost 65% of its exports to the Andean region, and 7.9% of its total exports (Table 3.3). Colombia exports to Venezuela such items as farm products, chemicals, clothing, machinery, electrical appliances, leather goods, beef, sugar and fertilizers, while it buys gasoline, aluminum, chemicals, iron, steel products, and other minor imports from that country.

Contrary to free-trade critics' worse fears, in only one year such integration brought enormous benefits to both economies, and even the most sensitive sectors in Colombia -such as the steel and automotive sectors-, have profited from bilateral free trade.

²/In 1992, apart from removing tariff barriers and eliminating import quotas, both countries put in force an external common tariff on more than 90% of total tariff items.

TABLE 3.1

COLOMBIA'S MAIN TRADE PARTNERS

	USA	EEC	JAPAN	ANDEAN COUNTRIES	REST OF LAMERICA	REST OF THE WORLD	TOTAL
	% SHARE						US\$ Millions
A. EXPORTS							
1988	36.6	27.1	6.2	8.1	12.0	12.0	5026
1989	40.8	25.7	4.4	7.1	13.6	10.2	5740
1990	41.3	30.0	3.8	5.6	15.0	4.4	6765
1991	35.2	25.1	3.2	10.7	18.6	4.7	7276
Jan-Sep 1992	35.6	25.8	2.7	14.2	15.4	6.4	5278
(% Var. 92/91)	(-0.1)	(0.3)	(-18.3)	(38.3)	(-21.9)	(-4.9)	
B. IMPORTS							
1988	35.6	20.0	10.8	8.8	15.3	11.4	5005
1989	35.6	19.3	9.4	7.6	15.4	12.7	5010
1990	35.1	20.8	8.9	9.2	13.5	12.6	5589
1991	36.6	18.7	8.3	10.6	14.6	11.1	4985
Jan-Sep 1992	37.2	18.9	8.3	8.7	15.8	11.2	4644
(% Var. 92/91)	(0.6)	(0.2)	(0.0)	(-1.9)	(1.1)		

Source: DANE (National Department of Statistics).

TABLE 3.2

THE ANDEAN GROUP IN 1992

	GNP GROWTH (%)	TOTAL EXPORTS US\$mill.	EXPORTS ANDEAN C's US\$mill.	TOTAL IMPORTS US\$mill.
Ecuador	3.5	2979	174	2491
Colombia	3.3	7029	1000	6115
Venezuela	7.3	13830	632	13472
Bolivia	3.5	751	84	1133
Peru	-2.5	3348	266	2945

Source: Junta del Acuerdo de Cartagena, CEPAL

TABLE 3.3

TRADE WITH MAJOR LATIN AMERICAN ECONOMIES
(% Share in total Colombian trade)

A. IMPORTS	ARGENTINA	BRAZIL	CHILE	MEXICO	VENEZUELA
1988	1.4	3.6	1.3	3.5	2.9
1990	2.4	3.3	1.7	2.1	5.8
1991	2.9	3.2	1.0	3.1	7.0
Jan-Sep 1992	2.8	3.7	1.3	2.7	5.3
(% Var. 92/91)	(19.2)	(27.8)	(45.0)	(8.7)	(2.3)
B. EXPORTS					
1988	0.8	0.4	2.0	0.2	4.4
1990	0.4	0.4	2.4	0.6	3.0
1991	0.5	0.7	2.5	0.8	5.9
Jan-Sep 1992	1.4	0.7	1.5	1.0	7.9
(% Var. 92/91)	(217.7)	(-13.0)	(-43.4)	(27.2)	(38.0)

Source: DANE (National Department of Statistics). Ministry of Trade.

Bilateral trade swelled from US\$750 million in 1991 to almost US\$ 1 billion in 1992 (30% increase), and it is expected to double this year to US\$ 2 billion. Colombia's exports to Venezuela, its third largest market, totalled US\$577 million in 1992, comprising 7.9% of total exports. Exports from Venezuela to Colombia reached US\$360 million, or 2.6% of its total exports and 5.3% of Colombia's total imports (see Table 3.3).

Accumulated Venezuelan investment in Colombia increased from US\$ 62 million in 1991 to US\$ 120 million in 1992. This makes Venezuela the second biggest foreign investor after the USA. This capital inflow has been invested mainly in the financial sector, as several banks and financial intermediaries have been bought by Venezuelan entrepreneurs in the last year and a half. Accumulated Colombian investment in Venezuela, on the other hand, totalled US\$65.6 million last year.

Apart from removing standard trade and investment barriers between the two countries, the following are some other important results of bilateral negotiations:

1. Red tape has been cut in the agricultural sector. National registrations for basic agricultural products are recognized in both countries, some agricultural and fito-sanitary permits have been eliminated and the process of obtaining others has been simplified.
2. There has been great progress in harmonizing quality certification permits and procedures for non-agricultural products.
3. A temporary "voluntary export restraint" agreement was signed for some "sensitive" products of the steel sector in order to give those industries more time to adapt to the new free-trade environment. This agreement will be in force only until April 1993 and so far has been quite successful in creating the conditions needed to increase bilateral trade and induce investment and technological change to make steel industries in Colombia more specialized and competitive.

4. A bilateral agreement to liberate air transport has resulted in a sixfold increase in binational flights over the course of one year.

The following are some of the remaining problems on the integration front:

1. Total elimination of non-tariff barriers. Officials are still working to unify and modernize customs procedures with the ultimate goal of creating a single binational customs office.

2. Macroeconomic Policy Harmonization. Government officials from both countries agree on the need to harmonize macroeconomic policies to ensure fair and equal competitive conditions as well as to provide a stable macroeconomic background that would guarantee increased trade and investment flows between Colombia and Venezuela in the long-run.

However, a monetary union or complete policy harmonization will not be possible in the short term. There are still great differences in inflation rates and fiscal deficits between the two countries, and sharp fluctuations in the Venezuelan exchange rate are likely to occur in the medium term. Mainly due to Venezuela's present unstable political situation, it is unlikely that strict macroeconomic adjustment programs will take place shortly in that country, or that tax systems could be harmonized soon. Nonetheless, there has been significant progress as far as export subsidies elimination in both countries is concerned.

3. Intellectual property rights harmonization. Though both countries have agreed to abide by Decision 313 of the Andean Pact, the group's common legal framework for intellectual property, there are still differences in domestic legislation and trade-mark piracy continues.

Though Colombian interests are not necessarily identical to those of its neighbor, in order to guarantee stability in bilateral

economic relationships and consistency between all trade agreements in which Colombia and Venezuela are involved, both governments have been trying to work jointly in trade negotiations with other countries. The idea is to compete with other parties under similar rules and a common set of principles. That is why both countries are making great efforts to homogenize their trade agreements with Mexico, Chile, Central America and other countries.

3.2 G3 NEGOTIATIONS

The next most important step toward trade liberalization in Colombia and Latin America will be the signing of a free trade agreement between The Group of Three (G3) : Mexico, Venezuela and Colombia.

3.2.1 Why is economic integration with Mexico important?

A G3 free trade agreement is a priority in Colombia's trade negotiations agenda for many reasons:

1. Economic integration between these nations is, in certain way, a natural consequence of geo-political integration. There have always been powerful extra-economical ties between the three countries; apart from having common historical and cultural backgrounds, they have shared similar political positions toward peace in Central America and other socio-political conflicts in the area.

2. Mexico is nowadays one of the fastest growing and most promising economies in the world. It represents a large potential market for Colombian products, comprising 90 million people, and a potential source of capital and technological transfer. The Colombian and Mexican economies are, to a great extent, complementary (which is not the case between Venezuela and Mexico), and full advantage of this fact has not yet been taken by entrepreneurs from both countries.

Though initial benefits from bilateral trade could be modest because the size of Colombian-Mexican two-way trade is

relatively small (Table Y), they should rise over time. Gains will be higher as the Mexican economy becomes richer, not only due to NAFTA but to ongoing structural reforms in that country and growing flows of foreign investment. If Colombia and Venezuela share a free trade area with Mexico, the former countries will certainly become a more attractive location for foreign investment.

3. Mexico has just completed negotiations on NAFTA, has signed a free trade agreement with Chile and a Framework Agreement with Central America, among other trade negotiations. In order to diminish the effects of trade diversion caused by this "hub-and-spoke" type of integration that is taking place in North America, it is important for Colombian goods, services and capital to gain access to the Mexican market on an equal footing with other Latin American countries and, hopefully, with Canada and the USA.

4. Colombian industries must prepare, and are already prepared, in many sectors, to compete with countries like Mexico. Despite clear complementation between the two economies, Colombian and Mexican products continue to be similar and competitive in large markets such as the US. Therefore, with or without G3, and more so if NAFTA is finally approved by the corresponding legislative bodies in North America, Colombia would have to face (at least for a few years) unequal competition from certain Mexican products in the US market. A G3 treaty would clearly help Colombia to gain a better position to meet increasing competition from other Latin American countries.

3.2.2 Brief history and present state of G3 negotiations

In October 1990, during the meeting of the "Group of Rio" in Caracas, President Gaviria, Mexican President Salinas and President Pérez from Venezuela, committed their governments to prepare trilateral negotiations in order to sign a free trade agreement.

Since then, there have been 8 meetings at a technical level. Government officials made substantial progress during 1991,

particularly in establishing guidelines to implement the agreement and discussing issues related to provisions against anti-competitive practices, government procurement, safeguards, rules of origin, etc. However, it was not until the second quarter of 1992, after the Colombian government started to push forward the agreement, that negotiations started to accelerate and liberalization schedules began to be negotiated.

During the third quarter of 1992, Colombian officials worked intensively, consulting with the private sector and elaborating a joint proposal with Venezuela, while radical changes were taking place in the Mexican negotiating team and negotiating strategy. In a meeting held in Bogotá at the beginning of December 1992, Colombia and Venezuela proposed a detailed liberalization program and a preliminary draft of the agreement was discussed with the new Mexican team. The Mexican government committed to study such draft and proposal during late 1992 and January 1993, for which proper consultations with the Mexican private sector regarding G3 negotiations began to take place for the first time.

After two other technical rounds of negotiations and a Presidential meeting during 1993, the draft of the agreement has undergone several changes and there has been substantial progress in the definition of the structure and schedule for tariff elimination. In February 1993, the three Presidents committed to sign an agreement before January 1994, date when it would start to go into effect.

3.2.3 The main elements of the G3 agreement

Though the final structure of the agreement is still under negotiation, it is certain that it will contain the following elements:

1. Market Access. There will be special provisions that establish rules governing trade in goods with respect to customs duties, quantitative restrictions (such as quotas, licenses and permits) and other requirements.

- a. Tariffs. The agreement will provide for the progressive elimination of all tariffs qualifying as Mexican, Colombian or Venezuelan under its rules of origin. The three countries

agreed to classify the tariff universe in four groups of products : i) Those whose tariffs will be eliminated immediately, ii) Those whose tariffs will be phased out over 3 to 5 years, iii) Those whose duties will be eliminated in 8 to 10 years and iv) A reduced group of sensitive items whose tariffs will be phased out over a period approximately 15 years.

Colombia and Venezuela demand that the tariff reduction schedule should be asymmetric; Mexico should eliminate customs duties faster than the other two countries, taking into account that the former is more developed than the latter. So far, however, the Mexican government has not formally accepted this principle of asymmetric liberalization.

Colombia wants immediate liberalization for at least 65% of total tariff items, and the rest will be phased out over a maximum of 15 years. The sectors most sensitive to competition from Mexico are automobiles and parts, steel and petrochemical industries, and some agricultural products. The most competitive are traditional export commodities such as coffee and sugar, and non-traditional exports such as flowers, some products of the textile and apparel sectors and certain electric domestic appliances.

b. **Import quotas** will be totally eliminated, except for certain drugs, military equipment and some used products.

c. **Special permits and licenses** will be maintained in limited circumstances; for example, to protect the environment or human and animal life or health. The three countries will homogenize such rules and certification mechanisms.

2. Rules of Origin. Goods incorporating imports from outside the region will qualify as originating in G3 countries if the imported materials are sufficiently transformed in the region, i.e. undergo a specified change in tariff classification. In some cases, G3 content must also represent a certain proportion of the transaction value of a product.

3. Investment. The agreement will remove significant barriers to investment, and ensure non-discriminatory protection of investments. There is still no agreement about which arbitration mechanisms will be used to settle investment disputes.

Other issues where there is still no complete agreement are the following:

4. Government procurement.

5. Anti-dumping and competition rules.

6. Dispute settlement procedures.

7. Services.

In 1992, Colombian exports to Mexico grew at a significant rate of 27%, foreshadowing the agreement.

3.3 OTHER TRADE NEGOTIATIONS WITH LATIN AMERICAN AND CARIBBEAN COUNTRIES

3.3.1 Chile

A free trade agreement with Chile is also high on the Colombian Government's list of trade negotiation priorities. Three basic reasons explain this:

1. Chile is probably the most stable economy in Latin America, and the country with the most advanced process of modernization and structural reform in the region.

2. Chile and Colombia are two complementary economies, with great potential for bilateral trade and investment flows.

3. Chile already signed a free trade agreement with Mexico, a country with which Chilean trade has increased substantially during the last year, and is about to complete similar negotiations with Venezuela. Thus, for strategic reasons

explained above, it is very important to guarantee that Colombia joins that trade block as soon as possible.

In 1992, both countries committed to sign a free trade agreement and Colombia obtained permission from Andean Pact authorities to do so. So far there have been four bilateral meetings, and a first draft of a general trade and investment agreement is ready (very similar in structure to that signed by Chile and Mexico and, - tariff reduction program aside- it is almost identical to the Venezuela-Chilean agreement).

However, due to different trade liberalization strategies between the two countries (Chile has made more emphasis on multilateral negotiations and is not so willing to sign bilateral agreements with Latin American countries), there are still differences regarding the tariff reduction schedule. Colombia is ready to liberate immediately almost 80% of its tariff universe, while Chile would prefer a much more gradual liberalization process. Chile wants also to exclude some items from the agreement such as coal and some products of textile and apparel sectors. It is the aim of the Colombian government to solve these differences as soon as possible and sign an agreement before the end of 1993.

3.3.2 Free Trade Agreement with Central America

In a Presidential meeting held on February 12, 1993, the Presidents of Colombia, Venezuela, Guatemala, Honduras, Costa Rica, Nicaragua, and El Salvador committed their governments to work in order to create a free trade area in 1993. They signed a Framework Agreement for Trade and Investment that lays out the foundations upon which more specific multilateral and bilateral negotiations should be based in order to sign a free trade agreement on June 30, 1993.

This Framework agreement sets out the general principles that would guide negotiations of rules of access, as well as provisions against anti-competitive government and private business practices, mechanisms to resolve disputes, and other general rules.

Negotiations regarding rules of access (tariffs and rules of origin) started already in March 1993. As in G3 negotiations, it was agreed that the process of tariff elimination should be gradual and asymmetrical, phasing out protection for certain sensitive

products over periods of up to ten or more years. Colombia and Venezuela, for example, the more developed countries within the group, committed themselves to open immediately their markets to certain products from Central America³, while the other countries will reduce tariff barriers more gradually.

3.3.3 Other Countries

Colombia is ready to sign an agreement with countries of the Caribbean basin similar to that subscribed to by Venezuela, and has also accepted to renegotiate already existing tariff preference agreements (Acuerdos de Alcance Parcial) with Brasil and Argentina under the framework of the Montevideo Treaty that created ALADI. Though limited in scope, such negotiations will help to improve access of Colombian exports to those markets (and viceversa) through tariff reduction.

3.4 NEGOTIATIONS WITH THE USA AND THE EEC.

As mentioned above, Colombia's government does not want to become a passive observer of the competition game between trade blocks. It is the desire of Colombian authorities to become a partner of big economies. That is why the Ministry of Trade has been working intensively toward creating a free trade relation with the USA and the EEC.

3.4.1 Trade negotiations with the USA

Since the Enterprise for the Americas Initiative was launched in June 1990, great expectations have been created in Colombia regarding trade and investment relations with the United States. As far as trade is concerned, however, so far they have only materialized in a bilateral framework agreement for trade and investment and in the creation of a Bilateral Commission that would work on issues such as the improvement of market access in agriculture through elimination of technical non-tariff barriers,

³ Colombia already proposed a list of 290 such products.

intellectual property rights protection, export promotion together with the private sector, etc.

Though crucial steps toward creating a free trade relationship have been taken by the US through the preferences given to Andean Countries under The Andean Trade Preference Act (ATPA), temporary tariff preferences are not enough. The "adhesion clause" introduced in the North American Free Trade Agreement (NAFTA), opened a new door to enter the US market. The government wants the latter to recognize Colombia as a priority on the list of candidates for a NAFTA extension. After the third meeting of the Bilateral Commission for trade and investment, a team was created to begin to work, with the advise of the USTR, towards the creation of a mechanism that would ensure this.

Since such access is conditional upon a set of requirements and conditions that will be set by NAFTA members (these have not been regulated yet) the Colombian authorities will have to evaluate costs and benefits of such strategy. If conditionality ends up being too costly, Colombia will continue to put pressure, if necessary through GATT, in order to make North America a truly open area to trade and not a North American fortress.

3.4.1.1 ATPA

The ATPA is the commercial component of the American Program to fight against drugs. It has two fundamental objectives:

- a. Offer new alternatives to cocaine production and processing by giving preferential access to the US market to goods being produced in drug producing countries (Colombia Perú and Bolivia).
- b. Stimulate investment in non-traditional sectors and increase exports.

Tariff preferences given to Colombia through ATPA started to come into effect in July 1992. Since then, and for a 10 year period, 4800 items have been enjoying such preferences. 2000 of these items normally pay taxes higher than 5%; in 1992, the US paid taxes on imports of these products totalling more than US\$132000, of which electronic and electric apparel represent US\$60000. ATPA excludes

products such as sugar, oil, textiles and apparel, leather goods, shoes and rum.

3.4.1.2 Some results of bilateral negotiations

So far, the Colombian government, mainly through the bilateral consultation mechanisms provided by the Framework Agreement of Trade and Investment, has been quite successful in eliminating non-tariff barriers to the US market. The following are some of the results of such negotiations:

1. The textile quota for some key Colombian exports had a two-fold increase, achievement with no precedent in any textile negotiation with the USA.
2. Fito-sanitary permits for some fruits have been eliminated.
3. The tuna-fish embargo which prohibited Colombian exports of that product to the USA was also eliminated.
4. Progress has been made in making changes in the methodology to calculate dumping rates in commodities such as flowers, allowing for seasonal effects on prices.
5. Colombia, in turn, has been making norms more flexible in order to facilitate imports of wine from the USA, among other measures.

3.4.2 Negotiations with the EEC.

The Government will also try to improve Colombian exports access to the EEC in order to take full advantage of the consolidation of that common market after 1993. An extension of the above mentioned Special Cooperation Program, due on October 1994, will soon be negotiated.

The first full year of operation of this EEC's special tariff preference (GSP) for Colombia was 1991. According to a recent study⁴, this program represents a substantial improvement with respect to the GSP. However, as of december 1991, the new preferences had not had any dramatic effect on the composition of the top 30 items. Though one year is too short a time to be able to identify such an effect, and it is also difficult to identify whether an increase is due to the new preference or to other factors, the Report suggests that four years are not enough to be able to take full advantage of the program, since it takes time for investors and exporters to make decisions and reallocate resources accordingly.

So far, coffee, coal and bananas dominate the picture, accounting for over three-quarters of the value of exports to the EEC in 1991. Other important products are : flowers, textiles and clothing, leather goods, fruit and vegetables. In 1991 26 new products (at the 8 digit level) entered this market; though value still indicates small scale of operation, it is not insignificant.

At present, negotiation efforts are concentrated in guaranteeing free access to Colombian and Latin American bananas into the community, since protectionist interests have recently changed the rules of the game for such product. If necessary, GATT mechanisms will be used for that purpose.

⁴ Report by the Institute of Development Studies at the University of Sussex. Briefing document to advise the Embassy of Colombia in Brussels of the extent to which exporters are taking advantage of the new scheme and to identify possible additional products into which exporters could diversify.

PRESENTATION OF COLOMBIA TO THE INTERNATIONAL COMMUNITY

FOREIGN CAPITAL IN COLOMBIA

September 1993

CHAPTER 4

FOREIGN CAPITAL IN COLOMBIA¹

4.1 CAUSES AND CONSEQUENCES OF RECENT CAPITAL INFLOWS

The transformation process which the Colombian economy has undergone in the past three years has created a positive climate in which the future of the economy is viewed with greater optimism. Partly as a result of these new favorable expectations about the future performance of the economy, there has been a general increase in the country's rate of return to investment. Indeed, the real estate and stock markets, as well as the financial accounts of important companies, are behaving surpassingly well. These factors, added to the generalized world recession, the low external interest rates and the country's high financial returns, have led to a massive flow of capital into Colombia. In fact, the amount of net reserves accumulated annually rose from US\$ 626 Million in 1990 to US\$ 1919 M in 1991 and US\$ 2024 M in 1992.

4.1.1 The Structural Reforms 1990-1992

As detailed throughout this report, the Colombian economy has, over the last three years, undergone a process of broad transformations aimed at opening the Colombian economy, increasing competition and economic efficiency, and stimulating economic development and private initiative. Towards these ends, financial, labor, commercial, foreign exchange, and foreign investment legislations underwent important changes. Below is a short summary of the most important reforms which have taken place, especially those affecting the recent capital inflows².

4.1.1.1 Financial Reform

Financial liberalization has been one of the goals of monetary authorities since the 70's, but it has suffered several setbacks in the past as a result financial crises like the one in the early eighties which led to the nationalization of several banks (see Chapter 6, below). To further the original liberalization

¹ From: Cardenas, Mauricio and Barrera, Felipe. *Efectos Macroeconomicos de los Capitales Extranjeros: El Caso Colombiano*. FEDESARROLLO. Bogota, Colombia 1993.

Ocampo, Jose Antonio and Steiner, Roberto. *Los Capitales Extranjeros en las Economias Latinoamericanas*. Interamerican Development Bank, 1993.

² The latter three, commercial, foreign exchange and foreign investment regulation reforms, are described fully in Chapter 2, above. Labor reform is discussed in Chapter 5, below.

objective, law 45 of 1990 was aimed at encouraging the entry of new agents (both domestic and foreign) into the financial system by simplifying the requirements for entry. Furthermore, the law encouraged the transformation of a system of specialized banking into a universalized one, through the creation of trust funds, leasing companies, pension funds and stock brokers, which stimulated greater competition within the financial system. The reform also reduced forced investments (at a time when reserve requirements were being lowered), in order to reduce the financial spread, and set out to reprivatize the banks that had been nationalized (see Chapter 6).³

4.1.1.2 Commercial Reform

The principal goal of commercial reforms was to liberalize the goods and services market. Originally, a gradual reform had been planned, but it was dramatically accelerated as a result of the unprecedented accumulation of foreign reserves during the 1990-1992 period. The liberalization implied the elimination of quantitative restrictions on 99% of tariff positions and the reduction of nominal protection (tariff and surcharge), which went from an average of 43.7% in December of 1989 to one of 11.7% in March of 1992. Similarly, fiscal incentives to exports were eliminated, and the red tape involved in international commerce was vastly reduced.

4.1.1.3 Foreign Exchange Reform

The foreign exchange regime that had been in place in Colombia until 1990 was characterized by a system of daily mini-devaluations, crawling peg, and a strict, centralized control over all foreign currency transactions. By law, all currency had to be exchanged in the Central Bank, and there were severe limitations on the amount of assets valued in foreign currency which people could own. This system was modified substantially in 1990 as part of the general internationalization and liberalization process. In order to simplify and decentralize the foreign exchange market, the illegality of possessing assets valued in foreign currencies was partially eliminated, and financial institutions were allowed to negotiate foreign currencies. Additionally, exchange rate controls were relaxed, giving the market a greater say in the determination of the exchange rate.

4.1.1.4 Foreign Investment Regulation Reform

This reform sought to encourage foreign investment in Colombia. By

³ See also : Lora, Eduardo. "El fortalecimiento del sector Financiero en el Proceso de Ajuste: Liberacion y Regulacion en el Caso Colombiano." *Project for Network of Applied Investigation Centers Proposal*, Interamerican Development Bank. 1992

industries and facilitate the integration of the Colombian economy to other markets. Towards this end, complete freedom of investment was guaranteed, with the exception of the public service sector (for which previous authorization from the National Planning Department is required), the mining sector (regulated by the Ministry of Mines and Energy) and some minimal limitations of informational character in the financial sector. Restrictions to profit remissions were eliminated; they are now subject to a national tax rate between 35.2% and 37.5%.

The government's privatization process, which is fully dealt with in Chapter 8, is also worth mentioning here for, while it has not advanced as much as similar processes in other Latin American countries, it has resulted in additional capital inflows, notable among which are the purchase of two banks by Venezuelan investors and several new energy generation projects carried out with foreign capital.

4.1.2 The Amount of Recent Capital Inflows

In observing Colombia's balance of payments statistics, it becomes apparent that Colombia has not received significant new levels of external financing through the capital account over past years (Table 4.1). With the exception of the current year (1993), capital inflows through this account have in fact been far lower over the past four years than over any similar period of time during the past decade. While direct foreign investment has increased (see below), the levels of new foreign debt contractions have decreased dramatically, with the 1990-1992 period actually being characterized by the pre-payment of debts.

This pre-payment of foreign debt was not only a long-term measure but also a short-term stabilization one, for the new inflows threatened to bring about a dangerous appreciation of the peso. This move was one of a group of measures the monetary authorities took to sterilize the capital inflows. The sudden rise in debt disbursements in 1993 is the result of the investments which are currently being made in developing Cusiana and other new oil fields (see Chapter 6).

Most of the new capital inflows, then, can be attributed to the behaviour of the current account, which has fared better in recent years than it had since the coffee booms of past decades. This statistic must be assessed critically, however, as "capital" entries often take place under the guise of goods and services transactions, especially transfers, because of the illegal nature of many capital transactions. People have registered fictitious exports, or under-invoiced imports, often in the past in order to disguise the repatriation of illegal money and evade certain fiscal controls.

Table 4.1
COLOMBIA: BALANCE OF PAYMENTS (MILLIONS OF US\$)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993		
I. Current Account	104	-1722	-2885	-2826	-2088	-1586	483	-21	-215	-198	533	2474	989	-452	-	-369
A. Balance of Trade	13	-1333	-2076	-1317	-404	109	1922	1461	827	1474	1857	3087	1454	634.1	-	703
1. Exports of goods	3724	3397	3282	3147	3623	3782	6331	5264	5343	6032	7064	7507	7203	7462	-	7814
2. Imports of goods	4148	4730	5358	4464	4027	3673	3409	3794	4515	4568	5108	4548	5749	6769	-	7180
B. Balance of Services	-74	-631	-978	-1673	-1983	-2166	-2244	-2483	-2008	-2570	-2451	-2310	-2100	-2278	-	-2143
1. Financial	-211	-427	-787	-918	-1070	-1202	-1183	-1692	-1675	-1976	-2087	-1832	-1708	-1850	-	-1778
2. Non-Financial	137	-204	-191	-755	-913	-954	-1061	-791	-431	-594	-364	-478	-392	-428	-	-365
C. Transfers	165	242	169	164	299	481	785	1001	964	899	1027	1697	1636	1123	-	1150
II. Capital Account	945	1916	1964	1138	944	2220	1078	-9	965	484	-173	-782	536	1142	-	1197
A. Long Term Capital	815	1641	1616	1528	1822	2350	2628	185	881	659	183	145	274	826	-	1000
1. Investment	48	226	330	512	558	1015	592	335	186	547	471	433	722	634	-	800
Direct	51	228	337	514	581	1016	562	287	188	547	471	433	722	634	-	800
Portfolio	-3	-2	-7	-2	-3	-1	30	48	0	0	0	0	0	0	-	0
2. Debt Contracted	807	1384	1280	1016	1264	1341	2038	-150	675	112	-207	-288	-448	182	-	200
3. Contributions to Intern. Organiz.	-40	31	-4		0	-6	-3	0	0	0	-81	0	0	0	-	0
B. Short Term Capital	130	275	348	-390	-878	-130	-1550	-194	104	-175	-356	-927	262	142	-	352
III. Errors and Omissions	186	48	220	32	-137	-311	-129	-82	-301	-277	282	253				
IV. Change in Net Reserves	1235	214	-739	-1812	-1283	547	1135	-28	380	57	731	1975	1347	690	-	838
V. Net Reserves	5416	5630	4891	3079	1796	2343	3478	3450	3810	3867	4598	6573	7920	8610	-	8759

Source: National Planning Department, Banco de la Republica and FEDESARROLLO

controls.

Additionally, recent studies⁴ have found that interest rate differentials and exchange premiums, defined as the difference between the official (state regulated) dollar and the black market dollar, which existed at the time attracted a large amount of capital. The flows in turn reinforced these differentials, by bringing about revaluation expectations, which made the Central Bank's stabilization efforts even more difficult. Still, these changes cannot explain the majority of new capital inflows, which leads one to conclude that, in large part, they are due to such factors as the recent world recession and increased confidence about the future of the Colombian economy.

Another factor which is worth pointing out is that, contrary to what occurred before the Latin American debt crisis, when capital inflows were corresponded almost exclusively by massive current account deficits, recent inflows have resulted in an important accumulation of international reserves. These have reached levels which, for non-boom periods, are unprecedented in Colombia's history.

4.1.3 Policy Reactions to Recent Capital Inflows

There has been a great deal of controversy in developing countries over the past decades with regard to what should take place first, commercial, liberalization or financial liberalization. Many economists⁵ have argued that commercial liberalization should take place some time before its financial counterpart for, otherwise, the capital inflows brought about by the latter can lead to an appreciation that hurts the tradable sectors and thus jeopardizes the commercial liberalization.

While this is true, its long-run effects can be counterbalanced if the inflows of capital, and the subsequent deterioration of the current account, translate into greater capital imports and other forms of investment. In this manner, the commercial liberalization process can be made successful in the long-run through increases in productivity. There is evidence that

⁴ See: Cardenas and Barrera, 1993.
Correa, Patricia. "Paridad Entre la Tasa de Interes Interna y Externa: Notas sobre el Caso Colombiano." *Coyuntura Economica*. Abril, 1992.

⁵ Among them: Edwards, S. "The Order of Liberalization of the External Sector in Developing Countries." *Princeton Essays on International Finance* #156. 1984.

financial liberalization has an expansionary effect on investment⁶. Thus, in assessing capital flows in the current Colombian context we find a conflict between their noxious effects on exports and their positive effects on investment. Macroeconomic policy in the face of such flows then aims to absorb them, channeling them into investment, while preventing harmful real appreciations.

In the end, the crucial factors in determining the possible positive or negative long term effects of capital inflows, and the manner, if any, in which they should be sterilized, is where they originate from and how permanent they will be. In other words, if capital flows are largely speculative, or otherwise volatile, they will do far more in terms of revaluation than in increasing investment, while more permanent inflows will have a more positive effect on investment. In the Colombian case, however, there exist a tremendous amount of controversy with regards to where the recent inflows have originated. Some posited explanations include: a strengthening of drug traffick revenues, a weakening of the same, the world recession and low international interest rates, Colombia's structural reforms and the previously mentioned interest rates differentials.

Despite these difficulties, the *Banco de la Republica* has recently employed several policy instruments in order to "sterilize" capital inflows. These include the use of exchange certificates, described above and more fully in Chapter 2, which allow the market a greater say in determining exchange rates while still allowing the monetary authority to control the general exchange rate trends. In synthesis, they serve both as an instrument of monetary sterilization and of foreign exchange intervention.

A second sterilization method used by the Central Bank was the issuing of interest bearing bonds. This move, however, is both limited and costly, as it can bring about increases in domestic interest rates, which in turn stimulate capital inflows, and lead to large quasi-fiscal deficits, originating from the difference between the rates of return of the bonds issued and those of the Central Bank's own foreign reserves.

Finally, both fiscal policy and the commercial liberalization timetable have had to adapt in efforts to stabilize the recent capital inflows. On the one hand, as was mentioned above, the commercial reforms were dramatically accelerated in 1991 because expectations of lower future import tariffs were resulting in massive reserve accumulations. As for fiscal accounts, they were

⁶ See: Zaidi, I.M. "Savings, Investment, Fiscal Deficits and the External Indebtness of Developing Countries." *World Development*. 13:5, 1985.

adjusted to reduce the inflationary, and thus appreciatory, effect of fiscal deficits on the economy.

As a final note, one must point out that, to a large extent, this series of policy measures has succeeded, for large appreciations have been avoided, as shown in Graph 4.1, at the same time that the inflation rate has been reduced from a historically high rate of 32% in 1990 to 21.4% in 1993.

4.2 DIRECT FOREIGN INVESTMENT

Both historically and in recent years, direct foreign investment has been relatively sparse in Colombia compared to that in other Latin American countries. When compared to such countries as Argentina and Chile, recent increases in direct investment into Colombia have been significant, but not nearly as large as those in the countries of the southern cone or Mexico. Part of the reason for this is that the Colombian privatization process, described in Chapter 6, is only just beginning, and advances have been limited up until this point. Thus, one can expect that foreign investment inflows will continue to increase in coming years. Another factor which has limited the entry of DFI is that Colombia's foreign debt has never been as great as in other Latin American countries, so that it was never necessary to carry out debt-for-capital conversions.

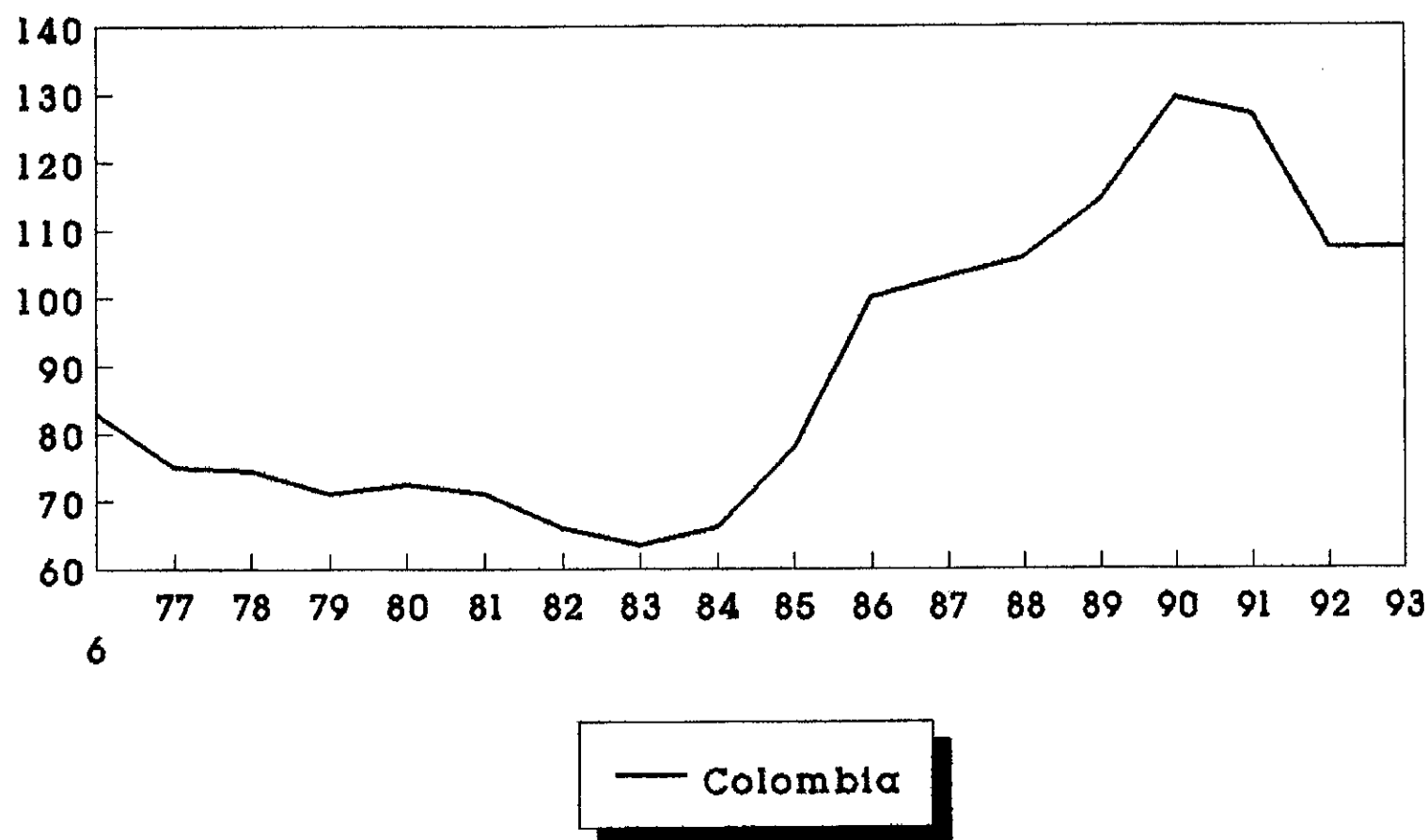
Additionally, Colombia's structural reforms are relatively recent, with foreign capital gaining equal status only between 1991 and 1992. As these reforms take hold both domestically and internationally, they will encourage greater levels of foreign investment. Another important factor in the future of Colombian capital inflows which goes hand in hand with the structural reforms is regional integration, especially with Venezuela (See Chapters 2 and 3). Over the past two years, Colombia has received over US\$ 50 Million in investment inflows from the neighboring country, while Colombian investment in Venezuela underwent a 60% increase between 1992 and 1993.

Still, the recent flows of DFI (Graph 4.2) have been significant from Colombia's standpoint, and the impact they have had, and will continue to have, on the country's economy cannot be denied.

4.2.1 Foreign Investment in the Petroleum Sector

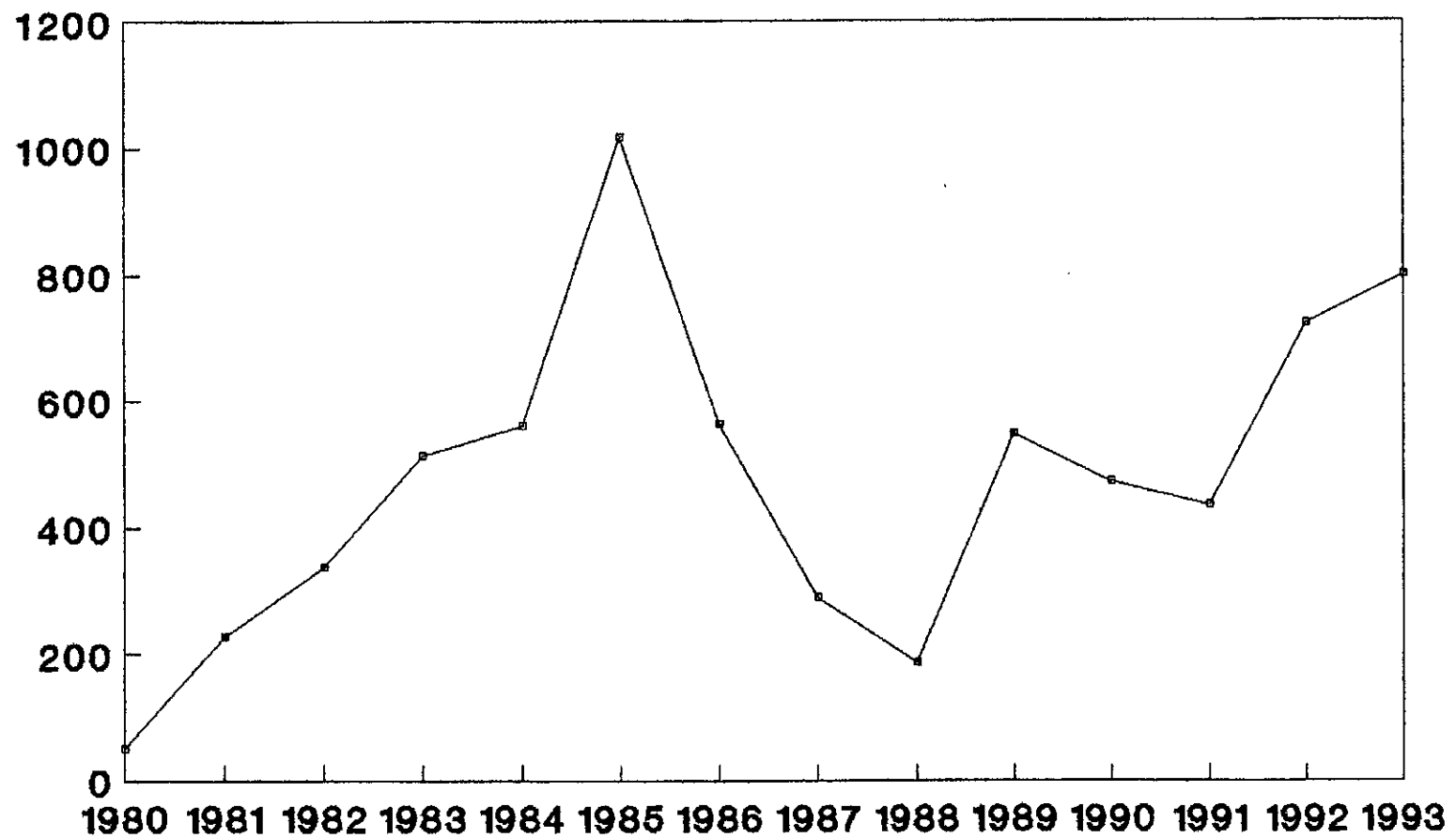
Historically, around 75% of foreign investment in Colombia has taken place in the oil sector. If one observes past trends of DFI, one finds that the historical high, US\$ 1,015 Million in 1985, coincided with the most important period in the development of the *Caño Limon* field. As Graph 4.2 shows, DFI trends are largely

Graph 4.1
Real Exchange Rate Index
(1986=100)



Source: Coyuntura Económica

Graph 4.2
Direct Foreign Investment
Millions of US\$



Source: National Planning Department

determined by the trends of foreign investment in petroleum. It is interesting to note, however, that DFI in other sectors has also loosely followed DFI in petroleum, tending to be helped rather than hurt by increases in the latter.

Foreign investment in the petroleum sector will tend to increase at least until 1997, and probably long into the future, with the development of such large new fields as *Cusiana*, *Cupiagua* and *Volcaneras*. Furthermore, recent studies⁷ have found that large oil discoveries, by improving the assessment of a country's oil riches and thus exploration levels, lead to greater future discoveries. Thus, it is very possible that Colombia's oil sector, and DFI in it, will continue to grow in size and significance well into the coming century.

A complete description of Colombia's petroleum sector and the rules governing private investment and exploration can be found in Chapter 6.

4.2.2 Direct Foreign Investment in Other Sectors

Other sectors which have been favored recently by DFI can be seen in Table 4.2. It is interesting to note how much they have changed from year to year. In 1990, as had mostly been the case up to that point, the coal industry drew the most investment, US\$46.2 M, followed by sectors surrounding the oil industry. This changed radically in 1991, when far more investment went to manufacturing sectors, a change spearheaded by new investments in the automobile industry, US\$ 54.0 M, especially by Japanese firms. 1992, in turn, was characterized by investments in Investment Funds, US\$ 86.5 M, and in such areas as Real Estate and Construction. It is interesting to note that, between 1991 and 1992, the financial sector has received a steady stream of investment, US\$ 24-25 M, much of it from Venezuela.

Historically, the most important source of foreign investment has been the United States. It has long invested the greatest amount of capital year after year, with the exception of 1991 which was characterized by the afore-mentioned boom in Japanese investment. Another interesting new development is the increased investment on the part of Venezuela, as mentioned above.

4.2.3 The Stock Market

The eighties were not a good decade for the Colombian Stock exchange, as shown in Graph 4.3 and 4.4. In fact, despite its

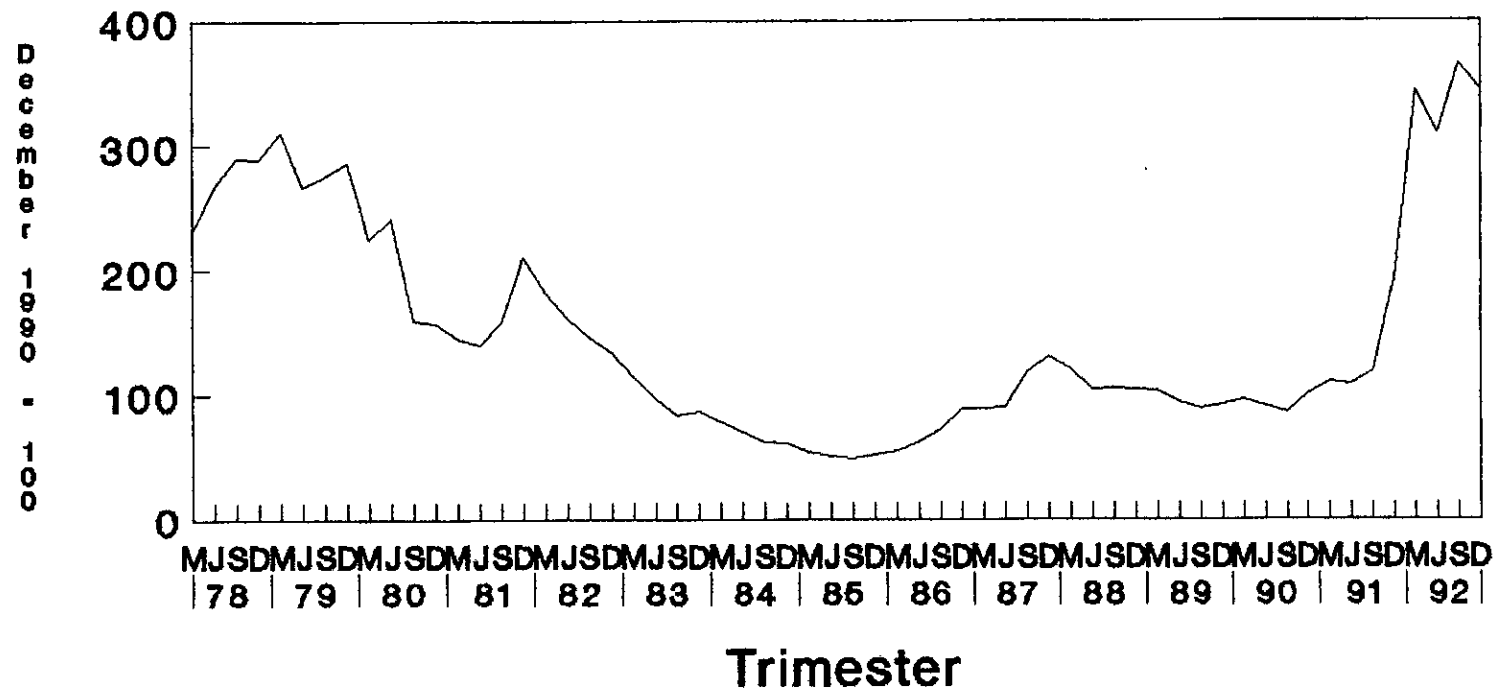
⁷ See: Lora, E., Perry G. and Barrera, F. *Macroeconomic Policy and the New Oil Revenues*. FEDESARROLLO. Bogota, Colombia, 1993.

Table 4.2
DIRECT FOREIGN INVESTMENT IN NON-OIL SECTORS
(MILLIONS OF US\$)

	Amount	%
1990		
TOTAL	195.7	100.0
Coal Mines	46.2	23.6
Oilducts and Gasducts	42.5	21.7
Automobile Manufacturing	20.8	10.6
Retail	17.8	9.1
Paper Industry	14.6	7.5
1991		
TOTAL	197.3	100.0
Automobile Manufacturing	54.0	27.4
Financial Entities	24.1	12.2
Farmaceutical Industry	16.8	8.5
Vegetable Oils	8.6	4.4
Textile Fabrics	7.9	4.0
1992		
TOTAL	307.7	100
Investment Funds	86.5	28.5
Financial Entities	25.3	8.2
Real Estate	20.2	6.6
Construction	19.4	6.3
Retail	18.9	6.2
Insurance	16.8	5.5
Annual Growth Rates		
1990/91		0.8
1991/92		56.0

Source: National Planning Department, Banco de la Republica and FEDESARROLLO

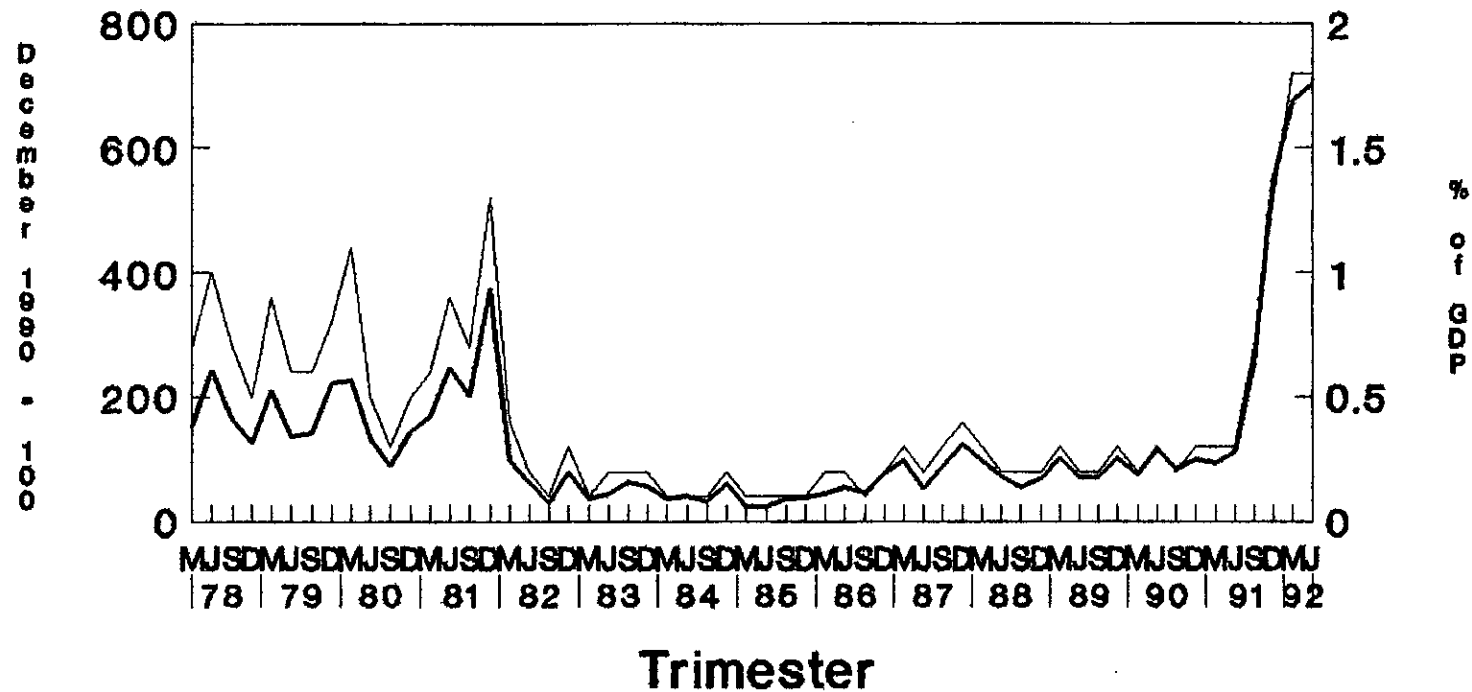
Graph 4.3
Bogota Stock Exchange Index
(Index Dec90=100)



— Stock Exchange Index

Source: Cardenas and Barrera, 1993

Graph 4.4
Stock Exchange Transactions
(Real Value, Index Dec90=100)



— Real Value Index — % of GDP

recent, and continuing, strengthening, it continues to be very small by international standards, having yet to recover from the 80's crisis, when stock transactions got to be only 0.1% of GDP. This crisis ran parallel to the financial crisis of the early eighties. Both sectors were rife with irregularities and corruption, and it was to a large extent the same people whose profiteering led to both crises.

Even after the crises, the market's credibility was so hurt that it did not begin to recover until the early 90's boom, which was brought about partly by the repatriation of capital, direct foreign investment and other capital flows, and, more recently, by falls in interest rates. The real value of stock transactions has increased almost seven-fold, and they now represent around 1.8% of GDP. This number is still small by any standard, however, and value increases have been largely nominal up until this point, resulting only in minimal increases in the real capital stock. Still, one can expect that the renewed confidence it now enjoys will in the future make the stock market a major engine of economic growth.

4.3 EXTERNAL DEBT⁸

4.3.1 A Short History of Colombia's External Debt

Colombia has a tradition of fiscal discipline which is unmatched in Latin America. As a result of this, and of its effective and diversified debt management, it managed to avoid the full effect of the debt crisis suffered the rest of Latin America during the 80's. It was, in fact, Colombia was the only Latin American country which did not default on its payments once during the crisis. Instead, it globally refinanced its debt through consultations with representatives of the banks it owed money to. These welcomed Colombia's efforts to stay abreast with its debt payments, and together four integrated credits were produced which allowed Colombia to overcome the crisis without major problems.

A large part reason for which Colombia succeeded in overcoming the crisis, besides lower debt levels, was its very diversified debt structure, the most diversified in Latin America at the time. As table 4.3 shows, Colombia was never too dependant on commercial banks for financing, and it has been transforming its debt structure so as to be less and less dependant on them, through greater loans from Multilateral organizations like the World Bank and the Interamerican Development Bank, as well as new instruments like Government Bonds. It is also worth noting that, while

⁸ From: Castellanos, Jorge. "Hacia una Nueva Estrategia del Manejo del Credito Publico." *DEBATES DE COYUNTURA ECONOMICA* No. 28. FEDESARROLLO and FESCOL, 1993.

Table 4.3
COLOMBIA: PUBLIC FOREIGN DEBT INDICATORS, PARTICIPATION BY SOURCE
(Billions of US\$)

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992
Total Foreign Debt	5.8	6.6	8.0	9.5	11.4	14.0	14.1	14.2	14.2	14.6	14.9
Multilateral Organisms	1.9	2.0	2.4	3.4	4.2	5.9	5.8	5.8	5.9	6.2	6.2
	32%	31%	30%	36%	37%	42%	41%	41%	42%	43%	42%
Commercial Banks and Investors	2.5	2.9	3.5	3.6	4.5	4.7	4.9	4.8	4.9	4.8	4.6
	44%	45%	44%	38%	39%	33%	35%	34%	34%	33%	31%
Bonds					0.1	0.1	0.1	0.3	0.3	0.4	1.2
					1%	1%	1%	2%	2%	3%	8%
Others	1.4	1.6	2.0	2.5	2.7	3.3	3.2	3.2	3.1	3.1	2.9
	24%	24%	25%	26%	23%	24%	23%	23%	22%	22%	19%

Source: Banco de la Republica and General Public Credit Administration

Colombia's debt levels have never been overly high, they have been stabilizing over recent years around US\$ 14 Billion.

4.3.2 Present Goals for Foreign Debt Management

Colombia's new foreign debt strategy is influenced by two major considerations. First is the above mentioned increase in capital inflows, which has led authorities to consider reductions in external debt, which would be replaced with greater levels of internal debt. On the other hand, there is the historic scarcity of external financing, which points to the necessity of developing new sources of such financing. While these factors may seem contradictory, and indeed both have different aims, strengths and weaknesses, they have together allowed the Government to develop a strategy which seeks to ensure the external financing the Government might need in the future without aggravating the present capital inflow situation. There are four major individual goals that must be achieved if the strategy is to succeed:

4.3.2.1 Diversifying the Sources of External Financing

By working towards this goal, the Government seeks to reduce the financial restrictions which have historically limited the country's growth, especially in the face of the uncertainty surrounding the permanence of recent capital inflows. Colombia's history demonstrates the value of having a diversified debt structure. A further advantage of having access to a broader range of sources of financing is that this translates into lower financing costs and savings for the country, as there must now be competition between the different sources.

4.3.2.2 Development of the Stock Market

The development of the stock market is vital for Colombia's modernization and future economic development. Not only would it make the investment process more efficient, but it would also have a positive effect on public financing. Because of the lower country and exchange risk premiums, domestic financing would in the long run offer lower interest rates than foreign financing.

4.3.2.3 Improving the Current Debt Situation

The fulfilling of this goal involves not only pre-paying debt but also changing the general debt structure so as to move away from more costly loans into cheaper ones. Additionally, the Government seeks to introduce technical improvements that stabilize debt servicing in advance, thus improving the country's payment capacity. The ultimate objective of these moves is to preserve the integrity of development plans by preventing sudden increases in debt servicing charges which can cause the interruption of planned investments.

4.3.2.4 Establishing New Mechanisms of Direct Credit

By issuing interest bearing bonds which are sold directly to investors, the Government not only diversifies its debt structure but also makes the financing process more efficient. Recent moves in this direction have included the issuing of dollar denominated bonds and "Eurobonds", in diverse markets throughout the world.

**PRESENTATION OF COLOMBIA TO THE
INTERNATIONAL COMMUNITY**

STATE MODERNIZATION REFORMS

September 1993

CHAPTER 5 STATE MODERNIZATION REFORMS¹

Contrary to what occurs in many developing countries, both in Latin America and elsewhere, the presence of the State in the Colombian economy is not excessive. As a matter of fact, the Colombian government has traditionally been one of the smallest in Latin America (see Table 5.1). Parallely, a privatization process is not a necessity in generating resources to cover fiscal gaps. The problem in Colombia, more than the size of the State, is its inefficient and often misguided performance. As a result, action has been taken in recent years in order to eliminate the deficiencies which the government has shown in the past.

5.1 PUBLIC FINANCE AND FISCAL REFORMS²

5.1.1 A Balanced Budget

The Colombian Economy's situation varied significantly during the decade of the eighties. An initial attempt at liberating imports during the 70's lead to a sudden influx of foreign goods that displaced domestic industries and increased foreign currency outflows. Additionally, the Latin American debt crisis lead to the closing of neighboring countries' market. Simultaneously, the government had been expanding, especially in the area of public, investment, while state revenues lagged behind. The result were fiscal deficits which oscillated between 6.5 and 8% of GDP between 1981 and 1984. As a result, the first part of the decade was characterized by a fall in industrial production, while GDP grew only an average of 2.2% annually between 1981 and 1983 and foreign reserves fell progressively (see Table 5.2).

The country then adopted a severe adjustment program in consultation with the International Monetary Fund. Thus, a plan was put into action in 1985 under which the real exchange rate was depreciated 20%, public expenditure was reduced, public sector salaries were increased at a rate lower than the inflation rate and indirect taxes were broadened. These adjustments not only helped Fiscal accounts but also the Current Account, which went from registering a U.S\$ 2,826 Million deficit in 1983 to a US\$ 463 M surplus in 1986.

¹ See also: President Cesar Gaviria. Report to Congress. Presidential Publications. Bogota, July 20, 1993.

² See also: Bernal, Joaquin. "La Política Fiscal en los Años Ochenta." Ensayos Sobre Política Económica. Junio, 1991. Banco de la República, Bogotá.

Table 5.1
TOTAL GOVERNMENT EXPENDITURES (% OF GDP)

	1970	1980	1982	1984	1986	1988	1989	1990
Argentina	10.5	20.8	22.9	19.9	23.1	15.8	13.0	NA
Brasil	17.3	20.2	20.9	20.6	27.9	31.4	34.7	33.8
Colombia	9.9	13.4	16.0	15.2	13.3	13.7	14.3	NA
Chile	20.3	28.0	34.1	32.6	29.9	29.9	NA	NA
Mexico	10.9	17.5	30.0	22.9	28.8	27.1	23.3	NA
Peru	17.5	19.3	17.6	18.2	16.1	12.2	11.5	14.7
Venezuela	18.8	22.0	29.0	20.3	21.4	27.2	22.0	22.4

Source: International Monetary Fund

Table 5.2
COLOMBIA: SOME ECONOMIC INDICATORS (MILLIONS OF US\$)

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
Fiscal Deficit/GDP*		3.0	6.5	8.0	7.9	7.0	4.0	-0.8	1.2	2.1	1.9	0.4
GDP % Growth	5.0	3.2	1.5	2.3	3.0	3.6	3.8	6.9	5.6	4.2	3.5	3.7
Inflation	24.7	26.5	27.5	24.5	16.5	18.3	22.3	21.0	24.0	28.2	26.1	32.4
Real Exchange Rate Index (1975=100)	81.7	83.5	81.6	75.6	73.8	79.9	91.4	108.5	111.2	111.2	120.1	135.8
Public Social Expenditure/GDP		7.45	8.08	8.14	8.8	8.04	7.75	7.43	7.21			
Current Account		104	-1722	-2885	-2826	-2088	-1586	463	-21	-215	-188	2474
Net Reserves	4106	5416	5630	4891	3079	1796	2343	3478	3450	3810	3867	6573

* Note: a negative number indicates a surplus
Source: CEPAL, DANE, Banco de la Republica

5.1.1.1 The Fiscal Situation Before 1986

The factors which contributed to the tremendous fiscal deficits of the early 80's were many and diverse. Initially, they mainly included an ineffective national tax system, a lag in the prices of public services and of such key products as gasoline and agricultural products with respect to their supply costs, excessive levels of current state expenditures (which rose by 2.4% of GDP between 1980 and 1984), and a progressive increase in public investment.

Even once the magnitude of the problem became apparent, further difficulties continued to plague attempts at a more balanced budget. For one, it was difficult to cut back on large investment projects which were already well underway. Additionally, there was the problem of balancing investment projects' maturity periods with the time-tables of the foreign debt flows used to finance them. The latter problem, and others as well, were aggravated by the ineffective transference of information within the government itself, which led to a severe lack of coordination within its different branches.

The one thing which most clearly sets the late seventies and early eighties apart from any other in Colombian history, however, was the ample access to external financing which Latin American countries then enjoyed. The traditional limits which small domestic financial markets and very closed external capital markets placed on public debt, and thus on fiscal deficits, were severely reduced in 1979 when the central government began to freely access an international financial market which had become increasingly active since the first "oil shock". This new financing mechanism allowed internal saving to be substituted by external saving, so that public expenditures were allowed to grow at a rate far greater than that of public revenues.

Thus, tremendous fiscal imbalances were added to the above described problems in the external and industrial sectors. Since it was assumed that efforts in the latter area would take more time to bear fruit, and an initial attempt to solve the foreign sectors problems between 1982 and 1984 almost depleted Colombia's foreign reserves, the government realized that it was vital that action be immediately taken to solve the public sector financial crisis, which had been brought to a head by the Latin American debt crisis. Not only was it expected that fiscal readjustments would have significant positive effects on the economy in the short term, but it was also believed that such reforms were vital if other policies were to have any credibility.

5.1.1.2 The Reforms 1983-1986

The reforms which the Colombian government undertook during the mid-eighties to improve its fiscal situation aimed to do so through two basic means: increasing its revenues and decreasing its expenditures.

While these may at first seem quite simple, straight-forward and even obvious, they were in practice not only vital but also complex.

5.1.1.2.1 Revenue Reforms

Few periods in Colombia's history include so many or such broad reforms to the tax system as do the eighties. These were aimed, primarily, at increasing the tax base and the level of state revenues and, to a lesser degree, at making the administration of taxes more efficient and fair.

As can be seen at the bottom of Table 5.3, the first half of the eighties was characterized by a severe drop in the Government's current revenues. These went from representing 11% of GDP in 1980 to only 7.8% in 1984. While the general slowdown of the economy contribute to this drop, other factors like the relaxation of administrative controls and an increase in tax evasion levels also had a profound impact. The foreign exchange crisis of 1983-85 made this even more acute, for broad quantitative controls on imports were established, and tariffs on foreign goods, which had been one of the only sources of state revenues which had remained strong, began collecting far less.

The first measures towards reducing tax evasion were taken in 1984, when most income taxes began being collected through a "withholding at the source" system, whereby taxes were collected at the very moment when people received their salary. This greatly simplified and stream-lined the tax-collection system, while allowing a large proportion of the tax-paying population to be exempt from the necessity of presenting income declarations. Sales taxes were also reformed, with the taxable base being broadened to include not only manufacturing sales but also retail sales and many services. Thanks to this reform, revenues from sales taxes also increased from 1% of GDP in 1981 to 2% in 1985. The strength of tariff revenues was also increased as a result of the substantial depreciation of the *peso* which was carried out as of 1985 and the removal of various non-tariff barriers to imports.

Besides increasing state revenues, these reforms achieved a second, equally important goal: they made the tax system more equitable and neutral, the latter meaning that its impact on the decisions of economic agents was reduced. On the one hand, a large number of tariffs, exemptions and deductions were eliminated, making the system more equitable both vertically and horizontally. On the other, tax levels for all companies were equalized, and the double taxing of company revenues (i.e. the taxing of both revenues and dividends) was eliminated. All this at the same time that traditionally state-owned companies such as ECOPETROL (the state petroleum company) became taxable, thus making competition between public and private agents fairer.

5.1.1.2.2 Expenditure Reforms

Table 5.3
COLOMBIA: STATE INCOME STRUCTURE (%)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993p
I. Current Revenues	85.3	84.6	88.2	79.4	61.8	69.3	72.0	79.6	77.6	75.3	73.4	73.2	68.6	70.0
A. Taxes	82.2	81.0	84.0	73.2	68.0	62.9	63.3	72.0	72.8	71.2	66.6	67.8	66.4	62.8
1. Domestic Economic Activity	40.4	41.4	45.3	40.4	43.1	42.6	39.6	42.6	45.0	45.2	43.3	51.8	46.6	60.8
Income and Complementaries	23.8	25.4	24.8	21.2	20.2	19.3	19.4	23.2	26.1	26.6	26.2	33.9	27.4	30.6
Sales Tax on Domestic Goods	9.3	7.2	12.2	10.8	14.7	14.6	12.6	12.9	13.2	13.7	12.6	12.9	13.3	15.0
Fuel Tax	6.0	6.7	8.3	6.6	6.3	6.6	4.8	4.9	4.4	4.6	4.3	3.9	3.9	4.3
Others	2.3	2.1	2.0	1.7	1.8	3.0	2.8	1.6	1.3	1.5	1.2	1.0	0.9	0.9
1. External Economic Activity	41.8	39.7	38.7	32.8	14.9	20.3	23.7	29.6	27.8	26.9	22.2	16.9	10.9	12.1
Taxes and Fees on Imports	19.7	18.6	18.6	17.0	14.4	18.4	20.7	27.8	26.2	24.4	21.0	14.9	10.9	12.1
Coffee Taxes	0.0	0.0	0.0	0.0	0.6	1.9	3.0	1.7	1.6	1.6	1.9	1.0	0.0	0.0
Others	22.1	21.1	20.2	16.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
B. Non-Tax	3.1	3.6	4.1	6.3	3.6	6.4	8.7	7.6	4.7	4.2	7.8	5.6	12.1	7.2
1. Transfers From Coffee-Growers and Ecopetrol	0.0	0.0	0.0	0.0	0.0	0.0	2.0	2.6	0.2	0.0	0.0	0.0	0.0	0.0
2. Others	3.1	3.6	4.1	6.3	3.6	6.4	8.7	7.6	4.7	4.2	7.8	5.6	12.1	7.2
II. Capital Resources	14.7	16.6	11.8	20.6	38.4	30.7	28.0	20.4	22.5	24.7	26.6	26.8	31.6	30.0
A. Domestic Credit	0.1	1.6	4.8	16.0	27.7	19.6	13.6	6.3	3.8	1.4	3.9	0.4	4.9	17.1
B. External Credit	10.4	10.9	6.6	1.3	10.2	11.0	13.6	10.4	14.7	16.9	14.2	9.3	16.0	6.7
1. IDB Resource	NA	1.3	0.8	0.6	1.1	0.8	0.6	0.4	0.4	0.2	0.1	0.7	2.6	1.9
2. IBR Resources	NA	1.7	1.1	0.6	1.0	3.6	6.4	3.3	2.6	2.8	0.3	1.8	1.2	1.1
3. Debt Refinancing Loans*	0.0	0.0	0.0	0.0	0.0	0.0	3.3	2.3	6.7	7.3	6.4	3.9	1.7	0.0
4. Others	NA	7.9	4.6	0.1	8.0	6.7	3.4	4.4	6.0	6.6	7.6	2.8	9.6	2.7
C. "Balance" Resources	4.1	3.1	0.6	4.3	0.5	0.3	0.8	3.7	4.0	3.0	2.6	2.6	1.6	0.0
	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.4	6.1	14.6	10.0	7.1
Total (%)	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Current Revenues/GDP	11.0	11.2	11.2	9.7	7.8	9.4	10.2	10.9	11.7	11.4	11.8	13.3	13.9	NA
Capital Resources/GDP	1.9	2.1	1.6	2.6	4.9	4.2	4.0	2.8	3.4	3.7	4.3	4.9	6.4	NA
TOTAL/GDP (%)	12.8	13.2	12.7	12.2	12.7	13.6	14.1	13.7	15.1	15.1	16.1	18.2	20.3	NA

p = programmed

* Includes the Jumbo, Concorde, Challenger and Hercules Credits

Source: Contraloría General de la Nación

The first division of state expenditures which was reduced as part of the deficit reduction effort was that of expenditures on the functioning of the State itself. During the early eighties, salaries in the Central Government rose, on average, 8% annually in real terms. This was only one of a group of factors, which also included an increase in Government payrolls and in transfers to other areas of the public sector, which lead to an overflow of public expenditure. According to a study by economist Joaquin Bernal, the State's functional costs rose from 6.4% of GDP in 1978 to 7% in 1980 and 8.6% in 1984.

Thus, it became vital that these excessive expenditures be curbed. In order to achieve this, the State's payroll was temporarily fixed, while public sector salaries' yearly raise took place at rates lower than the inflation rate. This method of reducing payroll costs was used repeatedly throughout the decade but, while such expenditures dropped from 6.8% of GDP in 1982/84 to 5.3% in 1988/89, the rise of public sector pension plans with broad, often ridiculously excessive benefits (see below), has curbed the effectiveness of this measure to reduce overall state costs.

Another area of state expenditures which was reduced was that of state investment, though its reduction was postponed until several large projects, such as the *El Cerrejon* coal mine and several oil fields and electric plants, were completed, for these were vital to the nation's future development. From that point forth, tremendous efforts were made to increase government saving, efforts which were aided a significant export boom during the latter half of the decade.

These reforms, added to other more directly administrative changes which made the entire system more efficient, allowed the government to go from an 8% fiscal deficit in 1982 to 0.8% surplus in 1986 and very moderate deficits in subsequent years, while GDP rose at an average annual rate of 5.4% between 1985 and 1987 and per-capita GDP rose 3.4% annually on average during the same period. This successful handling of its early 80's fiscal crisis is perhaps the one thing which most clearly set Colombia apart from other Latin American countries during that decade.

5.1.2 Tax Policy and Revenues

5.1.2.1 The 1992 Tax Reform

Economic liberalization has been the focus of the current administration's economic policy and its potential positive effects on efficiency and economic growth in the long run are enormous. In the short run, however, the reduction of import tariffs has a very harmful effect on the state's income structure. As shown on table 5.3, the percentage of State income originating from external economic activity went from 29.5% in 1987, and 41.8% in 1980, to only 10.9% in 1992.

According to the government, the reform of the Colombian tariff structure cost 1.1% of GDP in lost resources during 1992. Thus, it became vital to compensate for these lost resources with the collection of greater amounts of resources originating from domestic economic activity. Thus, the income tax, sales tax and gas tax regimes were reformed as part of the 1992 tax legislation reform, at the same time that tax-evasion legislation was strengthened. These changes are discussed below. The other major change introduced by this reform, which concerns tax regimes for state sub-regions, will be discussed subsequently.

With regards to income taxes, the principal changes concerned the broadening of the tax base and the equalizing of the regime for foreign investors. With regards to the first aspect, all industrial and commercial State companies are now taxable, as are mixed-economy and non-profit corporations. With regards to the latter aspect, the special tax on dividends and participations of non resident foreigners, as well as that on profit remissions, will be gradually reduced until 1999 and completely eliminated in the year 2000. Furthermore, technical assistance services by foreign individuals and companies will be exempt from income and remission taxes, as an incentive for greater transfers of technology into Colombia. Finally, a special, temporary surcharge on income taxes, which will be in place for ten years, was put into place, though it allows for special deductions for companies and individuals who invest significant proportions of their income³.

With the new sales tax reform, all goods and services would be subject to an equal tax save the following:

- Basic consumption goods: agricultural goods in a natural state, powder or pasteurized milk, vegetable oils, coffee, medicine for humans, etc.
- Beer, liquor and cigarettes, which would be subject to departmental taxes in the 30-50% range.
- Certain services, such as health, certain types of transportation and public services other than telecommunications.

Additionally, as an incentive to investment, the sales tax on capital goods will be transferable into a tax credit.

Finally, the *ad valorem* gasoline tax was set at 27% and it is programmed to increase gradually until 1996, when it will reach 35%.

³ For further information on the tax regime for foreign investors see: Business Guide for Foreign Investment in Colombia. National Planning Department of Colombia and KPMG Peat Marwick. 1993.

And with regards to tax evasion, new frauds were criminalist and investigation, sanction and control mechanisms were strengthened.

Additionally, and as part of the general decentralization effort, the reform advanced the cause of fiscal decentralization, establishing a general framework of regional taxes aimed at giving more autonomy, and more responsibility and accountability, to regional entities in fiscal matters. This was one of the most important aspects of the 1992 tax reform, for it paved the way for a discussion concerning regions' political, administrative and fiscal autonomy, and for an ongoing process of broadening reforms.

A final, significant reform in the area of state revenue collection has been the fusion of the tax and customs administrations, described in section 5.3, below, which has been put into action in order to simplify the revenue collection process. As a side note, it is worth pointing out that 75% of the revenues the Customs administration currently collects come from sales taxes.

5.1.3 Public Expenditure Priorities

The key term in the government's new expenditure priorities is long term investment. Colombia has come to realize that many of the development opportunities it did not take advantage of in the past, such as the inflows of resources from the different coffee booms, were lost because of economic nearsightedness. As a result, the country is embarking on a broad investment program led by the government. This program will concentrate on land and human capital investment, transportation infrastructure and environmental conservation in the former and education and public health in the latter, and investment in the petroleum sector will also increase (see Chapter 6).

5.1.3.1 The Transportation Infrastructure

If the Economic Liberalization policy is to succeed and Colombia is to continue to grow industrially and productively, it is vital to strengthen and expand the transportation infrastructure. The importance of this factor in the country's competitiveness cannot be understated, as producers and exporters realize and have repeatedly pointed out in the past.

The government realizes this, and as a result has embarked on one of the broadest infrastructure projects in the country's history. In it, not only will the road system be expanded and modernized, but the port system, traditionally the source of the country's greatest bottlenecks, will be restructured to increase competition and efficiency. Simultaneously, the country's railroads, which had fallen into disuse as a result of the past failure of a state-run railway company because of mismanagement and misdirected policies, is being restored and put back into operation. One of the most important new developments is the fact that private agents will be allowed to participate in these new projects, in carrying out projects under

contracts with government and in doing so independently with their own resources. A more complete discussion of these developments, and of investment opportunities therein, will be offered in the following chapter.

5.1.3.2 Environmental Conservation

As described in Chapter 1, Colombia is one of the environmentally richest, most ecologically diverse countries in the world, a true treasure for humanity. In order to conserve this wealth while maintaining economic growth, the government is putting a five-part strategy into action: it is creating an Environmental Ministry, it is making the environment a top priority in international relations negotiations, it is increasing the resources headed towards conservation, it is supporting and strengthening other environmental conservation organizations which work in Colombia, and it is instituting a number of specific programs aimed at improving the administration of renewable natural resources and the environment.

Since the beginning of the current administration, the government realized that greater resources weren't enough to guarantee environmental conservation, which for the first time in the country's history had been included in the nation's development plan. As a result, a legislative initiative was taken to institute the Ministry of the Environment, in order to have a central authority under which the multitude of local environmental organizations which currently exist could operate. It is expected that Congress will soon ratify this initiative, thus allowing the government to more effectively strengthen the many Autonomous Regional Corporations institutionally, technically and financially.

This ministry will handle a substantial amount of new resources. It is estimated that it will be in charge of the distribution and administration of a total of US\$ 243 Million in new resources, to be distributed within the various projects and local organizations. Additionally, Colombia has succeeded in attracting over US\$ 100 Million in international resources for environmental conservation, including negotiations whereby the U.S. and Canadian governments agreed on external debt reductions totalling over US\$ 50 Million in exchange for conservation projects.

Other national and international projects which the government is adopting and/or putting into action include: The Montreal Protocol for the conservation of the Ozone Layer, international reductions in the production of Carbon Dioxide (CO₂) in order to halt global warming, biodiversity studies and various projects aimed at preserving that diversity⁴, pollution controls for both industry and vehicles,

⁴ Colombia is, after Brazil, the most biologically diverse country in the world. One particular area, the Choco region, contains the greatest amount of different species of plants per

recycling projects, and many others.

5.1.3.3 Education

Improving the Colombian educational system is vital not only because a well educated population is a country's most valuable resource, as countries like Japan have amply demonstrated, but also because Education is one of the few ways in which the cause of equality can be advanced in an economically sound way. In an effort to achieve this goal, the government has restructured the educational system, placing greater responsibility at local levels, while increasing investment.

Important changes are being made in both elementary and higher education, the latter of which was raised to the category of public services. The autonomy of universities was guaranteed in order to allow them to function freely as motors of knowledge and progress, while the newly created National Accreditation System will ensure that all higher education institutions are responsible in achieving their objectives. Similarly, the professional character of teaching was legally recognized, though its exercise will be regulated to ensure that it is done within desirable ethical and pedagogical parameters. Perhaps most importantly, it was determined that education would not just deal with the academic but would cover the other intellectual dimensions of the human being, such as the ethical, the political and the aesthetical.

Finally, two moves were taken in very different directions as part of the general effort to improve the quality of education. On the one hand, the Ministry of Education has joined several international cooperation programs aimed at making the transference of new knowledge and technologies between countries more dynamic, as well as becoming involved in international debates about the nature and structure of educational systems. On the other hand, the autonomy of regional entities in educational matters was strengthened, thus making them more directly responsible to those to whom they render the service and improving the exchange of information and ideas between administrators, teachers, parents and students.

5.1.3.4 Health

The most important move in this area is the creation of a Social Security Health System as part of the more general Social Security reforms described in Section 5.2.1, below. This will function as a sort of national health insurance and will be based on three principles: universality, solidarity and efficiency.

In order to achieve universality, the system will be obligatory and will include family coverage. Similarly, a system of subsidies will be put into place to aid those with lower economic capabilities. Universality cannot be achieved solidarity, however, for the whole of

square meter of any region in the world.

society will have to contribute to the system, each in quantities proportional to his capacity to do so. As for the principle of efficiency, this will be achieved through decentralization and the resulting increased dynamism and accountability. Additionally, the project includes the concept of choice as vital for users both in guaranteeing their satisfaction and in increasing the system's efficiency. Through this project, it is expected that almost the entirety of Colombia's population will be covered by the year 2001, with the most needy being subsidized by state as well as aided by the contributions of their fellow citizens

5.2 LABOR REGULATION REFORMS

Colombia has a free labor market. Contracts and negotiations are usually done on an individual basis. Collective bargaining is used only by a small portion of the labor force, as union workers were only 7.8% of the total work force in 1990. In fact, the labor movement has grown notoriously weaker over the last decade.

5.2.1 Salaries and Contracts

Market forces play the vital role in the determination of salaries. Although there is a minimum salary, salaries in industry and in the modern sector of the economy are determined with relative independence from it and from government salaries.

Salary adjustments usually occur once a year. In the case of collective bargaining, salaries are adjusted every two years. The amount of the adjustment is associated with the inflation rate over the previous 12 months, a measure which aims to maintain or increase the real salary. Although the situation of the labor market does influence the percentage of salary increases, during the last 20 years the average real salary has increased at a rate of 2% per year.

In addition to the basic salary, labor law dictates several other benefits, including 15 working days of paid vacation a year, a premium of half a salary in June and another in December, and a "cesantiá" or compulsory savings for the worker which is equivalent to one month of salary per year worked and is given to him when he leaves the company or for the purchase of housing. There are other payments which must be made to social security entities, and to which the worker must also contribute. These entities are the Social Insurance, the Colombian Institute of Family Welfare, and SENA, a government entity for education and training. Total benefits are about 50% of the basic salary. Although this is relatively high, it is similar to the proportion of non salary costs to total labor costs of other countries : in 1981 it was 37% in the United States, 41% in Great Britain and 51% in Germany. It has also been estimated that these costs are similar to those in the other countries which are part of the Andean Pact.

Colombian Labor legislation was changed in 1990 as part of the

modernization effort. Labor regulations used to have rules which prevented firms from having any sort of flexibility in contracting and dismissing workers, which made it difficult for them to adjust their working forces to changing situations. As a reaction to these restrictions, companies had found ways of contracting workers that allowed them to avoid these regulations but that greatly increased the instability of employment, thus deteriorating workers' conditions and companies' productivity.

These problems were solved by the new legislation. An important change regarded the compulsory savings. Previously, all salary increases affected the savings amount, even if part of it had been already used by the worker. Due to inflation, this increased labor costs tremendously, especially in the case of employees who had worked in a company for a long time. With the new regulations, the amount saved is calculated each year and deposited in special funds for this purpose, which offer interests at least equal to those given by the financial system.

A further rule which was eliminated was one according to which, if a worker who had worked for a company for over 10 years was dismissed, he could petition through a labor tribunal to be contracted once more. Not only were the two previous policies responsible for the high rate of rotation of labor in Colombian companies, the average length of employment in the private sector being only 4.5 years, but they also led to the extensive use of temporary workers.

The new legislation makes the labor day more flexible, especially for new enterprises. It also allows companies to pay an integral salary, one that includes all non-salary payments, for high level salaries in order to reduce companies' uncertainty about labor costs.

5.2.2 Social Security

Under this initiative of state reform, one of the areas which is undergoing the greatest transformation is social security. It is probably also the single change that will have the strongest impact on the lives of Colombia's workers, and on public finances. According to the new constitution: "Social Security is an obligatory public service which shall be rendered under the direction, coordination and control of the state, according to the principles of efficiency, universality and solidarity, according to rules determined by law." The current system, however, is fraught with problems.

Social Security recipients are currently divided into two broad categories, the latter of which is divided into a myriad of minute ones. The first category is composed of those who work in the private sector and are affiliated to the Social Insurance Institute (ISS), to which they contribute throughout their working lives and, in return, receive health benefits, a disability and life insurance, and a pension upon their retirement. The second is made up by public sector workers, whose pensions come from Social Provision Funds to which they need not

contribute, so that about 80% of their pension costs are covered directly by the state, and who receive a broad range of health and other benefits from the state through the institutions they work for. It should be noted that this latter category is in fact composed of a multitude of different Social Security systems, as it is not uncommon for individual institutions to have unique pension systems. Not surprisingly, these many different regimes are full of inequalities and, as a general rule, the privileges they offer far surpass those offered by the ISS.

As was mentioned above, one of the reasons that the government's effort in the mid-1980's to reduce spending was that, at the same time that real salaries were cut and the payroll expansion was stopped, diverse, almost uniformly excessive pension regimes developed in most state companies. Corruption and injustice reached such heights that, currently, there exist public sector companies with pension regimes that allow a worker to retire, with full privileges, after working for only 12 years no matter what his age. This means that the State is, even now, paying the pensions of thirty-two year old retirees out of its budget. Simultaneously, pensions have become public sector companies' greatest expenditure requirements, with many traditionally efficient and even profitable institutions succumbing to these costs or being on the verge of doing so.

Despite the rampant inequalities of public sector Social Security systems, these do not hold the monopoly on the sector's financial troubles. As a result of both financial mismanagement and excessively low contribution levels, both because of low requirements (6.5%) and because of evasions, the ISS's reserves are rapidly being depleted, and it has in fact lost most of its capitalization characteristics, becoming a system of simple distribution. That is to say that current retiree's pensions are paid for with current affiliates' contributions. The changing nature of the Colombian work force, however, makes this system unsustainable in the long run without raising contribution rates to several times their current levels.

Some numbers alone demonstrate the demographic changes currently taking place in Colombia which threaten to plunge the ISS into a financial crisis. Between 1980 and 1989, the number of ISS affiliates grew at an average annual rate of 4.22% while the number of retirees receiving pensions from this entity rose at a rate of 13.5%. In 1980, there were over 30 affiliates for each retiree, while in 1990 the ratio was only 13 to 1. The reserve coefficient, which is defined as the ratio between the ISS's reserves at the start of each year and the cost of the pensions paid during that year, fell from 4.54 in 1980 to 1.55 in 1990. These trends will continue over coming decades, probably even accentuating themselves, making the 6.5% rate increasingly obsolete and increasing the costs of the pension system on the central government.

Thus, it is vital that radical changes be made to the Social Security system, and these reforms are taking place even now. The government has proposed a new Social Security plan, which is currently

going through congress. Its basic premise is that the pension system will be changed from one of simple distribution to one of capitalization, and that private capitalization funds will be allowed to compete with the ISS. Additionally, other, more technical changes will be made, such as raising the contribution requirement to a level between 12.5 and 13.5% of each workers salary and raising the minimum age of retirement. Additionally, the new system seeks to equalize the regime for all social security recipients, thus eliminating the tremendous inequalities described above.

While the change to a capitalization system will involve a certain amount of fiscal expenditures in the short run, as capitalization funds receive the amounts that workers have already "accumulated" in the ISS, it will be a strong investment in the long run, for pensions will be handled more efficiently and national savings will rise. A final but vital goal of the new system will be expanding Social Security's coverage, as only about 20% of Colombia's total population is covered by the current systems.

5.3 CHANGES IN THE STRUCTURE OF GOVERNMENT

Although, as was mentioned before, the state is not excessively present in the Colombian economy, it is a fact that state participation in it has been increasing over time. The participation of public investment in total Colombian investment increased from 31% in 1970 to 46%, in 1990; Government expenditures grew from 9% of the GDP in 1950 to 18% in 1990; and the state's contribution to the total national added value increased from 9% in 1950 to 21% in 1986. Still, the levels reached, with the probable exception of public investment with respect to the national total, are not particularly high by international standards.

The direct activity of the State in the economy has grown the most in the mining and quarrying sectors, primarily in the exploitation of exportable products such as coal and oil, manufacturing industries, and services like electricity, gas and water. The cases in which public activity represents a majority of the national total, however, are limited to mining and to those public services, primarily electricity, gas and water, which in Colombia are almost completely handled by the State.

The State also has a significant presence in the financial sector. Its participation increased in the first half of the 80's, when a serious financial crisis forced the Government to intervene directly in several institutions in order to limit the effects of the crisis on the system as a whole. In the manufacturing industry, on the other hand, its presence is relatively small, comprising only around 10% of the national total.

5.3.1 Objectives of Structural Reforms

Even though the size of the State is not considered a serious problem

in Colombia, there is a general agreement that the performance of the public sector is much less effective and efficient than it should be. As a result, measures are presently being taken in various fields in order to correct this problem. The principal ones are decentralization, the reduction of the official payroll, and the introduction of greater competition in areas that had long been served by State monopolies.

5.3.1.1 Decentralization

Beginning in the first half of the 80's, Colombia has undergone a rapid decentralization process. This policy aims to free the central government of a series of tasks that it does not, and often cannot, perform in an efficient way, and to transfer them to local administrations. Not only are the latter closer to the people, and can thus understand their needs better, but they are also subject to closer monitoring by their constituents. Throughout the past decade, important legislative developments were achieved in the area of decentralization, especially in what pertains to the transference of central government resources to regional entities, and in the popular election of municipal mayors. Decentralization was raised to the category of constitutional dictate in the 1991 Charter.

The main idea behind this policy is that the central government should gradually move away from most of the functions which it is executing at present. The central administration's role would now be that of general planner and supervisor, promoting competition, private enterprise and free markets, as well as establishing and enforcing clear and stable "rules of the game." The municipalities will be the principal executors in the field of public works and in the provision of basic services, and will receive financial support from the central government proportionate to the amount of resources they are able to generate on their own. Departments will plan at a regional level, and will be the executors in those cases in which the size of the project surpasses the capacities of the municipalities.(Annex 1).

This is a basic transformation of the institutions that make up the State. In all cases, the transference of tasks implies the liquidation or substantial reduction of those central institutions that were previously uncharged with them.

5.3.1.2 Greater Competition

As the distance that separates the users of public goods and services from the suppliers gets smaller thanks to decentralization, greater efficiency in the public sector's performance is expected. This, however, is not enough. The efficiency objective will not be achieved if the conditions that allow the State to occupy monopolistic positions in the supply of certain goods and services prevail, especially in the area of basic services.

Besides allowing greater room for competition, the objective is to

eliminate situations in which the government is at the same time the regulator and monopolistic agent of an economic activity. When the government has an interest in the production of a certain good and at the same time sets the rules of the game, it will probably use the latter function for its own benefit.

In fact, the plans of reform hold to the criteria that breaking the monopolies held by the state in the different markets is even more important than privatizing in itself. Whether the tasks remain in the hands of the state or are shifted to the private sector, it is essential that there be competition.

The electric sector is a good example of the problems involved in having a regulating entity subject to conflicts of interest. The company in charge of electric interconnection, Interconexión Eléctrica S.A. (ISA), was ruled in the past by a group of shareholders who were also its clients, and thus always fixed the prices for energy transfers according to their own convenience. This was one of the main causes of the sector's deep financial crisis, the chaotic state into which the electric structure descended and the severe electric rationing that the country endured between March of 1992 and April of 1993.

5.3.1.3 Reduction of State Payrolls

Apart from the decentralization process and the introduction of greater competition in the economic activities carried out by the State, a plan aimed at reducing the payroll of State institutions is currently being implemented.

Payrolls are frequently excessive, partly because offering jobs in the public sector has been one of the traditional political mechanisms to obtain votes. This type of expense is very inflexible downwardly, once again due to the political cost that laying off workers implies.

5.3.2 Reforms

Clearly, these three goals are not mutually exclusive. In fact, they tend to go hand in hand. Competition, for example, will demand that entities become more efficient, which implies both decentralization and payroll reductions. Similar relationships occur with the other two. With this in mind, the Colombian modernization initiative has been advancing at a steady pace.

Although certain limited efforts at fulfilling these three goals have been made for some time, it was not until the new constitution was drafted that the government firmly committed itself to eliminating the inefficiencies of the central bureaucracy. In adapting the public sector to the norms established by the new charter, the executive was, for a period of 18 months, given the power to eliminate, fuse and/or otherwise restructure all entities which it deemed necessary. Even

before this period elapsed, concrete action had been taken in several areas.

5.3.2.1 Some Initial Reforms

In the area of health services, the financial and administrative structure has been altered so that large hospitals will depend on the departments, while the municipalities will be responsible for health posts. This means that municipalities will generally attend minor cases while the departments handle the major ones. This shifting of duties will demand that the National Health Service, that had been designed to attend all kinds of cases, from vaccination to hospitalization, be restructured.

In education, the responsibility of hiring teachers will be shifted from the Nation to the municipalities. This, in turn, forces a revision of the Ministry of Education's tasks.

With respect to road construction, the Nation will be responsible only for those of national importance, essential to the economic liberalization strategy, giving priority to the ones that communicate the interior of the country with the ports. The regions will build and maintain their own roads. (At present, only 10% of the roads that are attended by the Nation are of national breadth.)

In these and other cases, the Nation will concentrate on general planning and control, and on the handling of credit. In synthesis, the central government should not perform tasks that others can carry out more efficiently. Both regional and private sector entities can replace the Nation in its role as executor. Tasks should be carried out by whoever is best able to respond before consumers for his actions, given some scale, operation and cost restrictions.

The electric sector, in turn, is becoming a pilot case for the new competitive scheme. The National Energetic Commission, a central entity, has been constituted and uncharged with the planning and regulation of the sector. Competition between suppliers will increase, as regional and local entities in charge of distribution will have greater autonomy in deciding who to buy energy from. This subject will be dealt with fully in the next chapter: *Sectors With Prominent Perspectives for Investment*.

5.3.2.2 December, 1992 Reforms

Even broader reforms were formulated at the end of the special 18 month term, however. Perhaps the greatest amongst these with regards to decentralization and the reduction of state payrolls was the transformation of the Ministry of Public Works into the Ministry of Transportation. This move eliminated several government agencies, most of them having to do with the building and maintenance of roads, fused others, and placed entities like "Aeronautica Civil", which is in

charge of controlling air traffic, under the new ministry. 12,000 state jobs were eliminated in the restructuring, which also paved the way for the use of private companies in the construction and maintenance of public roads.

Central government co-financing of regional and social expenditures, which in the past was managed by over a dozen inefficient and uncoordinated agencies, was also restructured into four funds. These will promote the economic and social development of the country's regions, while ensuring that this development take place in an efficient and transparent manner.

The Superintendence of Industry and Commerce was restructured to reduce regulations and unnecessary paperwork. At the same time, its basic functions were rationalized, strengthened and sub-divided into three groups: the promotion of free competition, the protection of intellectual and other property rights, and consumer protection, which includes such things as anti-monopoly legislation. These measures aim to reduce the red tape faced by corporations, strengthen fair and transparent rules of the game, and increase the positive impact of free markets on the Colombian economy, all in helping the private sector overcome the challenges and achieve the rewards implied by the liberalization and internationalization strategy.

With respect to public services, three regulatory commissions, which will function under the ministries of Communication, Mines and Energy, and Development, were created to supervise telecommunications, energy, and water and basic sanitation, respectively. These will replace the National Tariff Commission and make the regulation of these services more specialized and efficient. While the state will continue to participate extensively in these areas, its agencies will be treated more like private corporations. Those in a position to do so will compete among themselves, while others will be subject to monopoly regulations. In the area of telecommunications, the structure of Telecom, the state telecommunications company, was changed, making it a state industrial and commercial corporation and allowing it to enter into association contracts with other telecommunications companies. These measures aim to allow it to compete and adapt more efficiently in an increasingly open and dynamic sector.

ICA, a government agency involved in agricultural research and development, and SENA, a capacitation and technical education service, have been restructured. ICA has been split into a public sector, involved in epidemic prevention and control, and a mixed public-private sector, involved in agricultural investigation and technology, while SENA's regional learning centers have been given greater autonomy, allowing them to specialize according to the area that they serve. These measures aim to better accommodate the needs of the private sector and facilitate the process of industrial and agricultural adaptation and conversion, crucial factors in today's rapidly changing economy.

Finally, the customs and tax administrations were fused, a measure which streamlined and improved two government agencies which had long been known for their inefficiency and high levels of corruption. Not only did this place the collection of all state taxes and tariffs under a unified entity, but, in the public eye, it also definitely institutionalized the internationalization of the economy. As a side note, it is worth noting that the National Tax Administration's payroll has been decreased by 2,400 employees over the past three years.

These reforms both make part and are complemented by several government initiatives to reduce corruption and excessive red tape. Their purpose is not only to make the state's performance more efficient but also more transparent, as legal loopholes and other spaces which facilitate corruption are eliminated. While it will take more time before we see the impact of these reforms on state corruption, they have already helped reduce state inefficiency. The January 1993 reform reduced the number of state employees by 22,912, added to 34,164 who had voluntarily retired through a special government measure between 1991 and 1992, for a total that represents over 10% of the central state's payroll.

5.3.3 PRIVATIZATIONS

It is within this general framework of State reform that Colombian privatization initiatives should be understood. Privatizing is not an urgent fiscal need, as it was in many Latin American countries, since state deficits are under control and the sales aren't expected to draw inordinate amounts of resources. It is, however, a powerful tool in introducing greater competition to the goods and services markets, and can thus be used to bring about greater efficiency and productivity in activities that until now have been carried out by the public sector. Privatizing government entities, and allowing the private sector to participate in what have traditionally been state controlled markets, will not just help achieve the modernization and improvement of the state but will also result in an absolute improvement in the efficiency and effectiveness with which services are rendered. The specific privatization initiatives currently taking place will be discussed in Chapter 6, below.

Annex 5.1

DISTRIBUTION OF FUNCTIONS IN THE COLOMBIAN PUBLIC SECTOR

	NATION	DEPARTMENT	MUNICIPALITY
HEALTH	<p>Develop general policies</p> <p>Financially support programs</p> <p>Regulate and advice</p> <p>Promote investigation and prevention programs</p> <p>Administer "Bienestar Familiar" funds</p>	<p>Administer regional, university, and specialized hospitals. The hospitals will have administrative autonomy</p> <p>Financing with transferences from the nNation and own resources</p> <p>Some activity in the formulation of capaigns in the areas of health and prevention</p>	<p>Administer local services health posts and centers</p> <p>Health centers would have administrative autonomy whenever this were possible. Where it were not, they would be subject to local directives</p> <p>Execute health and family welfare projects</p>
EDUCATION	<p>Set general policies</p> <p>Issue technical and teaching directives</p> <p>Advice and evaluate territorial entities</p> <p>Finance and administer National University (UN)</p> <p>Transfer resources to territorial entities</p> <p>Cofinance investments</p>	<p>Prepare teachers</p> <p>Administer regional universities</p> <p>Advice and evaluate municipalities</p> <p>Participate in local investments and in the administration of services</p> <p>The SENA's activity will be decentralized at this level</p> <p>Promote athletics</p>	<p>Administer and offer pre-school, basic elementary and secondary school services, as well as technical and technological capacitation services</p> <p>Build, endow and maintain schools</p> <p>Administer school services</p> <p>Hire teachers and set salary scales</p> <p>Establish methods for the entrance and promotion of teachers</p>
WATER AND SANITATION	<p>Develop policies</p> <p>Technical and control directives</p> <p>Advice and evaluate other levels</p> <p>Establecer? los criterios para fijar tarifas</p> <p>Define credit and cofinancing policies to reduce regional imbalances</p>	<p>Advice municipalities technically</p> <p>Can help municipalities in the financing of projects and/or the administration of services</p>	<p>Plannify, program, finance and execute aqueduct and sewage projects</p> <p>Operate, maintain and adminster systems</p> <p>Individually or in association with other municipalities, creat companies or contract with the private sector for the building and adminstration of works</p> <p>Guarantee the provision of sanitation services. Set rates</p>

HOUSING	<p>Define housing and urban development policies</p> <p>Support municipalities through cofinancing credits and subsidies</p>	<p>They could concur with municipalities in the financing of projects</p>	<p>Regulate urban development</p> <p>Use their resources to finance social interest housing</p> <p>Adopt plans for the ordering of the municipality</p> <p>Set regulations for construction companies</p>
ROADS	<p>Plan, program, construct and maintain (through contracts if desired) national roads</p> <p>Define technical regulations for the construction and maintenance of other roads</p> <p>Advice, evaluate and support departments and municipalities in the construction of roads</p> <p>Establish incentives for the investment of local governments' own revenues</p>	<p>Program, build and maintain regional roads</p> <p>They could associate themselves with sectional entities or municipalities</p> <p>Manage Departmental Road Funds created with transferences from the Nation</p>	<p>Cofinance the building and maintenance of sub-regional roads</p> <p>They will count with transfers and their own resources for the financing of road projects</p>
ELECTRICITY	<p>Develop policies</p> <p>Define technical and normative rules for the generation transmission, distribution and setting of rates for interconnected services</p> <p>Responsible for the countries interconnection rates</p> <p>Regulate, advice, evaluate and control territorial and private entities in their investment projects</p>	<p>Distribution at a sectional level</p> <p>Regional interconnection</p> <p>Administer regional entities which will come from the dissolution of the ICEL</p> <p>Provide energy to non-interconnected zones through alternative generation mechanisms</p> <p>They could associate themselves w/ other departments, municipalities or private entities</p>	<p>Guarantee distribution at a local level</p> <p>They will construct the necessary infrastructure (extend the network)</p> <p>Larger municipalities could generate, transmit and distribute energy</p> <p>They could associate themselves with other territorial entities or with the private sector</p>

PRESENTATION OF COLOMBIA TO THE INTERNATIONAL COMMUNITY

**SECTORS WITH PROMINENT
PERSPECTIVES FOR INVESTMENT**

September 1993

CHAPTER 6

SECTORS WITH PROMINENT PERSPECTIVES FOR INVESTMENT¹

6.1 THE COLOMBIAN OIL INDUSTRY

6.1.1 Brief History and Present Production Levels

Petroleum exploration began in Colombia at the turn of the century. The policy of concession contracts remained in force until 1974. The average number of exploratory wells drilled per year up to the 1950's was only 10. In the late 50's and early 60's, exploration increased to an average of 30 wells a year. In 1969, Law 20 set forth the preliminary terms for "Participation" Contracts, which five years later became what are now known as "Association" Contracts, discussed below. Production increased substantially as of 1980, and exploration rose from 27 wells drilled in said year to 87 in 1988. In 18983, the *Caño Limón* Field, which added close to 1.2 billion barrels of crude to the country's reserves, was discovered, increasing the attractiveness of Colombia's oil perspectives. Now, with the discovery of the *Cusiana*, *Cupiagua* and *Volcaneras* fields, these have improved even more.

The State's own petroleum operation commenced with the creation of the National Petroleum Company (ECOPETROL), a State commercial company operating under the Ministry of Mines and Energy, in 1951. It is responsible for the investigation, exploration, development, transportation, refining and merchandising of crude oil and some of its derivatives. Ecopetrol is likewise responsible for the domestic availability of fuels and oil derivatives. The Company currently provides employment to 12.000 people directly and to another 50.000 indirectly.

In its two refineries, Ecopetrol refines 200.000 barrels a day, with an average production of:

Gasoline	35%
Intermediate Distillates	25%

¹ For further information on regulations governing foreign investment see:

Business Guide for Foreign Investment in Colombia.
National Planning Department and KPMG Peat Marwick. Bogota,
February 28, 1993.

New Opportunities for Private investment in Colombia.
National Planning Department and CONPES. March 18, 1993.

Petrochemicals	10%
Fuel Oil	30%

Despite this, the country imports 28.000 barrels a day of gasoline. The transportation of the fuel is solely Ecopetrol's responsibility.

The production of crude is divided up as follows:

Ecopetrol directly produces about 90,670 barrels a day.

Private companies produce 37,400 barrels a day under the concession system (which is now being phased out).

Under Association Contracts, they produce 343.800 barrels a day, 60% of which (some 201.000 BOPD) goes to Ecopetrol from its 40% share and 20% royalty.

Out of the foreign companies' remaining crude, Ecopetrol purchases whatever it requires for its refineries, at international prices, and the rest, some 107.000 barrels per day, is exported by the Associates. Addition, Ecopetrol exports approximately 115.000 barrels a day of its own crude.

6.1.1.1 *Cusiana, Cupiagua and Other Recent Discoveries*²

Up until 1992, Colombia had proven petroleum reserves of only 1.8 billion barrels, which would have ensured its self-sufficiency only until 1996. This all changed, however, with the discovery of the *Cusiana* and *Cupiagua*, and later *Volcaneras*, oil fields. In fact, the country's known reserves have more than doubled with the new discoveries. Located in the country's Eastern plains off the eastern branch of the Andes mountains, in the hydro-carbon rich region know as the "Piedemonte Llanero" (*Llanero* Foothills), these fields have radically changed Colombia's oil and energy outlook, as well as the perceived value of its exploration areas.

Between the two of them, *Cusiana* and *Cupiagua* hold oil reserves amounting to between 2000 and 3000 million barrels. The new *Volcaneras* field promises to expand these reserves even more, as initial tests indicates that it is at least as large as one of the other two individually. Furthermore, these fields contain very "light" crudes, which allows them to be sold at a premium because of their lower refinery costs. *Cusiana* has already gone into production, although

² See also: Perry, Guillermo, Lora, Eduardo and Barrera, Felipe. Macroeconomic Policy and the New Oil Revenues. FEDESARROLLO. Bogota, August 1993.

production levels will not be very significant in 1993. By 1995, however, the well will be extracting 175 thousand barrels a day, quantity which will rise to 712 tbd in 1996 and will be maintained at that level at least until the year 2000.

It is likely that the expansion of Colombian petroleum production could go well into the next century. Recent estimates by geological models indicated that the "Piedemonte Llanero" could well hold around 10,000 million barrels in reserves.

6.2 Investment Opportunities Upstream and Downstream

Colombia has now entered into a determined trade liberalization process, defining clear policies favorable to foreign investment and to free competition. Parallely, a privatization process is currently under way, whereby the formerly bureaucratic, intervention-minded State is transformed into a manager/director State, aimed at promoting progress in all areas.

6.2.1 Upstream

The Colombian Petroleum Association Contract is an open, general model, not negotiable in each case, which considerably expedites the contracting process. Out of a total of 71.5 million hectares of sedimentary basins, Ecopetrol has reserved 5.6 million hectares for its own exploration, while the 95 currently active Association Contracts cover a total of 14.9 million hectares. This means that 71% of Colombia's sedimentary basins are open to new contracts. The presence of Japanese and other foreign capital and undertakings in this area is very attractive from the Colombian Government's standpoint.

The foreign companies' own crude can be marketed or processed directly by the companies, with the exception of the portion that is purchased by Ecopetrol at international prices.

It is estimated that the development of the fields over the next five years will call for investments in the order of US\$4588 million, a large portion of which will go to materials and engineering, which represent further business opportunities.

6.2.2 Downstream

Among Ecopetrol's different projects there is the construction of a refinery to process heavy crudes. This project, on which the basic engineering is now completed, requires certain adjustments with respect to location and structure, principally because a greater size is desired. Recently, Ecopetrol decided that this project should be left

to the private sector to carry out and, considering the ample supply of raw materials (crude) with low transportation costs and a large and growing domestic market³, this project has enormous potential for private entrepreneurs. In fact, at a recent banking seminar, refineries were said to be the sector with the top short- and medium-term perspectives for investment. A second project, this one more intimately tied to Ecopetrol, would be the modernization of its existing refinery at Barrancabermeja.

Colombia's production of petrochemicals amounts to 200.000 tons a year, against a current domestic demand of 340.000 tons a year. The principal products are:

Low-density polyethylene	55 Ktons
Paraffins	21 Ktons
Lubricant bases	100 Ktons
Detergent bases	20 Ktons
Aromatic OILS	50 Ktons
Cyclohexane	24 Ktons

There is no valid reason why Colombia, with the largest domestic market in the Caribbean area, and with the necessary raw materials, should not have an active policy to develop its petrochemical industry. That is why the Government recently changed the rules of the game in order to provide definite support for these activities.

I cite here a recent speech by our President:

"First, the medium and long-term supply of raw materials will be ensured through supply contracts to be signed between Ecopetrol and the concerned firms. After a review of the supply of domestic requirements, we will make sure that the petrochemical industry will obtain the input required for its development. Said contracts will set forth clear, stable rules of purchase, with the consequent benefit to the expansion projects.

"Second, although the burden of the investments must be attached to the private sector, of domestic or foreign origin, one must not dismiss Ecopetrol's temporary participation on a minority basis, in the implementation of high-return projects, provided they fit within the framework of the country's petroleum policy and priorities, as approved by the economic and energy authorities. Ecopetrol, in turn, will optimize its productive process.

³ Colombia imported US\$ 238 Million worth of gasoline in 1991 and US\$ 276 M in 1992.

"Third, the prices of inputs sold by Ecopetrol to private investors shall be determined by stable, transparent methods. Generally, they will be identical to international prices. Ecopetrol, however, will initially sell certain products derived from the refining process --now used for conversion into gasoline and other derivatives-- at prices equivalent to those of these products. These prices will, at the end of a transition period, level with the international prices of the currents, i.e. their opportunity cost.

"Based on this policy, Ecopetrol is at present carrying out studies to expand its production of polyethylene and to build a Paraxylene Plant in Cartagena, designed principally to meet the demand of a future Terephthalic Acid Plant which will be erected by Monomeros Colombo-Venezolanos in Barranquilla.

"We are confident that with these rules of the game, we will receive a diverse set of projects from private investors and, in particular, an active Japanese participation.

"There is no doubt that our country is better known for its difficulties than for the opportunities it offers. Our Government, as well as the vast majority of our people, who are good and kind, are determined to overcome these difficulties, and to do so peacefully, through the greatest political transformation ever known in this country over such a short period of time.

"Some of the opportunities being offered have been presented to you today. To that I wish to add that Colombia has a history of meeting its commitments, which provides investors with the kind of assurances so necessary for any long-term plan.

"Here are the opportunities as well as the rules, and I am fully confident that the other part of the equation, namely your availability and liberalization towards us, will be equally forthcoming."

6.2 COAL AND ITS BUSINESS POTENTIAL IN COLOMBIA

6.2.1 Introduction

Colombia boasts abundant coal deposits, with a predominance of thermal coal, although there is also metallurgic and anthracitic coal.

The use of coal in Colombia goes back to before the Spanish Conquest. Our native inhabitants used coal in such activities as gold and silver smithing.

With the energy crisis of the 1970's, Colombia saw an opening for itself in becoming a significant player in the new and promising international coal market. At the same time, the country was changing from a net importer to a net exporter of hydrocarbons, which led the Government to consider the possibility of utilizing the enormous potential of our coal reserves, with an aim at diversifying the country's exports and stabilizing its balance of trade.

Accordingly, Carbones de Colombia S.A. (CARBOCOL), was founded in 1976, with the purpose of centralizing the responsibility of implementing government policy in the colombian coal sector into a single entity.

The Colombian coal industry took off in the early eighties, when the El Cerrejón complex, in northern Colombia, near the Atlantic Coast, was completed and began production. By 1991 El Cerrejón Norte had exported 54 million tons of coal, worth approximately US\$1.9 billion, to 28 countries, becoming one of the largest and most modern coal mines in the world, with full commercial success.

The development of El Cerrejón called for the Government to invest around US\$1.5 billion, which necessitated a significant rise in the level of the country's foreign debt. As a result of the size of the required investments and their maturity term, it was decided in 1988 that large new mining projects would be carried out under exploration and exploitation contracts with private firms under which the government would make no direct investments, leaving the private sector to explore and exploit at its own risk. The State receives royalties or some other form of compensation for the exploitation of its coal resources, such as investment-free stock participation, contracting premiums, profit share, contributions to the development of the region, and the right to use the ports. Three projects have now been negotiated under this policy, namely: La Loma-Boquerón, with Drummond Ltd., the Calenturitas project with Prodeco S. A., both of them in the Department of Cesar, and the Oreganal project in La Guajira, with Carbones del Caribe S. A.

6.2.2 Overview of the International Coal Market

This is a relatively new market new market which emerged as a result of the energy crisis of the 1970's. In 1990, the international thermal coal market totalled 180 million tons, produced basically by Africa (25.2%), Australia (28.2%), U.S.A. (21.8%), Colombia (7.6%), and other countries (17.2%).

Between 1990 and the year 2000, the world demand for thermal coal will grow from 180 million tons a year to 330 million. The increase in the international trade of this energy product over the next 10 years demonstrates the strength and promise of this market.

The increased demand is linked to power generation expansion plans in Europe and a 10.2% growth in the Far East market, with Hong Kong, Taiwan, Korea and Japan being the main consumers. Accordingly, by the year 2000 the Far East should become the principal world buyer of coal, with a 47% share. Colombia has also explored the possibility of penetrating Middle Eastern markets, with positive results.

Furthermore, in order for Mexico to develop its power sector, it is face with a choice between importing coal and seeking self-sufficiency through fuel oil, with dual plants. Mexico's coal demand is estimated at 10 to 15 million tons in the course of this decade.

Market prospects beyond the year 2000, while pointing towards continued growth, are uncertain since they depend on consumer countries' energy policies which are subject to environmental considerations and to technological advances in different energy sources. There is the possibility, however, of a growing world demand for coal, which could well lead to a total demanded volume of 600 million tons by the year 2010.

6.2.3 Colombia in the World Market

Colombia is one of the world's principal coal exporters, holding fourth place after Australia, South Africa and the United States. In 1990, Colombia exported 13.7 million tons, worth a total of US\$ 537 Million FOB, equivalent to 7.6% of the world's supply in said year. Export levels rose to US\$ 624 M in 1991 and, while they dropped slightly in 1992, they are again on the rise, with coal exports between January and May having grown 11.9% in value compared to the similar period in 1992. At present, Colombian exports go in their majority (79%) to the European Market, while only 2.2% goes to the Far East. These volumes are equivalent to 12.7% of Europe's coal imports and only 0.4% of Far Eastern imports.

The international thermal coal market has entered into its maturity stage and shows sustained growth. Colombia's medium term

strategy is to increase its share aggressively, without lowering prices below the current levels, which amount to US\$34-38 per metric ton. It expects to export 37 to 45 million tons by the year 2000, equivalent to 11.3 % of the market by said year, and it expects to increase the share of sales to the Far East 2.2% to 6% of total Colombian exports.

A higher volume of exports, say 50 million tons, would depend to a large extent on the development of the Mexican, Central American, and Brazilian market, or on the changes which will take place in the European market with the changing nature of Russia, which raises some serious questions. In any case, a viable option to achieve greater volumes would be through a significant increase in Far Eastern market shares. It is estimated that this share could reach 3.5% of the region's total imports, against the current 0.3%. This would represent 10% of Colombia's production in the year 2000.

6.2.4 Colombia's Reserves and Production Capacity

Colombia's coal reserves amount to 20 billion tons. Based on research carried out in the past fifteen years with regards to the location, assessment and evaluation of reserves, the country has now identified coal deposits throughout its territory: Guajira, Cesar, Córdoba, South and North Santander, Antioquia, Boyaca, Cundinamarca, Valle, Chocó, Cauca, a production of 50 million tons could be sustained for three centuries.

To achieve an export target of 40 million tons by the year 2000, Colombia already has the potential to produce 38 million tons per year, given the projects currently under way and those which will go into operation in the next years. It is very feasible to reach said target either with the development of new mining areas or the expansion of existing operations, as is the case of Cerrejón Norte, the production potential of which is very high.

New projects would be required if Colombia's market share (12%) were to be maintained beyond the year 2000. Given the wealth of our coal reserves, this is completely viable.

6.2.5 Colombia's Coal Projects

Below is a list, by regions, of attractive projects designed to take advantage of our coal potential, which offer attractive opportunities for new investors. Carbo-electric generation projects, another attractive area for investment, will be dealt with below, in Section 6.6.

6.2.5.1 La Guajira

The *El Cerrejón* project is divided into three zones, namely North Cerrejón, Central Cerrejón, and South Cerrejón.

Cerrejón North Zone: The North Cerrejón coal complex is currently being exploited. In 1976, the Colombian Government and Exxon, through their companies Carbocol and Intercor, signed an Association Contract for the exploration and exploitation of this area, dividing investments and costs equally. The project was declared commercial in 1980, when the installation phase, which lasted until 1986, began. The associated exploitation of the Cerrejón Norte deposit will last from 1986 to 2008. Under the terms of the Association Contract the ownership of the project will revert to the Nation in the year 2008. After 15 years, we have the largest open-pit coal mine in the world in operation. This project has already reached its planned production level of 15 million tons a year, and is a commercial as well as technical success. The investments in this Complex thus far amount to US\$3.3 billion. Future production may be increased to 25 million tons a year with additional investments.

Central Cerrejón: There are other large coal deposits just south of Cerrejón North Zone. The two major ones are:

-Central Zone: This is a private project. The El Cerrejón Community, which owns the coal deposit, contracted out its exploitation to the Colombian firm Prodeco. It has a production capacity of 3 million tons a year. The costs associated with this operation amount to US\$150 million.

-Oreganal: The exploration, feasibility study, and installation of a large-scale coal project in this area will be done under an exploration-exploitation contract with a 30-year term of duration, with the Colombian firm Carbones del Caribe. The level of production, in the order of 3 million tons, and the cost of the project, shall be determined by the findings of the feasibility study.

Cerrejón South: The reserves in this zone have not been fully evaluated as yet but some test boring indicates enormous amounts of an excellent quality coal.

Ocean Terminal at Bahía Portete: The exploitations of Central Cerrejón and Oreganal lead to expectations of coal exports from these areas amounting to between 6 and 10 million tons a year (Mtons/year) by the year 2000. It is necessary to provide an outlet for this coal, either through a new port to be built, possibly in the vicinity of the Termoguajira Power Plant, or by expanding the facilities at Bahía Portete, at an approximate cost of US\$115 million for the port and US\$100 million for the railroad. However, pertinent feasibility

studies must be made first, to establish the features and dimensions of the ports and determine their exact costs.

6.2.5.2 Atlantic Coast (other than La Guajira).

There are a number of mining, and port projects located in this region, specifically in the Departments of Cesar, Córdoba, Bolívar and Magdalena, among others.

La Jagua de Ibirico: There are approximately 20 mining companies operating here. They have grouped together for marketing purposes, having set up two or three groups aimed at the export market. Their production level is 1.5 Mton/year, which can be increased with additional investment. The coal is of excellent quality and the reserves are substantial.

La Loma-El Boquerón: Carbocol signed an exploration-exploitation contract with Drummond Ltd. from Alabama, U.S.A., for the production of up to 10 Mton/year of thermal coal for export. The production stage is about to begin, with an approximate investment of US\$800 million which covers the costs of the open-pit mine, a port on the Caribbean, and the branch railway lines to connect the mine and the port through State-owned Railways.

Calenturitas: This is an open-pit mining operation, also contracted with Prodeco, to produce up to 3 Mton/year. Prodeco has carried out surface and underground explorations, and is in the process of performing a feasibility study. This study will determine the mining facilities, infrastructure and port facilities required, as well as the associated costs.

La Aurora: This project is being carried out by Minera La Aurora S. A., with Carbocol acting as promoter. It will produce up to 0.8 Mton/year for exports.

El Descanso: This project covers the installation of an open-pit mine for the production of approximately 12.5 Mtn/year of thermal coal for exports. Surface and underground explorations as well as a pre-feasibility study have been completed. The total estimated necessary investment amounts to US\$1.6 billion, which covers investments on the mine, railway transportation and human settlements, but does not include the port. Further feasibility studies, as well as the installation and exploitation of the project, shall be in the charge of the investor.

Puerto Libertador Zone: These deposits are being exploited by Carbones del Caribe, and the coal produced is being used by cement plants and for exports.

San Jorge- Las Palmeras: An open-pit mine, it is to produce coal for domestic consumption and for a power plant to be located at the mine head. It will have a production capacity of up to 1.150.000 tons/year, with associated costs of around US\$355 million, including investments and operating costs over a period of 30 years.

Ciénaga Ocean Port: The purpose of this project is to design and build a port for the export of 8 Mtn of coal produced in the Departments of Cesar, South and North Santander, Cundinamarca and Boyacá, using railways to transport the coal to the port. Necessary investments amount to US\$ 110 million for the port and US\$25 M for the railway branch lines and incidental equipment.

6.2.5.3 North and South Santander

Tasajero Zone: This mining operation was created around a carbo-electric project, and the coal produced has great export potential. Between 70.000 and 500.000 tons are being exported to Venezuela this year. The coal is of excellent quality and very competitive.

San Luis: A mining project which allows for the exploitation of 1 Mton/year of thermal and cooking coal for domestic consumption and for exports, produced by underground mining, with an investment of US\$40 million.

Páramo del Almorzadero: This project consist of the exploitation of 60.000 Tons/year of anthracific coal through underground mining. It is aimed for the export market, and will require the installation of five small mines (modules), at an approximate cost of US\$700.000.

Tibú-Catatumbo: This underground mining project consists of the exploration and exploitation of a deposit with a production capacity f up to 0.5 Mtons/year of thermal and/or metallurgic coal. This mine can be used for supplying domestic demand or exported.

6.2.5.4 The Cundinamarca-Boyaca Highlands

This zone, formed by the Departments of Cundinamarca and Boyacá, is very rich in both thermal and metallurgic coal.

Mining Projects: There is Wide variety of coal projects in this zone, both for export and to meet domestic demand. The primary objective is to export 1.5 to 2.5 Mtons/year of metallurgic coal by building the Saboyá-Carare railway, which will shorten the distance to the port of shipment. The investment costs amount to US\$80 million in mining and US\$400 million on the railway.

Coal Utilization Project: This consists of evaluating and selecting a coking technology with industrial applications, with views to exporting an even-quality coke. The cost of the project, including the feasibility study and the industrial implementation, amounts to US\$2 million.

6.2.5.5 Western Colombia

The thermal coal market with the fastest rate of growth lies across the Pacific form Colombia. The Far East thermal and metallurgic coal markets are very promising. To supply this market adequately from Colombia, a port on the Pacific is required. That is possible given the location of the coal deposits in Antioquia and Chocó. Studies are being made of the possibilities of a port on the Pacific coast which would allow said markets to be accessed.

The existing projects in this part of Colombia are located in the Departments of Chocó and Antioquia, as follows:

Tadó: Its relative proximity to the Pacific Ocean makes this project extremely attractive, provided there is sufficient coal of a quality suitable for export. Surface and underground explorations are required, as well as a feasibility study, to determine the potential of the deposit. The initial investment in exploration and feasibility study is estimated at US\$1.3 million.

Amagá-Venecia-Bolombolo: A US\$24 million investment would cover the installation and underground exploitation of three 120.000 ton per year thermal coal mining projects and another 240.000 ton one. These can be integrated into a single project or into two groups of two. The coal could be used for domestic consumption or could supply a thermoelectric plant which could be to be constructed near the mine.

Gasification Plant: A feasibility study is being carried out for the construction of a coal gasification plant, with an aim at replacing hydrocarbons in certain Medellin industries with coal gas with a low or medium calorific power (150 to 300 BTU/ft³). The study evaluates various technological alternatives, and will select the most suitable for the industries' requirements, according to the quality of the available coal. The firm Gases de Antioquia coordinates the study, including the creation of a company to promote the project.

Coal Briquettes: The building of a pilot plant in Antioquia with a capacity to produce 20.000 tons a year has been proposed. Its main initial objective is to replace firewood. The technology to be used will be that developed in the people's Republic of China. The investments required for the purchase of equipment, adoption of technology, construction, training, and initiation, are in the order of US\$2.1 million.

6.2.6 Conclusions

The investment required for the implementation of the above projects is estimated at close to 3.6 billion dollars. The contracts signed to date for the exploitation of some of the deposits represent investments of close to US\$2 billion, not including the Cerrejón North Zone operation.

Coal is a commodity which offers promising possibilities as a profitable investment with long-term benefits. Colombia also offers the investor clear, lasting rules of the game in any undertaking.

A review of the coal-bearing zones in Colombia shows that there is a growing market, with ample investment opportunities and substantial advantages for investors already active in foreign markets or with possibilities to penetrate the same. The new rules of the game for foreign investment, resulting from the Colombian Government's trade liberalization policy, ensure a cloudless horizon with respect to legislation and terms of operation for the investor.

6.3 PRIVATIZATION INITIATIVES

The Colombian Privatization process is divided into three basic areas. The first, known as disinvestment, is the sale of companies, or assets in companies, that function in traditionally competitive, private sector areas and of which the state, for a variety of reasons, is currently a partial or total owner. The second area is the use of private resources to carry out government projects, such as the construction, modernization or maintenance of roads and airports. The central idea here is that the state's role should mainly be that of planning and regulating, as is fully described in Chapter 5. The final area in which privatizations will take place, and probably the one that implies the most significant change, is the sale of companies which render services that have been traditionally considered the state's responsibility, such as electricity generation, garbage disposal and telecommunications. Alternatively, private entities could also get involved, through the development of new projects in these areas.

The most important privatizing initiatives currently taking place in Colombia are described below, and others are dealt with in sections 6.4 to 6.7.

6.3.1 Banks

In 1982, the Colombian financial system underwent a crisis which forced the state to intervene in various institutions in order to control the damage that a banking disaster would cause and return some of the system's solidity. Among the institutions intervened were the "Banco de Colombia", once the biggest private Bank in the country, "Banco del Comercio", "Banco Tequendama", "Banco del Estado" and "Banco de los Trabajadores".

The financial crisis was gradually overcome in the second half of the 80's, when portfolios were cleared and capital was increased substantially throughout the system. This process has taken longer in the banks that were intervened than in other institutions. Some of these, however, have already achieved acceptable levels, and their performance in recent years has been outstanding.

Since the original intervention occurred, it has been the government's intention to return the banks to the private sector once the crisis had been overcome. This policy was given concrete form in 1989, when a first privatization scheme was defined. This attempt failed, however, mainly because the privatization structure used was too rigid to be applied to all the entities, and because the process pretended to achieve too many, often conflicting, objectives at once. Among the latter were the return of the banks to the private sector, the

democratization of their property and the generation of substantial financial resources.

In 1991 the reprivatization policy for financial entities was modified, and it is beginning to show significant results. The new policy's priority is to return the banks to the private sector and ensure that they continue to operate. Prices are now being set according to expectations of future income flows, making the recovery of the investments made by the public treasury at the time of the interventions only a secondary objective. Additionally, less importance is being given to democratizing the property structure.

As part of the sales strategy, the government has made a point of ensuring that the entities have clean financial accounts before they are offered to the public. Furthermore, a guarantee has been issued to ensure that the institutions' contingent liabilities (eventual losses that could materialize depending on the outcomes of judicial processes that are currently being carried out against some banks) will be covered by the State and not by the purchasers when their value exceeds the provisions that each entity has made against such losses.

The sales conditions have been designed individually for each institution, depending on its outlook and attractiveness for purchasers. Thus, while in some cases only one purchaser has been sought for, in others there has been room for small investors.

Until now, the sales of "Banco de los Trabajadores" (with US\$30 million assets in June 1991), "Banco Tequendama" (US\$ 65 million assets) and "Banco del Comercio" (US\$349 million assets) have been completed. "Banco del Estado" (US\$382 million assets) and "Banco de Colombia" (US\$1000 million assets) are currently being valued for sale by an international consulting firm, while certain traditionally state-owned banks, such as the "Banco Cafetero" and the "Banco Central Hipotecario", whose role in the past was to direct credit to specific sectors of the economy (coffee growers and housing, respectively, in these two cases), are being considered for privatization.

A fundamental factor in the success of bank privatization has been the Financial Reform Law, which, at the end of 1990, modified the legal framework for financial sector operations. Since the enactment of this reform, restrictions on foreign investment in the sector were removed, while new spaces were opened for the development of financial operations such as fund management firms and stock brokers. Furthermore, the regime regulating fusions, asset transfers, liabilities and contracts between financial intermediaries, among other things, was made more flexible. The new legal framework makes Colombia a regional leader in what pertains to financial entities' freedom of action.

As a proof of the attractiveness of the Colombian financial market, it should be noted that two of the three banks sold during 1991 and 1992 as part of the privatizing process, "Banco de los Trabajadores" and "Banco Tequendama", were bought by Venezuelan financial entities. A partial list of the financial institutions still to be privatized is included in Table 6.1.

6.3.2 The IFI Companies

The Industrial Promotion Institute (IFI) was founded in 1940 and aimed to support the country's industrial activity. In 1963, IFI became a financial entity. Its objective is to contribute capital for the creation of companies, mainly in the areas of basic industries and of first stage transformation of national raw materials, that have not been able to develop in a satisfactory manner by themselves.

IFI's role as an industrial promotor lost credibility with time, however. The temporary nature of its capital contributions promotion was affected when firms' performance did not fulfill expectations, and the institute became a permanent partner.

By government order, IFI is now bound to sell its shares in these firms, which belong to a wide range of industrial, agroindustrial and mining activities. In the future, every IFI investment will function exclusively as seminal capital and the rules for the retirement of IFI form a corporation shall be made clear from the beginning.

In the recent past, IFI's share in several firms of national relevance, such as Sofasa (the Colombian assembly company of Renault automobiles, in which Toyota now has a share) and Papelcol (a major paper producer) have been sold. Several other, smaller companies have also been put on sale through the Colombian stock exchange, while larger IFI investments, in companies like "Monomeros Colombo-Venezolanos" and "Alcalis", are currently being valued either for sale or for liquidation. A partial list and description of these companies is included in Table 6.2.

6.3.3 Free Zones

Free zones exist in Colombia since the 1950's, but their economic impact has not fulfilled expectations. Until now they have been operated and controlled by the State. As part of the changes surrounding the new liberalization policies, a new free zones code has been issued which substantially changes the rules of the game for their constitution and operation.

Under the old regime, free zones could only be industrial or commercial, and their locations were limited and set by government. Under the new regime, the private sector will be able to promote,

TABLE 6.1
FINANCIAL SECTOR ASSETTS TO BE PRIVATIZED

ENTITY	STOCKHOLDER	% TO BE SOLD	ENTITY IN CHARGE
BANCO DE COLOMBIA	Nation: 53% FOGAFIN: 47%	100	FOGAFIN
BANCO DEL ESTADO	Nation: 100%	100	FOGAFIN
BANCOLDEX	Nation: 100%	11	FOGAFIN
BCH	Nation: 83%	To Be Defined	MinHacienda
BANCO CAFETERO	National Coffee Fund: 100%	100	MinHacienda/ National Cofee-Growers Comm
CORPAVI	National Savings Fund: 23.7% Inurbe: 20.6% B. Popular: 20.9 Previsora: 0.6%	65.4	MinHacienda/ MinDesarrollo

TABLE 6.2
INDUSTRIAL PROMOTION INSTITUTE ASSETTS
TO BE PRIVATIZED

ENTITY	AREA	IFI STOCK %	SITUATION
MONOMEROS	Fertilizers and	33.44	Colombian and Venezuelan
COLOMBO-VENEZOLANOS	Other Chemicals		Stock Markets
PROPAL	Paper	23.47	IFI/MinHacienda. Yet to be Valued
CERROMATOSO	Ferronickel	47.69	To be Defined
FRIGOPESCA	Fishing Industry	47.39	Stocks in Stock Exchange
CORFIDESARROLLO	Finance	IFI: 16.06 Bancoldex: 5.53	IFI Board of Directors and Bancoldex to decide method
FEDERALTEX	Textile Fabrics	21.86	Stocks in Stock Exchange
CATSA	Agro-Industry	37.35	Currently Being Sold
QUIBI	Farmaceuticals	18.35	Completing Valuation
INTELSA	Telecommunication Equipment	15.71	Completing Valuation
PESTOLU	Fishing and Shellfish	64.07	Completing Valuation

develop and operate free zones anywhere in Colombia, so long as the area has been geographically bounded; the surface should be no less than 50 acres and have the capacity to support the necessary infrastructure; it should not be in use in the same area of commercial and/or service activities for which it is intended; and it should receive the approval of the Ministry of Foreign Trade.

Free zones will be classified according to their area of activity, which is to say depending on whether they produce goods or services (the latter essentially in the areas of tourism and technology). While these free zone firms will be basically intended to produce goods for export, there will be no restrictions on sales in national markets. Foreign companies will be allowed to freely remit their profits abroad, free of income and remittance taxes, regardless of the amount invested. Additionally, negotiations of all types of foreign exchange will be allowed within each zone. They will not have to exchange their currency through the banking system.

Four types of users of free zones are defined by the new code: operators (in charge with promotion, administration and management), the 'developers' (in charge with the construction of the premises and the provision of basic services), goods industrialists and services industrialists.

With regards to taxes, free zones don't have to pay income or asset taxes on the proceeds from exported goods or services. They are also exempt from sales taxes on imported materials. Finally, passenger vehicles, yachts or other vessels for tourist zones will also be tariff free. On the other hand, free zone entrepreneurs will have free access to credit from national financial entities. It should be noted that the first private free zone in Bogota was opened earlier this year.

6.3.4 Garbage Collection

Municipal garbage collection firms have traditionally been inefficient, mainly due to the machinations of local politicians. As a result, in 1989 the garbage collection tasks were transferred to the private sectors in the cities of Bogota and Barranquilla. The results have been strongly approved by the citizenship.

The process by which entities are contracted has been subject to some criticism, especially because the municipal companies that used to render this service have not been completely eliminated, which has limited the efficiency with which resources are used. The contracts' terms have also been the subject of controversy, and it is probable that they will be revised in the future. The idea of privatizing waste management, however, has become very popular among consumers, and other cities will probably opt for the same solution in the future.

6.4 TELECOMMUNICATIONS

Decree 1900 of 1990 defines the restructuring of the Colombian telecommunications sector and allows for the creation of private firms to handle the cellular phones, added value telecommunications industries, and local and long distance services.

Although this field is ripe with investment opportunities, the government has faced resistance from union organizations in establishing regulations and procedures to translate what was ordered in the decree into concrete changes, especially in the case of the Colombian telecommunications company (TELECOM), which handles national and international long distance services. Recently, however, Telecom has been entering into joint ventures with foreign telecommunications companies in its effort to establish 400,000 additional telephone lines between 1993 and 1995.

In the case of the cellular phones, the temporal structure for the adjudications and commencement of operations has been defined. Candidacies have been registered and the bidding process has begun, based on the procedure established by decree 741 of 1993. Assignments are expected before the end of the present year, with the system going into operation during the first semester of 1994.

Another area which shows great promise in the future is that of private television channels, which were recently allowed by law and will go into operation in 1997.

6.5 NATURAL GAS⁴

Colombia has ample natural gas reserves. A 1992 estimation of 3,700 GPC rose to 7,000 GPC recently with new discoveries, especially that of the *Cusiana* and *Cupiagua* oil wells (see above), and better estimations. These deposits exist throughout the country, though the greatest concentrations are located in La Guajira and in the Eastern Plains. It is also likely that these will increase over coming decades as oil exploration efforts, and direct gas exploration efforts, increase throughout Colombia.

These ample resources make natural gas far more cost efficient, as well as environmentally friendly, than alternative energy sources, so the Nation has decided to massify the use of gas throughout urban and rural areas through the construction of a network of gas pipelines which will interconnect the country to the many deposits. The government is now more firmly committed to the project than ever, and is set on having the national interconnection complete by early 1995.

This is where the private sector comes into play. The construction major pipelines will be contracted by the government with private companies, while regional sub-systems will be constructed by such companies under a BOMT system. This scheme, which stands for Build-Own-Maintain-Transfer, means that the private company is contracted to build, operate and maintain a project, of which it becomes the owner. The contracting entity pays for the right to use the project, and it has the option of buying it from the developer. This system has the additional advantage that it is feasible within the financial constraints which the current, broad investment program has placed on the State. With regards to the distribution of gas within cities and towns, private, public or mixed entities will all be able to participate.

The construction of the Guajira-Barrancabermeja duct, one of the most important stretches of the national network, is currently being contracted with foreign investors, and its construction should begin before the end of the present year. Similarly, contracts regarding the other major ducts are currently being perfected, with the idea being that all major cities be connected more or less simultaneously in early 1995, so that the entire system can be put into operation.

According to an economic evaluation by the national planning department, the program would result in savings of US\$ 560 M up to the year 2005. It should also be noted that much of the Atlantic Coast is

⁴ See also: Strategy for the Development of the Gas Program. Ministry of Mines and Energy, Ecopetrol and the National Planning Department. Bogota, March 18, 1993.

already interconnected through gas ducts, which serve 30 municipalities with a level of coverage of approximately 60%. Coverage levels in Bucaramanga and Neiva have reached 95%, while a program is currently going into action which will extend the service to 68 new municipalities in the Atlantic Coast.

6.5 ELECTRICITY⁵

The government's plan for the expansion of the electric sector seeks to increase the installed generation capacity by 2500 MW over the next ten years in order to effectively cover the country's energy needs and avoid any future crises like the one experienced during 1992. In order to meet this target, the Plan Proposed that the private sector be allowed to invest in the construction and operation of new projects. The private sector will be able to participate under three basic schemes: self-generation, independent generation, and the purchase of assets, shares, bonds and securities in other generation projects.

6.5.1 Self-Generation

As the name indicates, self-generation is defined as the production of electricity to be consumed by the producer. Colombian industries have been operating generating plants for their own consumption in an effort to reduce their costs and their dependence on distribution companies. In fact, a recent survey indicated that there are currently over twenty self-generators with capacities greater than 1 MW in the country, with a total installed capacity of around 150 MW.

The regulating scheme has now been expanded, and consumer groups may form associations to generate electricity to be sold only to their partners. While independent, these groups will have access to the national grid, and may thus install their generating plants in remote places and transport their electricity through connection and distribution networks owned by public utilities. Several generating plants have been built recently under this scheme, including one with a capacity of 90 MW in Mamonal, Cartagena's industrial sector. An additional advantage is the ready availability of fuels because of Colombia's Coal, Natural Gas and Petroleum wealth.

6.5.2 Independent Generation

Under this scheme, electricity is produced by an entity and sold to a third party or parties, usually a distribution company or large supplier. Because an effective system of subsidies has not yet been established, it is not economically viable right now to produce privately for small consumers. The national grid is also available to this type of producer. Recently, two projects have been developed in the Atlantic coast under this scheme, both of them by foreign investors.

⁵ See also: Development of Some Projects for Thermal Generation in the Expansion Power Plan. Ministry of Mines, Ministry of Finance and National Planning Department. February 16, 1993.

6.6.3 Purchase of Assets, Shares, Bonds and Securities

Private investors may also purchase production assets, shares, bonds or securities. During the financial restructuring of the Electric Sector, the State assumed the liabilities of several of the sector's companies, including the Betania Hydroelectric Plant and the Colombian Electric Energy Institute, and in return received assets in various plants. These can now be sold to cover financial obligations. These assets will continue to provide public services, but will now do so with private participation.

6.6.4 Risks and Risk-Reduction Instruments

Like any long term investment of similar size, investments in electricity generating plants imply substantial risks. This, added to the fact that electricity generation has traditionally been a public service and is thus highly subject to state regulation, results in the uncertainties surrounding the size of future demand, the monopoly conditions of energy distribution and the stability and clarity of the regulatory framework.

As a result, several measures are being taken in order to minimize these risks and ensure substantial levels of investment. First of all, a regulatory framework which will guarantee stable rules for all competitors is being independently developed. These rules will also ensure that electric generation take place under fair and competitive conditions. The Domiciliary Public Services Law and the Electricity Law will strengthen the process by making the regulatory framework not only stable but also transparent.

Another valuable tool is that of the Power Purchase Agreements (PPA's) established by the recent electricity law. These are contracts under which purchasers assure themselves a regular energy supply while guaranteeing producers a regular cash-flow providing returns on their investments. The price paid should include the fixed investment cost and a variable operating cost for energy delivered, and is a take-or-pay price in the sense that it depends on the production capacity of the plant that was agreed upon, not on the actual demanded production of the plant. Above all, PPA's must clearly establish such conditions as the place of delivery, the term of the contract, price formulas on power and energy, and payment mechanisms. Projects only began being contracted through PPA's in Colombia in 1992, so that the government is currently being advised by international consulting firms in the financial, technical and legal aspects of seeing that this initiative is carried through effectively.

PPA's, in turn, will be guaranteed through double-billing systems (in which revenues from consumption go to the producer and other revenues to public utilities), pledges of income from large consumers,

bank guarantees or guarantees from the National Electrical Financial Company (FEN) which is directly supported by the State, to ensure that contracts between private suppliers and public utilities are stable and transparent in the long run.

6.6.4 Some Attractive Thermal⁶ Power Plant Projects⁷

La Loma Carbo-Electric Plant (Cesar):

This power generation project, located near the coal mine of the same name, is designed for a 300 MW pulverized coal unit. The estimated cost is US\$ 460 Million, and a feasibility study is available.

San Jorge Carbo-Electric Plant (Cordoba):

To be located at the head of the mine of the same name, this project would involve the construction of one or two pulverized coal units with a capacity of 300 MW each. The total cost has been estimated at US\$ 450 Million for one unit and US\$ 840 M for two.

Tasajero II Plant (North of Santander):

This project would use pulverized coal from local mines. The approximate cost is US\$ 236 M for a 1.5 MW unit and US\$ 443 M for a 300 MW unit, according to a feasibility study by Lee & Infante Ltd.

Tibita Plant (Cundinamarca and Boyaca Plateau):

This project involves the construction and operation of one or two 300 MW units. The project's cost is US\$ 449 M for one unit and US\$ 839 Million for the 600 MW project.

Paipa Plant (Cundinamarca and Boyaca Plateau):

Construction and operation of one 150 MW power plant at an approximate cost of US\$ 222 M.

⁶ Note that all these areas have ample coal reserves and good local markets.

⁷ Prices are set at Dec. 1988 price levels.

6.6 MODERNIZING THE TRANSPORTATION INFRASTRUCTURE

In the context of the new international orientation of the Colombian economy and the redefinition of the state's role, it is worth mentioning that a great portion of public investment during the coming years will be directed towards improving the basic transportation infrastructure. Colombia's geography is particularly difficult and the fact that a major part of the country's productive activities are located in the interior of the country, a further result of the development model, oriented towards internal markets, which prevailed until recently, makes the transportation problem a central issue in achieving the goal of successful internationalization. There presently exist major government initiatives with regards to roads, railroads, ports and air transport.

6.6.1 Roads

Due to the terrain difficulties and to the traditional scarcity of resources for public investment, Colombia's roads are neither adequate nor sufficient for the country's needs. It is essential to build roads appropriate for the present methods of land transportation, containers, vehicles for high tonnage vehicles, etc., and that communicate the production centers with the ports with the greatest possible expediency. In other words, the system that communicates Colombia's three largest cities, Bogotá, Medellín and Cali, with each other and with the main ports, Barranquilla in the Atlantic Coast and Buenaventura in the Pacific, must be modernized.

The present government has presented a road investment plan for the decade of the 90's. It involves the building of 1000 kilometers of roads and the improvement of 3770 kms already in existence in order to complete the main network, at a cost of approximately US\$2230 Million. If the necessary investments in regional roads are added, this sum amounts to US\$5530 M. Estimates of the resources available for such investments reveal a gap of US\$2500 M. The additional resources will be obtained, first, from an institutional effort to improve the efficiency of the entities encharged with these investments (approx. US\$1000 M.) Another US\$1000 M will be provided by the Modernization Fund, created with the resources from import duties. The rest will come from increases in oil taxes, tolls, etc.

Additionally, many of the roads will be contracted with private sector companies, which could either simply work for the state or take over roads entirely, receiving returns for their investment in the form of tolls. A partial list of road construction projects to be carried out by the private sector can be seen in Table 6.3.

TABLE 6.3
PUBLIC WORKS CONSTRUCTION PROJECTS
TO BE CARRIED OUT THROUGH THE CONCESSION SYSTEM

PROJECT	LENGTH KMS	PLANNED LICITATION OPENING DATE	COST US\$ MILL
NORTH BOGOTA ROAD DEVELOPMENT	Const: 21.7 Reh: 22.8	June/93	50.0
BOGOTA-CAQUEZA HIGHWAY	Const: 43.2 Reh: 13.6	August/93	82.1 With Tunnel 57.7 W/out Tunnel
CHUSACA-MOSQUERA CHIA HIGHWAY	Const: 30.0 Reh: 16.0	Nov/93	45.5
BARRANQUILLA-CIENAGA HIGHWAY	Reh: 60.0	March/93	18.0
BUGA-TULUA-LA PAILA* HIGHWAY	Total: 58.0	June/93	53.9
BRIDGE OVER GUATIQUEIA RIVER AND ACCESSES	Const: 5.0	July/93	9.0
TOTAL	270.3		258.5

* Regional Projects

Source: National Palanning Department and CONPES

6.6.2 Railroads

The Colombian railroad system is outdated. The State railroad corporation, which had not shown good financial results for many years and was subject to enormous pressures from labor organizations and to government policies which forced it to participate in economically unmanageable operations, fell into a serious crisis and was liquidated in the eighties. Recently, however, the state has come to realize that a good railway network is one of the most valuable infrastructure assets Colombia can have in facing the challenges, and reaping the benefits, of economic liberalization. As a result, it is rehabilitating the railroad system and putting it back into action, with some important technical and policy changes.

A new state company, FERROVIAS, has been constituted, but it will be in charge only of the rehabilitation and maintenance of the lines, which will in turn be contracted with the private sector and payee for through tolls. Private companies will be in charge of the actual transportation activity as well as the maintenance of trains and other equipment, and will work thorough contracts with FERROVIAS.

Considering the large volumes of uniform products which often have to be transported over long distances, such as coal to the Atlantic coast, ferronickel and others, and the natural river valleys which connect important cities and industrial centers to ports, an efficient railroad network promises to be one of the country's most important tools of economic development into the coming century. While Investments in this area will have to be substantial, so will the benefits they will reap.

For this purpose, several projects are already being put into action around the country:

Bogota - Santa Marta Line:

Two contracts already exist on this line. The first is with Drummond, which will transport 10 million tons of coal between their mine in La Loma and the port in Santa Marta, for period of ten years. The second is with the Railway Transport Society (STF), also a private company, which will transport general cargo.

The Pacific Railroad:

Several routes along this line, which includes the vital Buenaventura - Yumbo track, have already been contracted with private companies. The 304 km Buenaventura - Zarzal - Cartago line, however, has yet to be assigned under a concession contract which would involve both its rehabilitation and its administration

La Caro - Belencito Line:

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La Caro - Belencito Line:

Important rehabilitation works were done on this line during 1992. It is expected to transport around 165,000 tons over the course of 1993, when it will be under STF administration.

Puerto Salgar - Neiva Line:

The operation, administration and rehabilitation of this line, which is made up of 402 kms of tracks, is yet to be assigned under a concession contract.

6.6.3. Ports

The firm "Puertos de Colombia" (Colpuertos), encharged exclusively with handling general cargo at Colombian ports, has been one of the country's traditional examples of State inefficiency. Financially, it shows chronic losses (in the 80's it functioned at a loss for seven consecutive years), while its efficiency indicators are far below international standards and its workers have negotiated benefits that widely surpass what is normal in the country.

By means of Law 01 of 1991, the Colombian government decided to liquidate "Colpuertos" and reform the operational structure of the country's sea terminals. In the new administrative scheme, the role of the national government will concentrate on the Port Superintendence, a dependency of the ministry of transport, which will operate as Colombia's sea and port authority, and will be responsible for planning and regulation in the sector. The government will continue its substantial investments in ports and highways, however, in order to improve Colombia's infrastructure and eliminate the bottle-necks brought on by the growth of external trade.

"Port societies", entities that can be conformed by public, private or mixed capital, will be in charge of the building, maintenance and administration of port terminals, as well as the rendering of port services, mooring, loading and unloading of merchandise, storage, etc... Tariffs will be set freely by the economic agents, though there will be some state surveillance. These companies will receive 20 year concessions, that can be extended, in 20 year blocks, an indefinite amount of times.

Port societies, in turn, will be able to render services directly or through contracts with "port operators", companies that do not require concessions or authorization, and need not be conformed as societies. This will ensure the development of independent service providers throughout the port system.

The privatization process is already well on its way. The liquidation of Colpuertos will be completed by the end of the present

month of September, and almost 100 private port operators have already been inscribed. Several terminals are already in the hands of the private sector, with visible benefits. Rates in the Santa Marta Port, for example, have dropped 25% and efficiency has increased since it began to be administered by private agents. By October, 1993, all ports belonging to the Nation will be in the hands of their new administrators and operators.

6.8 CARTAGENA CONTAINER TERMINAL

6.8.1 Project Background

In 1981 Lyons Associates Inc., a North American consulting firm working for the Colombian government, finished a thorough study of Colombian port facilities. The results of this study demonstrated the great benefits Colombia would obtain from the development of specialized container handling facilities in the ports of Cartagena (Atlantic Coast) and Buenaventura (Pacific Coast). The construction of these terminals would result in the recovery of the country's port system, which is more than 30 years behind world standards.

The study proposed the Cartagena Bay as the best site for the construction of the Atlantic Coast terminal, since this zone has excellent depth and protection, as well as available land for future expansion. Furthermore, land adaptation costs are the lowest among all the possible sites in the Atlantic Coast.

6.8.2 FMG Commitment to the Project

Since the Colombian government had limited possibilities to pursue the modernization of port facilities through Colpuertos, especially more recently with the latter entity's liquidation, the idea could not be put into action immediately. Six years after the Lyons Associates Report was presented, the *Flota Mercante Grancolombiana* (FMG), Colombia's largest ocean transport company, decided to commit itself to the project and promote private investment in the construction of the Cartagena Container Terminal. FMG understands the immense importance of this terminal for the development of Colombia's external sector and for the future of the internationalization of the economy. FMG also wants to see further improvements in the efficiency of Colombian ports, in order to eliminate delays, extra costs and sanctions from international ocean transport organizations.

High handling costs reduce the international competitiveness of Colombia's export products. Colombia transports less than one half its cargo using containers, due to the lack of specialized terminals. The main import, export and shipping companies doing business in Colombia are under pressure from trade partners and clients to handle cargo using containers, to reduce port tariffs, freightage and insurance fees, and to offer a more efficient, fast, and low risk transportation of goods. The lack of a modern port system restricts the possibilities of expansion and diversification of the country's economy.

FMG has contracted feasibility studies, purchased 80 Ha of real estate with 1085m of shore line in Cartagena's Industrial Zone, and has obtained a 20 year grant from the government to construct and

commercially and industrially exploit the terrain. The grant can be extended after 20 years if both parties agree to do so.

6.8.3 Cargo Forecasts

Container cargo forecasts for the Cartagena Container Terminal for the 20 years covered by the grant are the following:

Year	TEU
1994	69.500
2005	163.000
2015	216.000

This analysis assumes that up to 85% of total general cargo will be handled in containers. It is worth noting that during 1991 the Cartagena Port, without proper facilities, serviced 43,000 TEU.

6.8.4 Terminal Features

The studies conducted to determine the required installations in the FMG property, based on container cargo forecasts, concluded that the new terminal should be developed in two phases:

- First phase: Installations with a capacity to handle up to 14.000 TEU per year up to the year 2005.

- Second phase: Expansion of the terminal to a capacity of 350.000 TEU per year.

Characteristics of the First Phase:

- Terminal limited to container service and occasional special cargo, such as construction or industrial equipment.
- Area of property to be developed: 34 Ha
- Wharf: 425m x 34m
- Number of ships served simultaneously: 2
- Port Cranes: 2 Panamax Gantry Cranes with a loading capacity of 40.6 MT each.
- Yard Equipment: Composed of Top-Pick loaders, yard trucks and container trailers.
- Construction of associated buildings, facilities and services.

The second phase of the terminal foresees the construction of 600m of additional wharfs, enlargement of the inner harbor and of the container yard area with its facilities, the purchase of up to 4 additional gantry cranes and required yard equipment.

6.8.6 Cost Structure

The budget cost structure is presented in Table 5.4. It includes all the investment required to develop the first phase of the project. The budget for the first phase totals US\$71 million. The investment cost structure can be divided in 5 areas: Management, Engineering and Works Supervision, Construction, Equipment Acquisition and Interest Loan Payments during construction.

6.8.7 Economic Benefits

Considering this cost structure, the above container cargo forecasts, competitive tariffs for the Caribbean area and maintenance and operating costs during a 20-year period, the IRR of the project ranges between 18% and 12%, depending on the assumptions of the different scenarios.

6.8.8 Construction Schedule

The first phase of the project is being developed in two parts. The first part deals with property acquisition and land recovery works. The second part includes the construction of wharfs, buildings, yard upgrading and the purchase of cranes and equipment. Tenders for civil works and equipment supply will be issued in the near future. The date will be defined once an agreement is reached with the Colombian government with regards to the use of the present Cartagena Terminal, which is located in a residential sector of the city. The construction of this second part of the first phase should take 26 months.

6.8.9 CONTECAR S.A.

The Colombian government authorized the construction of the container terminal, indicating that a separate company should develop and operate the project. Following government guidelines, a society called CONTECAR S.A. was established on December 14, 1990. Neither FMG nor any other stockholder can own more than 40% of total equity. Sixty percent of the new company will be sold to national and/or foreign entities which have expertise in land transportation, operation of container terminals and longshoremen, in order to develop multimodal transportation in Colombia.

TABLE 6.4
CARTAGENA CONTAINER TERMINAL
CONTECAR S.A
COST STRUCTURE
BASE YEAR 1991

	THOUSANDS OF DOLLARS	COST %
MANAGEMENT	1.500	2.1
ENGINEERING & SUPERVISION	3.500	5.0
CONSTRUCTION COSTS	42.400	60.1
EQUIPMENT ACQUISITION	18.200	25.7
INTEREST LOAN PAYMENTS	5.000	7.1
TOTAL	70.600.1	

6.9 PETROCHEMICALS: OLEFIN AND AROMATIC OIL PROCESSING PLANT

The Colombian Government has a definite interest in the growth of the petrochemical industry. The availability of crude petroleum gives Colombia an important comparative advantage in this area, but this industry's degree of development is relatively low, even when compared to other countries in Latin America.

Colombia maintains a balance of trade deficit in several of these strategic areas, while at the same time having a domestic market that warrants the construction of petrochemical plants with favorable economics in accordance with international standards. Additionally, there is the certainty that a greater domestic supply of these raw materials will lead to a rapid increase in the production of industrial and consumer goods which use them as prime materials and, furthermore, there is a significant potential for expanding exports.

The most important petrochemical project at present is the construction of a plant to process olefins and aromatic oils, raw materials for a great variety of products. Olefins, such as ethylene, propylene and butadiene, and aromatic oils such as benzene, toluene and cracker xylenes, are used to manufacture materials with a wide number of applications (industrial inputs, tubing, paints, and synthetic rubber are but a few examples). It is estimated that sales (domestic and external) will amount to US\$569 million in 1996 and US\$724 million by the year 2010.

The plant will be located in the industrial complex of Mamonal, adjacent to the city of Cartagena, Colombia's principal port on the Caribbean. The plant is intended to go into operation in 1996. The plant's production will cover domestic demand and, additionally, will serve external markets. The investment needed to put the project into operation is close to US\$ 1 billion. It is estimated that the olefin plant will generate foreign exchange savings in the neighborhood of US\$170 million a year, and its contribution to GDP will be over 0.5% a year.

According to the studies that have been made, the projects's internal rate of return is close to 20% after taxes, and may fluctuate between 16% and 24%, depending on the assumptions in the sensitivity analysis with respect to the participation of credit in the sources of financing, and the behaviour of the final prices in either optimistic or pessimistic settings.

The Government's particular interest in this sector is easy to understand since it is more profitable to export intermediate petrochemical products than crude petroleum, considering the higher value added. Thus, the Government is determined to ensure that the

State petroleum company, Ecopetrol, will provide the olefin and aromatic oil plant with sufficient, timely supplies. This is an additional guarantee for the private investor with respect to the solidity of the project. Furthermore, the Government will maintain a special watch over unfair competition practices in the international market, such as "dumping".

Moreover, the rules of the game established with respect to all industrial policy apply equally to the petrochemical industry. The State's direct intervention in this activity will be limited to that which might be strictly necessary. The prevailing interest in the development of the sector will not lead the government to grant any subsidies or special protection. Ecopetrol may participate in the project, in association with private capital, but this will not imply any preferential treatment on the part of the Government.

6.10 TOURISM

Important credits have been granted by a number of national institutions with the purpose of developing a modern, basic hotel infrastructure throughout the country. Public Investment in this area has also increased, from \$4520 million pesos in 1991 to \$6323 M in 1992. Additionally, the government is promoting the creation of tourism oriented free zones with broad tax benefits, as described in section 6.3.

Perhaps the projects with the greatest promise, are eco-hotels, tourist attractions based on Colombia's environmental wealth. Not only will these institutions help improve the country's international image, but they will also take advantage of the country's vast resources in this area. As described in Chapter 1, Colombia is an ecological treasure trove, being, after Brazil, the second most bio-diverse nation in the world and containing such unique ecosystems as the *Páramos*, which exist only in Colombia, Venezuela, Ecuador and Costa Rica, and 65% of which are located in Colombia. By reflecting and advertising Colombia's commitment to the responsible enjoyment of its natural wildlife and environment, and drawing the attention of the international environmental and artistic communities to Colombia's rich and diverse wildlife, flora and fauna.

Colombia's greatest failing in this area was that it was long unrecognized in the international community for its environmental wealth. Recently, however, thanks to the work of such renowned scientists as the recently deceased botanist Alwyn Gentry and to the government's own conservation efforts, the true value of Colombia's ecology is coming into the international spotlight. In fact, part of the reason that Colombia did not attract as much attention as countries like Brazil and Ecuador was that its environment did not run as great a risk of being destroyed as it did in the latter countries.

Thus, this is the perfect time to take advantage of Colombia's environmental wealth economically while at the same increasing international consciousness about the environment in general and about Colombia's in particular. In this respect, two major projects are currently being studied in the ministry of Development:

Eco-Hotel facility at Pozos Colorados (Santa Marta):

Composing 76 hectares of terrain, this project includes 120,000 square meters of construction and 3,200 luxury hotel rooms.

Eco-Hotel facility at Baru:

Composing 266 hectares, this project, located near Cartagena includes 2,810,000 square meters of construction and 4000 luxury hotel rooms.

6.10 AGRICULTURAL EXPORTS

6.10.1 Bananas and Other Fruits

Colombia's climate and topography are particularly favorable for the cultivation of fruit, with the country offering a very wide variety of fruit as a result with the added advantage of low production costs.

Within this variety of fruit, bananas hold the most important place. The cultivation of bananas in this country started at the turn of the century, but the first marketing attempts showed only limited success. Exports on a major scale began in 1969. At present, Colombia is the third largest exporter in the world, after Ecuador and Costa Rica.

Bananas have become one of the country's principal export products. They hold first place among the so called "minor exports", with 11.8% of the total for this group, equivalent to US\$410 million in 1992. (See Graph 6.1)

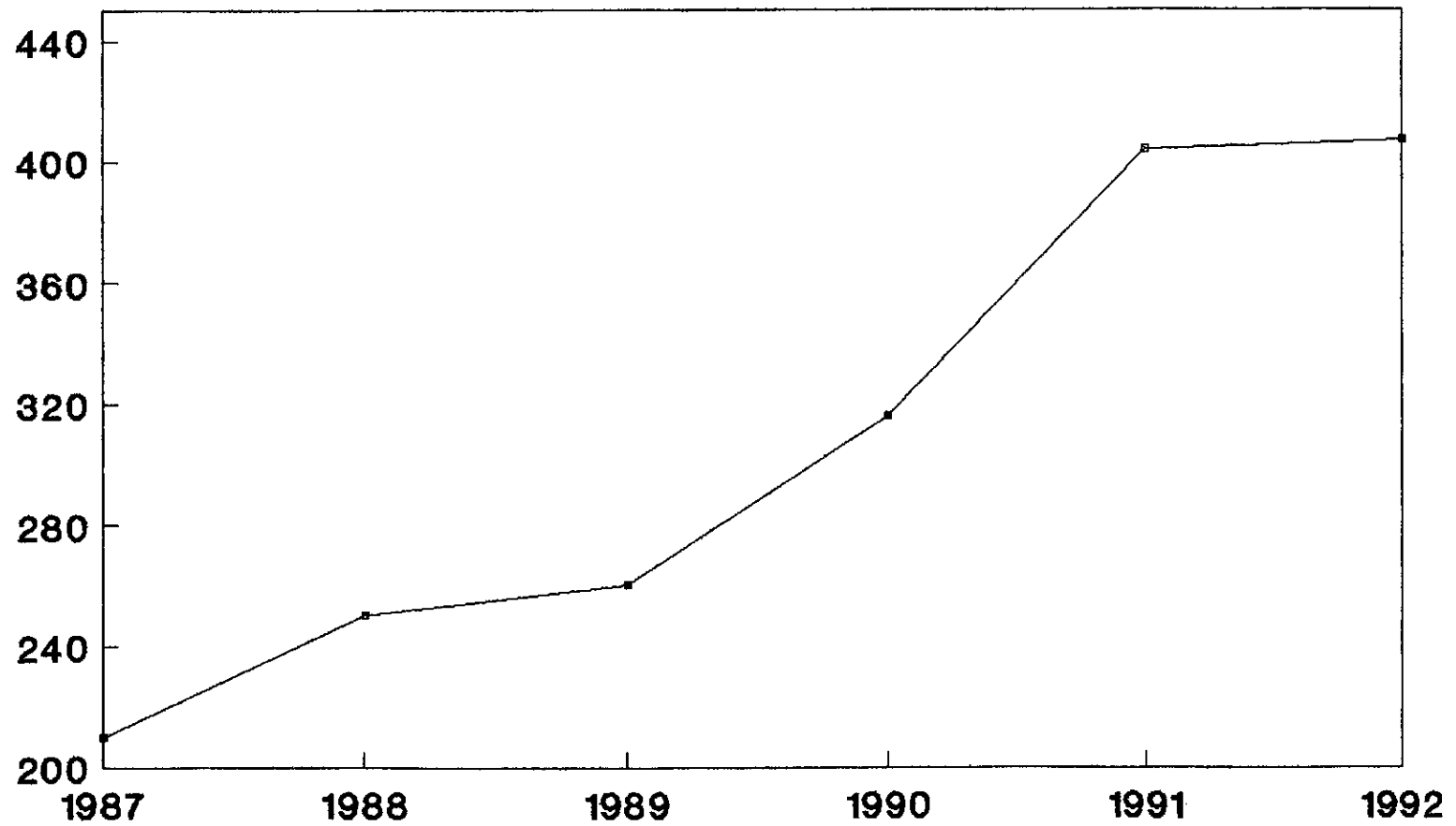
Our banana plantations have a technology suitable to our environment, which is reflected in higher productivity and competitiveness in the international market. Production is centered on the Atlantic Coast, which results in significant savings in the transportation cost of exports.

The principal markets for Colombian bananas have traditionally been Europe (47% of total exports), and United States and Canada (52.1%). Bananas are exported to 25 countries, thanks to the campaigns run by PROEXPO and certain large local marketing companies. Japan and other Asian countries have recently surfaced as growing markets for exports of bananas as well as of other Colombian fruit.

Besides bananas, other fruits such as strawberries and mangoes have adapted extremely well to Colombian conditions, reaching production levels which place them amongst the most promising lines of the country's non-traditional agricultural exports. The comparative advantage of these products lies, fundamentally, in the fact that they are harvested the whole year round, even when other products are not on the market due to weather factors or to their cyclical conditions.

The first varieties exported have opened the way to other fruit which up to a short time ago was unknown to foreign consumers and which now profits from developed countries renewed interest in exotic tropical fruit. These varieties, which have been traditionally cultivated in Colombia on a wide but untechnical basis, have now started to be cultivated intensively and making good use of technologies such as the hydroponic cultivation, with highly satisfactory results in terms of productivity.

Graph 6.1
Colombian Banana Exports
(US\$ Millions)



Fruit exports, made by 51 firms, are usually shipped by sea, using the ports on the Atlantic Coast as well as on the Pacific Coast. The recent measures designed to modernize and expedite international air and ocean transport, will be of enormous help to this export effort which depends greatly on the availability of prompt, efficient transport facilities.

In addition to the production and exports of fresh fruit, there has recently been substantial development in the fruit processing industry which converts fresh fruit into pulp, juices and concentrates. These new forms of presentation broaden the market for these products, since they make them easier to market and to transport. These exports have shown rate of growth of close to 44% per year, from US\$3.2 million in 1985 to US\$15.5 million in 1989.

The dynamics of fruit production and exports has been backed up to a large extent by the Coffee Growers Federation's diversification campaigns, designed to persuade small farmers in certain areas of Colombia not to depend excessively on the cultivation of coffee. PROEXPO has also supported diversification through lines of credit for cultivation, marketing and research.

In this line of exports there are wide opportunities for foreign investors, who can contribute with a better knowledge of the consumer markets. In particular, there is great potential in the production and exportation of fruit-based products with a greater domestic added-value component.

6.10.2 Flowers

One of Colombia's most successful export sectors is that of flowers. This industry was started in the early 1960's, making good use of the comparative advantage given to Colombia by its climate and environmental conditions over the principal world supplier of flowers, the Netherlands. On the plains of the Bogotá Savannah it is possible to cultivate flowers the whole year round, with no need for hothouses, which allows for substantial cost reductions. Another advantage is the availability of skilled and relatively cheap labor.

Colombia succeeded in rapidly consolidating an efficient marketing and merchandising system which allowed it to win the U.S. flower market, in becoming practically the sole supplier in some specific varieties like carnations. Colombia's merchandising strength has allowed it to maintain its position in the market, despite the Netherlands' technological advances and the entry of new producer countries which also have certain advantages as far as nature and costs are concerned. Furthermore, although Colombia may not be up to par with Dutch technology with regards to the generation of new varieties, our

cultivations are excellent from a technical standpoint, and are particularly effective in adapting and propagating imported species.

In 1970, Colombia's flower exports totalled one million dollars; by 1992, they reached US\$ 335 million (See Graph 6.2). The principal market for Colombian flowers is United States, which buys over 80% of our production. Colombia, however, has also achieved important advances in penetrating the European market, despite the tariff disadvantages it faced until a few months ago with respect to other producer countries, such as the Netherlands and Israel. The recent customs exemption granted by the European Economic Community to Colombian flowers up to 1994 (in consideration of Colombia's hard struggle against the drug traffic) opens up promising possibilities for broadening Colombia's position in the European market.

6.10.3 Farm-Bred Shrimp

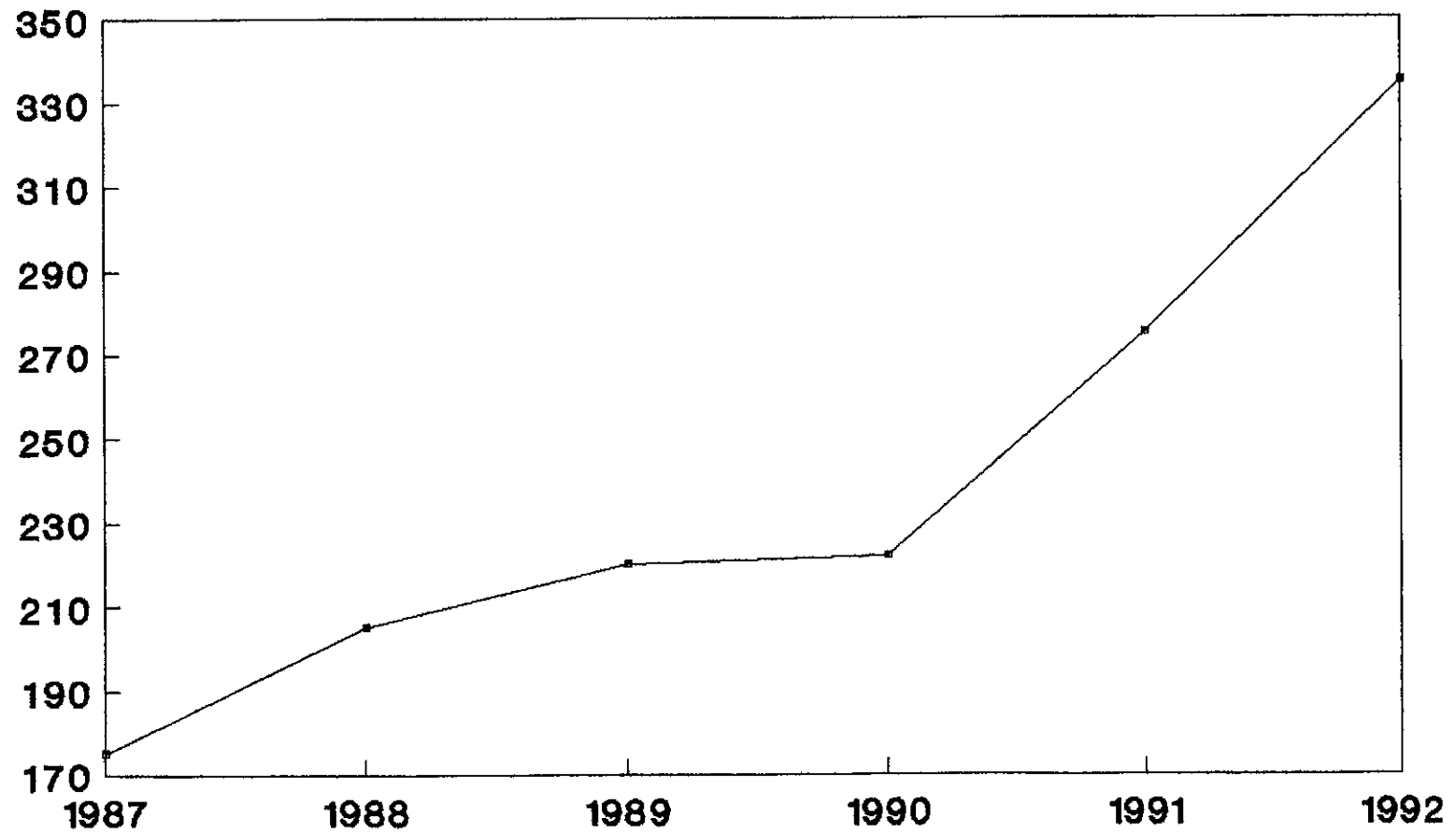
Although Colombia's entry into the farm-bred shrimp market is recent, since it only goes back to the mid-80's, the country has already shown its wide potential among the Latin American producers. The principal producer in the region is Ecuador, with 45.000 tons in 1989 (it was then the fourth largest shrimp producer in the world, after China, Indonesia, Thailand and the Philippines). In 1989, Colombia produced 3.000 tons but even then its productivity per hectare per year was 1.5 tons, almost three times that of Ecuador. Production in Colombia has maintained an substantial rate of productivity growth, and everything indicates that such rate will continue increasing in the future. Sales have risen from US\$600.000 in 1985 to US\$31 million en 1991 (See Graph 6.3).

Colombia is a leader in penetrating new markets. Initially, all of its production went to the United States. Since 1988, Colombian exporters succeeded in selling to Spain, which pays higher unit prices. At present, close to 70% of our shrimp exports go to Spain. The West European market is particularly attractive in the medium and long term since, within the industrialized world, it is the region with the lowest per capita consumption and presents the highest possibilities of expansion.

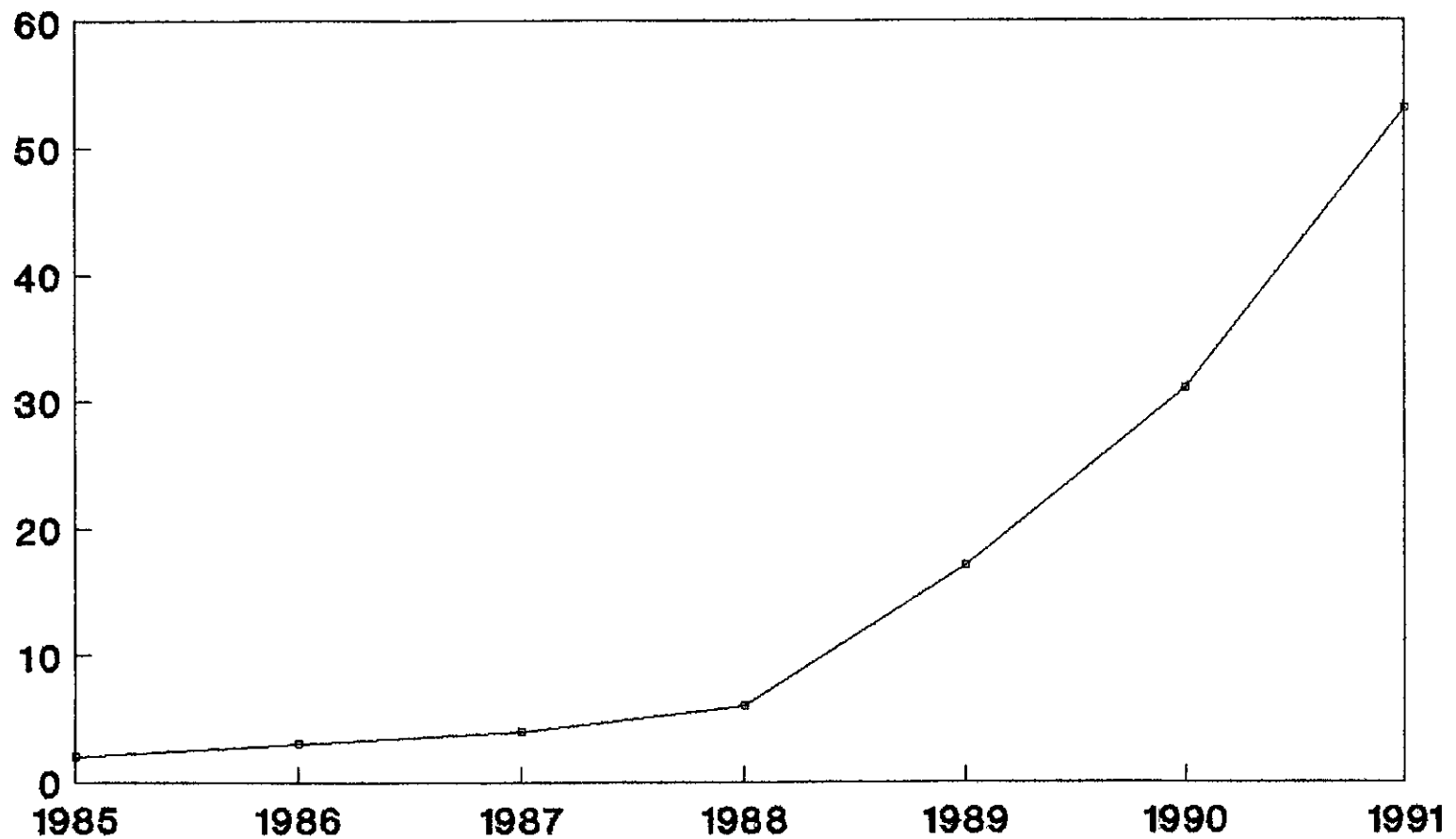
In as much as shrimp fishing has reached its maximum levels of exploitation the world over, practically the entire growth of production in the future will come from farm-bred shrimp. This is an expanding market, with possibilities all over the world. In Colombia, there is ample availability of land suitable for shrimp production, experience in the cultivation, and good transportation facilities, all of which are clear advantages for foreign investment in this field.

Colombia still has but a marginal share of the world market, and experience shows that there is no difficulty in finding buyers for its

Graph 6.2
Colombian Cut Flower Exports
(US\$ Millions)



Graph 6.3
Colombian Exports of Farm-Bred Shrimp
(US\$ Millions)



current levels of production. The next challenge for Colombian producers is the merchandising, particularly with regards to the development and sale of products with a higher added-value. This will call for sizable investments in packaging and processing plants for new presentations, but the Colombian shrimp companies could only make investments like these to a limited extent, considering the large sums of capital involved. Additionally, the Colombian producers have little experience in the merchandising and distribution of shrimp directly in international markets, especially in Europe and Japan. This problem becomes particularly serious in dealing with the merchandising of products with a higher degree of processing, which face much more complex markets since one must be well acquainted with the tastes of the final consumer in each country. One formula which may give good results is the association of Colombian producers and processors with importers and agents in developed countries, who are fully familiar with the market and at the same time have greater financial solvency.