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THE COLOMBIAN ECONOMY: A SURVEY

**Structural Characteristics, Recent Reforms,
and Medium-Term Perspectives**

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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 Peru and Ecuador to the south. It has a 1,600 kilometers long coastline on the Caribbean and 1,300 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; see country map.

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 results in a wide 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.

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, 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 species. As a result, Colombia is beginning to come into the spotlight, for it is a true environmental treasure 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 than any other country in the world. Moreover, it has 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.

¹

See also Banco de Occidente (1992), Banco de Occidente (1990) and The Economist (1988).

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 almost unique to Colombia. 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. In fact, as renowned botanist Alwyn Gentry pointed out: "In one hectare of the Amazon rain forest, one can find as many species of trees as in all the forests of North America's temperate zone, as many species of birds, an one-and-a-half times more butterflies than in the United States and Canada combined"². 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 order to conserve this wealth while maintaining economic growth, the government is putting a five-part strategy into action: it created an Environmental Ministry, it is making the environment a top priority in international negotiations, it is increasing the resources headed toward conservation, it is supporting and strengthening other environmental conservation organizations working in Colombia, and it is instituting a number of specific programs aimed at improving the administration of renewable natural resources and the environment. The latter include pollution controls for both vehicles and industry, and recycling programs.

The private sector is also contributing to the conservation program. For example, a reforestation effort was initiated recently through the "Forestry Action Plan for Colombia", headed by the National Federation of Coffee Growers. 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. The program aims at increasing forestry participation in the economy, protecting the ecosystem and biological variety, and decontaminating waters, among others.

1.1.2 The People

Colombia's population of 35.8 million (1993 census) comes 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 common 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. According to the 1993 census, 72.9% of the population live in cities and 27.1% in rural areas. The past decades have been characterized by significant migration to the country's five largest cities and resulted in a population for 1993 of: Bogota (6.31 Million), Cali (1.78 M), Medellin (1.69 M), Barranquilla (1.09 M) and Cartagena (0.66 M).

² Alwyn Gentry (1990).

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. Colombia has achieved a literacy rate of 87%, up from 73%, 25 years ago, high among Latin American countries and, especially, within the group of developing countries as a whole (see below, and Table 1.1).

With regards to the country's work force, the government has an apprenticeship service, SENA, which provides technical training. It aims at helping workers to adjust to changing technologies and market structures, allowing them to adapt their skills to those demanded by the productive sector. Furthermore, its 137 training centers were restructured in February 1994, giving them more autonomy and allowing greater participation of the private sector.

Higher education 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 years, 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. Improving the Colombian educational system is vital because a well educated population is a country's most valuable resource, as countries like Japan have amply demonstrated. In an effort to achieve this goal, the Constitution of 1991 strengthened the decentralization process and restructured the educational system. Now local entities have a greater responsibility in the provision of educational services, and higher transferences from the central government for educational investment, (see Annex 1 for the distribution of functions in the Colombian public sector).

Important changes are being made in both elementary and higher education, the latter of which was raised to the category of public services. Regional entities are more directly responsible to their users and the exchange of information and ideas between administrators, teachers, parents and students improved. Furthermore, universities were given greater autonomy to allow them to function freely as motors of knowledge and progress. The recently created National Accreditation System will ensure that all higher education institutions are responsible in achieving their objectives.

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 headed 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 Cali, in the west, and Medellin, in the north, followed by Barranquilla and Cartagena on the Atlantic coast. There is also a large number of cities ranging between 100,000 and 500,000 inhabitants.

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.

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

The President of the Republic is also the Commander-in-Chief of the military forces. Congress operates in accordance with the Constitution and maintains a strong power of veto over the President's actions. There is a free press.

There are two traditional political parties, the Liberal and the Conservative, which have fought for power since the beginning of the Republic. Although other parties have emerged periodically in the past decades, none has ever succeeded in establishing a permanent place in the country's political scene. Even though some have achieved considerable popularity at a given time, none has ever won the presidency.

At present, however, the two-party system is opening up to a larger number of political parties. The new Constitution issued in 1991 changed the political "rules of the game", favoring the emergence of independent movements. During the local elections of 1994 for example, most majors elected came from civic coalitions. The president elected in 1994 for a four year period, was Ernesto Samper, a candidate from the liberal party.

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 a wide participation of all political forces, including representatives of former guerrilla groups, that had returned to civilian life. Threats from guerrilla groups continue to be a source of uncertainty, but they are being strongly counteracted. 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.

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 comes 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 acquired 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 the country cannot be explained as a response to a repressive political regime. Nor is it due to any deterioration in the population's quality of life since, as we will see below, Colombia has shown positive and acceptable rates of growth in per capita income and in the principal social indicators during the last decades. Moreover, recent studies indicate that the inequality in income distribution has 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 the aim of seizing power. Popular response, however, has been negative. In recent years, those guerrilla groups that returned to civilian life were rewarded with some electoral support. 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 in the recent past.

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 of the speed of social transformations in Colombia. Forty years ago, Colombia was a rural country, but it has rapidly become fundamentally urban. As a result, people's horizons and ambitions changed at a rate which Colombia could not satisfy in the short term, especially in the case of the lower classes. In recruiting followers, guerrilla groups then focused on social and economic inequalities which were coming to light in the public consciousness rather than becoming worse.

At the same time, the escalated violence linked with the drug traffic was a result of the drug traffickers avowed purpose of intimidating the civilian population for the specific goal 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 Medellin, 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 fighting the sources of violence discussed above 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, of several guerrilla groups to civilian life in 1990 and 1991. 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 Colombia, 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 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, the main 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 in Caracas, Venezuela and Tlaxcala, Mexico, it was forced to suspend them towards the end of 1992, because of violent and terrorist actions which the guerrilla groups perpetrated in the midst of negotiations. The FARC and ELN, which were recently denounced as a multi-million dollar business of extortions, kidnapping and drug trafficking (the news-weekly SEMANA calculates their joint revenues at over US\$200 millions), continue to enact acts of terrorism against Colombia's resources.

Still, the gradual disappearance of the guerrilla movement remains an unquestionable fact; the only unknown is when this will end. In fact, even these groups' decision to remain in arms had been anticipated by the Government, which complemented its negotiation policy with an economic and military strengthening of the armed forces as well as a change in its strategy in order to effectively deal with the changing situation. Moreover, for the first time in several decades Colombia has, since 1991, 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 an 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. The 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". Still, this policy has brought about the surrender of the principal drug barons, and the cessation of the narco-terrorist actions specially after Escobar's death. 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 life on the run, and surrendering to Colombian justice.

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.

1.2 SOCIO-ECONOMIC STRUCTURE AND PERFORMANCE

In the field of economics, the stability and continuity of Colombia's sound economic performance are noteworthy. It is one of the medium sized economies in Latin America, with a Gross Domestic Product of 48.6 billion dollars in 1993. The economy is smaller than that of Brazil (US\$456 B) in the same year, Mexico (US\$349 B), Argentina (US\$253 B), Venezuela (US\$62 B) and Peru (US\$50 B), but larger than Chile's (US\$45 B) and Ecuador's (US\$14 B). Not only Colombia was not affected by the foreign debt crisis which troubled 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 growth in Gross Domestic Product during the 1980's. Furthermore, the growth of GDP was substantially stable throughout the decade.

1.2.1 Main Social Indicators

Regarding social development indicators, Colombia is close to the average for Latin America (Table 1.1). The indicators show that the countries in this region have achieved notable progress over the past decades. According to World Bank and UNDP data, life expectancy in Colombia increased from 56.6 to 69 years between 1960 and 1992. Infant mortality dropped from 99 per thousand births to 30 in the same period. The rate of adult literacy rose from 78% in 1970 to 87% in 1992. The average annual demographic growth rate was 2.3% in the period 1960-1992, and it is estimated that it will drop to 1.6% during 1992-2000. These figures are similar to those covering Latin American countries as a group, and are higher than those of developing countries as a group. However, the distance separating Latin America from the industrialized countries is still large.

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. These changes will be discussed throughout this report.

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 recessions experienced by other Latin American countries. However, it achieved the highest percentage growth in Latin America between 1975 and 1991, and it is now surpassed only by Chile. 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 it occurred in other countries.

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 1980 and 1993, per capita GDP showed an absolute drop in Brazil, Mexico and Venezuela, and rose only in Chile and in Colombia (26.7% and 21.2%, 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 (Table 1.2). Between 1975 and 1980, one of the most dynamic sectors of the economy was that of construction. Throughout the 80's, the growth of mining, specifically coal and petroleum, accelerated dramatically. In the latter half of the eighties, agriculture and manufacturing both outpaced construction. Thus, there has been a switch in the leading growth rates, from non-tradeable goods to tradeable goods. Agriculture and industry drop behind slightly, with their share in total production decreasing during this period, but remaining the most important sectors in the economy.

Table 1.3 shows the annual rates of growth of GDP, by sectors, over the past five years. Due to the adjustment policies designed to fight inflation, and to the acceleration of the trade liberalization process, the years 1991 and 1992 present a lower rate of economic growth. However, during 1993 and 1994 the economy regained growth rates above 5%, and it is expected that in the medium term the indicators will continue on this path, as the control over the inflation rate is consolidated and the Colombian economy increases its degree of integration to international trade and capital flows. In Table 1.4, there are the main economic indicators for Colombia for the period 1970-1994.

1.2.3 Inflation

Inflation figures in Colombia also stand out in comparison with most Latin American countries, even though inflation levels are nonetheless higher than those prevailing in the developed world and in Asia's rapidly industrializing countries.

Between 1980 and 1993, average inflation in Colombia was 24.3%, whereas in Chile it was 19.4%, in Mexico 48.6%, in Brazil 739.5%, in Argentina 587.5%, and in Venezuela 30.7% (see Graphs 1.3a and 1.3b). 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.

The highest rate of inflation throughout the period under review for Colombia occurred in 1990 (32.4%), and led the economic authorities to make the fight against inflation the central focus of economic policy. This became particularly complicated during 1991 and 1992, given the 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 was accepted by most people as necessary. During 1991 inflation was 26.8%, while in 1992 the rate was 25.1%. In 1993, the monetary authorities were relatively close to their stated goal of inflation and achieved a 22.6% rate. In 1994, inflation reached 22.6% again. In 1995, the government is committed to achieve a 18% inflation rate and subscribed a Social Pact with the main economic agents to facilitate this goal. This Pact will lead to inflation rates of the range of 10% by 1998.

1.2.4 Fiscal Situation and External Debt

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 (Graph 1.4). In the first half of the 80's, Colombia's fiscal deficit stayed close to 6% of GDP. As of 1985, the fiscal deficit was rapidly corrected, and in 1991 public finances were in balance. In 1993 a surplus of 0.3% of GDP was achieved. For 1994 the fiscal surplus including the privatizations reached 2.6% of GDP. These proportions of fiscal performance are good in international terms and, in particular, in a Latin American context (Table 1.5).

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 1.6). 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 32.5% in 1994, or US\$21.1 Billion. It is important to note the role of the public government in these results given the decrease of the public debt from 31 to 20.1% of GDP for the same period, see Graph 1.5.

The total servicing of the debt has increased slightly as a proportion of exports, due to the concentration of amortizations in the current period. However, prepayment of foreign debt and substitution of debt with high interest rates for debt with more attractive interests through emission of bonds in the U.S., Japan and European stock markets, led to a reduction of public debt service as a proportion of exports during the last two years from 47.5% in 1992 to 28.6% in 1994, see Graph 1.6.

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 its foreign debt see Chapter 4, below.

CHAPTER 2

EXTERNAL SECTOR: PERFORMANCE AND REFORMS

2.1 THE FOREIGN SECTOR

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

2.1.1 Overall Balance of Payments

The last row of Table 2.1 shows the level of international reserves. In 1980, Colombia had close to US\$5.4 billion in international reserves, by 1985 this amount dropped to US\$2.3 billion. Since then it has risen steadily, to over US\$7.9 billion in 1993 and US\$8.1 billion for 1994.

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 7.2% 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 kept up until 1992. An increase in imports because of the fall in tariffs (described below) led to a trade deficit for 1993 and 1994. This has been offset, however, by a solid capital account due to the massive entry of private capital. Its most important component is the flow of foreign investment, estimated at US\$1,092 million for 1993 and at \$2,099 million for 1994.

2.1.2 Exports

It is worthwhile 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 and 64% of traditional exports¹. The remainder was distributed among non-traditional exports (30%), petroleum and its derivatives (11%), coal (3%), ferronickel (2%), and gold (10%). This composition of exports had prevailed for several decades, and 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 economic fortunes up to that time.

¹ The traditional exports are composed by coal, coffee, gold, ferronickel and petroleum and its derivatives. Among the most important non-traditional exports are bananas and flowers in the agricultural sector, chemicals, food and tobacco products, clothing, leather and leather goods, paper and printed matters in the industrial sector, and emeralds in the mineral sector.

In the second half of the 80's, however, some very significant changes suddenly took place in the exports. 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 1993 nominal statistics, coffee now represents merely 15% of total goods exported, while the share of petroleum and its derivatives rose to 18%, that of coal to 8%, and that of non-traditional exports to 54%. The average annual growth in the exports of petroleum and its derivatives was 27.9% from 1985 to 1993, while non-traditional exports showed an average rate of growth of 31.8%.

Growth in exports of hydrocarbons originated in 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 oil fields and other large new fields (see Chapter 6).

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 exchange rate (Graph 2.1). Colombia undertook a drastic adjustment of the exchange rate in the mid-80's, in order to correct the overvaluation accumulated since the late 70's. Between the end of 1983 and 1986, the real exchange rate was devalued by 65%. Since then, the exchange rate 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%. Since 1991, the stability of the exchange rate has been the subject of considerable economic discussion, due to the Colombian economy's buoyant external position. In light of an unprecedented level of international reserves, the real exchange rate has revalued 14% since the last months of 1990. Nevertheless, the exchange rate still remains at similar levels than those which prevailed in 1986.

Non-traditional exports have taken advantage of this stability. Although the revaluation of the exchange rate affected their impetus during 1992 and 1993, they have continued to expand, with the total value of non-traditional exports growing at 11.7% during this period. As mentioned above, the average annual growth of these exports has been 31.8% since 1985. As shown in Table 2.3, non-traditional exports are quite diversified, with agricultural exports generating only 26.7%, and industrial exports representing 62.6% of them in 1993. The principal non-traditional exports goods are clothing, chemicals, bananas, flowers, food products, and leather goods.

With regard to foreign markets for Colombian goods (Table 2.4), the United States holds first place, purchasing close to 40% of total exports in 1993. It is followed by the European Union, with 23%, and the Andean countries with 16%. The distribution of imports by country of origin presents a similar order, although the amounts are slightly different. United States has a 35.5% share of total Colombian imports for 1993, the EU 17.3% and the Andean countries 13.7%. Japan receives 3.3% of exports and provides 9.7% of imports in 1993.

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 until 1991, 3.9% in dollar terms as an annual average between 1985 and 1991, has accelerated rapidly in the past three years, as a result of the trade liberalization policies the Government is committed to, and of the recent real appreciation the peso has undergone. Imports grew 28% between 1991 and 1992, and 51% 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 excessive effect on the country's balance of trade. At the same time, the external sector has shown itself to be one of the most important engines for Colombia's long run development and economic growth.

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 at increasing the country's wealth and growth potential through what has been called the "internationalization" of the economy.

In sharp contrast to 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. First of all was the relative small size of the Colombian market that makes it difficult to enjoy the benefits brought about by economies of scale and specialization. Second was the lack of competition and the difficulties involved in importing goods because of protectionist policies that arose specially during the 1980's that led industries (and to some extent, the agricultural sector) to loose their capacity to change and grow efficiently, while great technological setbacks occurred in many sectors. Finally was the emergence of a truly global economy that makes it impossible for Colombia to remain isolated from the rest of the world.

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 was under the administration of Cesar Gaviria (1990-1994) that the most radical institutional and trade reforms were 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 elements²:

1. Trade negotiations³
2. Import liberalization
3. Export promotion
4. Foreign investment promotion
5. Reform of government institutions and administration

2.2.1 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 Gaviria Administration was elected on a platform which explicitly included trade reform, from 1990 to mid-1991 there was a 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%.

Table 2.6 shows the tariff structure in Colombia after 1990 and 1992 decrees. The average tariff in the economy fell from 36.3% in 1990 to 11.6% in 1993. 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, followed by raw materials and to a lesser extent capital goods.

² 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 Finance, 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 BANCOLODEX, and two Council Advisors.

³ Trade negotiations will be discussed in Chapter 3.

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 past Government was 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.

2.2.2 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\$3,782 Million in that year to US\$8,545 M in 1994. 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\$1,125 M in 1985 to US\$3,985 M in 1993. This 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 República", 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, and the export business was 102% more profitable in 1990 than in 1983. This change had an important impact on the above mentioned evolution of small exports since 1985.

In 1991 the daily mini-devaluation system was modified and the market was given greater importance in determining the exchange rate. Since January 1994, the Banco de la República established a band with a 15% range. The Bank sets the annual exchange rate target and lets the intermediaries fix the market rate freely within the band. In this way, the Central Bank increased the control over the monetary policy given the inflow of capitals and the accumulation of international reserves.

2. Directed Lending. Loans directed to the export sector have been the most stable incentive for exports and one of the most effective because they have counteracted the limitations of the Colombian financial system, and satisfied 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 general tendency of the Colombian financial system, interest rates for loans to exporters have increased in the last several years, becoming slightly higher than the inflation rate. In this manner, the financial subsidy inherent to these loans has been eliminated, as it was not essential to the efficiency of the instrument. The availability and permanent character 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 is BANCOLDEX, the new Export Import Bank. On the other hand, PROEXPORT Colombia carries out now the international promotion and commercial assistance to exporters and importers.

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.

5. Establishment and/or operation of processing factories (*maquila*) and free trade zones may now be done by foreigners. These special entities produce goods or services primarily for export. Hence they are subject to special tax and investment rules. 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.

2.2.3 Foreign Investment Liberalization and Promotion

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 nonetheless 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 other benefit or support offered to national producers. It also means an equal income tax rate, which according to the new tax law is effectively 37.5%. 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 regard 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 10% as of 1994 for dividends or partnership profits received by non-residents, and for the remittance of commercial profits from foreign companies or entities branches. This rate was reduced to 10%, and will continue to decrease gradually in 1995 to 8% and from 1996 onwards to 7%. In the hydrocarbon sector the rate is 15% for 1995 and will be 12% for the following years.

6. Elimination of income taxes on profits for foreign capital investment funds that invest in portfolios in the Colombian stock exchange. These funds were previously subject to two different tax regimes. Law 6 of December 1992 established that these 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. Special conditions for the hydrocarbons sector There is no obligation to bring the currency obtained from the sale of crude into the country or sell it to the "Banco de la República" or to financial institutions. Conversely, currency for payments abroad cannot 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 this authorization⁴.

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 in Colombia).

2.2.4 Institutional Reform

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.

2.2.4.1 Exchange controls

⁴ Complete information on all regulations covering foreign investment in Colombia can be found in National Planning Department (1993).

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 an occasional regulator of the market.
- 2) Currency originating from trade of goods or from financial transactions must be negotiated through the financial system, but 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 took advantage of the fiscal amnesty offered to these type of capital.

These new exchange policies, added to the above mentioned new handling of the exchange rate, have created a positive climate, which has in turn fostered the return of a large amount of Colombian capital that had been held abroad.

2.2.4.2 Transportation Policy

Sea

Sea transportation policies have changed in accordance with the internationalization of the economy, as part of a general policy that aims at modernizing and streamline the transportation of goods within and outside the country. On the one hand, private port ownership (see Chapter 6) means that port operators 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 is taken into account, so that conditions to foreign transport are 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 such as railroads and roads will be dealt with in Chapters 5 and 6.

2.2.4.3 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 of US\$200 million has been established with the World Bank. 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 Union, 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 transfer, creation and diffusion 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. Some sectors have already taken steps in this direction. The Productivity Centers are the result of joint efforts by the private and public sectors, together with foreign governments.

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. This program includes the elimination of many existing regulations (i.e. limit to the number of models, etc.), the establishment of a requirement for a national value added, and the removal of the positive list system.

4) Anti-monopoly Law: Recently, congress was presented with a legislation project that aims at changing 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 that these might have on consumers.

CHAPTER 3

TRADE AGREEMENTS

3.1 INTRODUCTION

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 EU and the US), and a growing tendency to form separate trade blocks rather than a multilateral free trade area, international negotiations are crucial to guarantee increased and stable access to world markets. On 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 high 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 EU and the US as well as signing several regional trade agreements.

The ultimate goal of this strategy is to help to construct a hemispheric free trade zone, along the same lines as the "Enterprise for The Americas Initiative" proposed by the Bush administration in the US. This strategy is clearly justified by the large share of regional trade in total trade in Colombia. As shown in Table 2.4, during 1990-1993, more than 60% of Colombian imports came from Latin America and the US, and more than 62% of the country's exports were destined to those areas.

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 four years. Colombia has become a leader in Latin America, - and particularly within the members of the Andean Pact (Colombia, Venezuela, Ecuador, Peru and Bolivia)- in breaking with the long-standing tradition of routinely seeking access to foreign markets while trying to shield its own. In the past, 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 called "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 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 enjoyed temporary preferential access to the most important world markets: the US and the EU. Since November 1990 (and until 1996) the vast majority of Colombian products have free access to the European Union market, and since June 1992 through the ATPA, and for a 10-year period, nearly all trade barriers were eliminated for 4,816 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 70 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, in December 1993 Colombia and Chile signed a trade agreement to eliminate tariffs completely by 1999. In June 1994 Colombia, Venezuela and Mexico reached also an agreement to create a free trade area under the framework of G3 negotiations. Finally, Colombia and the Caribbean countries subscribed a trade agreement in July 1994. If negotiations with Central America and the Mercosur continue to develop, 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 America's GNP and total exports.

A more detailed description of the present state of Colombia's most important trade negotiations is offered below.

3.2 ANDEAN PACT

1992 represented 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.

The agreed tariff structure has four levels: 5%, 10%, 15% and 20%, according to the amount of value added of the corresponding product¹. Though there were still differences between countries regarding the level of protection that should be given to some items², in February 1993 officials reached an effective consensus on nearly 95% of the total tariffed items. Andean Pact authorities, including Bolivia, Ecuador, Colombia and Venezuela, officially approved the corresponding decision in November 1994, and the Common External Tariff (Arancel Externo Común, AEC) is effective since February 1995.

It was agreed that Ecuador could enjoy some preferential treatment, on the grounds that this country is still at an earlier stage of industrial development than Venezuela and Colombia. Therefore, for a period of 4 years, tariff rates in Ecuador for up to 990 specific products will be 5 percentage points below the common external tariff charged by the other countries.

Peru did not participate in the AEC agreement, but has been following closely all the negotiations given his willingness to reenter the Andean Pact.

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 support general rules set out by the Andean-Pact authorities.
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 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 14.9% of Colombian total exports and reached 16.4% in 1993, while 10.3% and 13.7%, respectively, of its imports came from Andean countries (see Table 2.4).

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\$ 2,150 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%). Historically, Colombia has been the most important exporter of the group, accounting for

¹ Bolivia could maintain its current tariff structure of 5 and 10%.

² Main differences are with Ecuador, in petrochemical, agricultural, and steel sectors.

nearly 41% of total intra-Andean trade in 1993, but in 1994 Venezuela surpassed Colombia by 4.5% (see Table 3.1.)

3.2.1 Integration with Venezuela

Without any doubt, economic integration between Venezuela and Colombia is the single most important recent event in Colombia's trade negotiations. In January 1992, under the framework of Andean-Pact negotiations, a free trade zone and customs union was created between the two countries³. This area represents a trading market of more than 50 million people and US\$104 billions worth of economic production.

For Colombia, the Venezuelan market represents almost 61% of its exports to the Andean region and 9.7% of its total exports in 1993 (Table 3.2). 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 items.

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.

Bilateral trade swelled from US\$750 million in 1991 to almost US\$1 billion in 1992 (30% increase). Colombia's exports to Venezuela, its third largest market, totalled US\$692 million in 1993, comprising 9.7% of total exports. Exports from Venezuela to Colombia reached US\$968 million, or 2.6% of its total exports and 9.8% of Colombia's total imports (see Table 3.2).

Venezuelan investment in Colombia increased from US\$337 thousand in 1991 to US\$65,810 thousand in 1993. This makes Venezuela the third biggest foreign investor after the US and Panama. Capital inflows have been invested mainly in the financial sector, as several banks and financial intermediaries were bought by Venezuelan entrepreneurs. Some of these banks however, are currently being sold due to the economic problems faced by Venezuela in the past year. Colombian investment in Venezuela, on the other hand, increased from US\$6,760 thousand in 1991 to US\$21,460 in 1993.

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 phyto-sanitary permits have been eliminated and the process of obtaining others has been simplified.

³ 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.

2. There has been great progress in harmonizing quality certification permits and procedures for non-agricultural products.

3. 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 support 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 American countries and other countries.

3.3 THE G3 AGREEMENT

The negotiations for the Group of Three (G3) started in October 1990, during the meeting of the "Group of Rio" in Caracas, where President Gaviria from Colombia, President Salinas from Mexico, and President Pérez from Venezuela, committed their governments to prepare trilateral negotiations in order to sign a free trade agreement. The talks continued throughout 1991 and 1992 and boosted in 1993. In June 1994, the G3 Free Trade Agreement was signed. This constituted one of the most important steps toward trade liberalization in Colombia and Latin America.

The G3 Free Trade Agreement could be viewed as an extension of powerful extra-economical ties that exist between the three countries, not only because of common historical and cultural backgrounds, but also because of similar geo-political positions toward peace in Central America and other socio-political conflicts in the area.

With the inclusion of Mexico in the Venezuelan-Colombian trade negotiations, the process of integration has benefitted considerably. In fact, Mexico is one of the most promising economies in the world, and represents a large potential market for Colombian products given the large population (90 million). It is also 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, 1.1% of Colombian exports and 2.6% of Colombian imports in 1993, they have been risen recently (Table 3.2). In 1992, Colombian exports to Mexico grew at a significant rate of 29.5%, foreshadowing the agreement. In 1993, Colombian exports grew at 15.2%, whereas Mexican exports to Colombia increased 51.8%. 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.

Mexico has signed recently NAFTA, 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.

3.3.1 The main elements of the G3 Agreement

The treaty is effective as of January 1995, where 50% of the Colombian manufacturing exports will enter Mexico free of tariffs, and 9% of the Mexican exports will be able to enter Colombia without tariffs.

The final structure of the agreement contains the following elements:

1. Market Access. There are 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 provides for the progressive elimination of all tariffs after a 10 year period ending in 2004. The three countries agreed to classify the products covered by tariff into four groups: i) Those whose tariffs will be eliminated immediately; ii) Those whose tariff will decrease linearly in a 10 year period; iii) Those belonging to the automobile sector whose tariffs will be negotiated during 1995; and iv) A reduced group of agricultural sensitive items whose tariffs will be determined later after studying the degree of protection and subsidies existing in each country.

The tariff reduction schedule is asymmetric: Mexico eliminates customs duties faster than Colombia and Venezuela and on more products, taking into account that the former is more developed than the latter. The reduction of the existing tariff for Mexico is 28%, whereas for Colombia and Venezuela is 12%.

For Colombia the sectors most sensitive to competition from Mexico are automobiles and parts, steel and petrochemical industries, and some agricultural products. The most competitive products for Colombia 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 chemicals.

b. **Import quotas** have been 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, 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 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 (50-55%).

3. Investment. The agreement removes significant barriers to investment, and ensure non-discriminatory protection of investments. As a complement to the treaty, a common investment regime was established.

4. Government procurement. The three governments agreed to treat government purchases as been made by any other national entity. Foreigners and nationals will be treated equally.

5. Anti-dumping and competition rules were established in order to avoid monopolistic and unfair government competition. State firms should follow commercial criteria. For anti-dumping regulations the criteria will be the one of GATT.

6. Dispute settlement procedures. In case of defaulting the agreement, any of the three countries is entitled to dispute the problem according with a procedure that follows consultation, mediation and arbitration.

7. Services. The agreement contemplates a gradual liberalization. Nationals and foreigners from the region are treated equally.

3.4 OTHER TRADE NEGOTIATIONS WITH LATIN AMERICAN AND CARIBBEAN COUNTRIES

3.4.1 Chile

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

1. Along with Colombia, 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 in 1991 a free trade agreement with Mexico, a country with which Chilean trade has increased substantially during the last years, and completed similar negotiations with Venezuela in 1993. Thus, for the strategic reasons discussed above, it was very important to guarantee that Colombia joined that trade block as soon as possible.

In December 1993 the two countries signed a free trade agreement that started to be effective on January 1994. Roughly 40% of the tariffs were eliminated as of that date. The rest of the products will have a three year reduction of the tariff until reaching 0% in 1997. For the most sensitive products, the elimination of the tariff will be done in a five year period.

Colombia has a comparative advantage in industrial textiles, coffee essences, printed matters, chemicals and pharmaceutical products and cocoa. Sectors like leather goods, coffee and silk among others, have a great potential for expansion in the future. Chile instead has a comparative advantage on apples, wine, dried fruits, wood, agroindustrial products and copper goods.

3.4.2 Free Trade Agreement with Central America

In a Presidential meeting held in February 1993, the Presidents of Colombia, Venezuela, Guatemala, Honduras, Costa Rica, Nicaragua, and El Salvador committed their governments to work 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 on.

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 America⁴, while the other countries will reduce tariff barriers more gradually.

3.4.3 Other Countries

Colombia already proposed a list of 290 such products.

Colombia signed already an agreement on July 1994 with countries of the Caribbean basin, similar to that subscribed to by Venezuela. It has also accepted to renegotiate already existing tariff preference agreements (Acuerdos de Alcance Parcial) with Brazil and Argentina under the framework of the Montevideo Treaty that created the Latin American Integration Association, LAIA. Under the present government of President Samper, it is expected that negotiations with Mercosur (Argentina, Brazil, Uruguay and Paraguay) will boost up. Such negotiations will help improve access of Colombian exports to those markets, and viceversa, through tariff reduction.

3.5 NEGOTIATIONS WITH THE US AND THE EU

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 US and the European Union (EU).

3.5.1 Trade negotiations with the US

In June 1990, the Enterprise for the Americas Initiative was launched creating great expectations in Colombia regarding trade and investment relations with the United States. As far as trade is concerned, however, so far these expectations 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, intellectual property rights protection, export promotion together with the private sector, etc.

Although the US took crucial steps towards creating a free trade relationship through the preferences given to Andean Countries under 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 US to recognize Colombia as a priority on the list of candidates for a NAFTA extension. A team is working with the advise of the USTR, towards the creation of a mechanism that would ensure this. The access is conditional upon a set of requirements that will be set by NAFTA members when they regulate it.

3.5.1.1 ATPA

The Andean Trade Preference Agreement, ATPA, is the commercial component of the American Program to fight 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 produced in drug producing countries (Colombia, Peru 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, 4,800 items have been enjoying such preferences. 2,000 of these items normally pay taxes higher than 5%. In 1992, the US importers paid tariffs on these products totalling more than US\$132,000, of which electronic and electric apparel represent US\$60,000. ATPA excludes products such as sugar, oil, tuna, textiles and apparel, leather goods, shoes and rum.

3.5.1.2 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 US.
2. Phyto-sanitary permits for some fruits have been eliminated.
3. 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.
4. Colombia, in turn, among other measures, has facilitated the import of wine from the US.

3.5.2 Trade Negotiations with the EU

The Government is also trying to improve Colombian exports access to the EU in order to take full advantage of the consolidation of that common market in 1993. An extension of the above mentioned Special Cooperation Program is being negotiated at the present time and it is expected to extend the preferential treatment to Colombia for another 10 years⁵.

The first full year of operation of this EU's special tariff preference (GSP) for Colombia was 1991. According to a recent study⁶, this program represents a substantial improvement with respect to the GSP. However, the new preferences had not had any dramatic effect on the composition of the top 30 export items. 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. That is why an extension for another 10 years of the agreement could increase Colombian exports to the EU.

⁵ The agreement's signature was scheduled for December 20, 1994.

⁶ 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.

So far, coffee, coal and bananas dominate the picture, accounting for over three-quarters of the value of exports to the EU 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, the banana dispute has been settled and Colombia is entitled to export 462,000 metric tons into the EU for 1994. Because Austria, Finland and Sweden joined the EU, this quota is expected to rise to approximately 530,000 metric tons.

CHAPTER 4

FOREIGN CAPITAL AND FOREIGN EXCHANGE MARKET

4.1 CAUSES AND CONSEQUENCES OF RECENT CAPITAL INFLOWS¹

The transformation process that the Colombian economy has undergone in the past four 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. The real estate and stock markets, as well as the financial accounts of important companies, are behaving extremely well. These factors, added to the generalized world recession during 1990-1992, the low external interest rates of 1991-1993, and the country's high financial returns, have led to a massive flow of capital into Colombia. The amount of net reserves accumulated annually rose from US\$4,501 Million in 1990 to US\$7,713 M in 1992 and US\$8,002 M in 1994.

4.1.1 The Structural Reforms of the Nineties

As detailed throughout this report, the Colombian economy has, over the last four years, experienced 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 legislation underwent important changes².

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 of financial crises such as the one in the early eighties which led to the nationalization of several banks (see Chapter 6, below).

To further the original liberalization objective, the Gaviria government issued Law 45 of 1990. It stimulated 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 the specialized banking system into a universalized one, through the creation of trust funds, leasing companies, pension funds and stock brokers, creating a 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

¹ See also Cárdenas, Mauricio & Barrera, Felipe (1993), and Ocampo, José Antonio & Steiner, Roberto (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.

spread, and set out to privatize the banks that had been nationalized (see Chapter 6).

Law 35 of 1993 went further on the reforms established by Law 45 of 1990. The scheme of multiple banks was strengthened by allowing different savings corporations and commercial financing companies to enter the exchange market, and all the intermediaries the mortgage business. At the same time, financial corporations as well as the leasing companies were allowed to drive in funds, and savings corporations were entitled to lend without mortgage guarantees.

After this reform the government continues to practice its regulatory functions, i.e. fixation of minimum capital requirements and authorization of financial institutions new activities. The Finance Ministry and the Financial Superintendency monitor and regulate the financial market, whereas the Central Bank Board supervises the monetary and exchange policies.

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 the past years (Table 2.1). During 1990-1992, capital inflows through this account have been far lower 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 1990-1993 period being characterized by debt prepayments.

The prepayment of foreign debt was not only a long-term measure but also a short-term stabilization tool, because the new inflows threatened to bring about a dangerous appreciation of the *peso*. Prepayment was one of the measures the monetary authorities took to sterilize the capital inflows. The sudden rise of debt disbursements in 1993 is also 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. In the past, people have often registered fictitious exports, or under-invoiced imports, in order to disguise the repatriation of illegal money and evade certain fiscal controls.

There is evidence 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 capital³. 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. In large part, they are due to such factors as the recent world recession and increased confidence about the future of the Colombian economy.

³ See Cárdenas, Mauricio and Barrera, Felipe (1993), and Correa, Patricia (1992).

It is worth pointing out that during the previous Latin American debt crisis, capital inflows were accompanied almost exclusively by massive current account deficits. Recent inflows however, resulted in an important accumulation of international reserves. These have reached levels which, for non-boom periods, are unprecedented in Colombia's history (see Table 2.1).

4.1.3 Policy Reactions to Recent Capital Inflows

While capital inflows can lead to an appreciation that hurts the tradable sector, their 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. There is evidence that financial liberalization has an expansionary effect on investment⁴. 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 aims at absorbing such flows, channeling them into investment, while preventing harmful real appreciations.

In the end, the crucial factors determining the possible positive or negative long term effects of capital inflows, and the manner, if any, in which they should be sterilized, are 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 positive effect on investment. In the Colombian case, there exist a tremendous amount of controversy with regards to where the recent inflows were originated. Some posited explanations include: a strengthening of drug traffick revenues, 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 República* has employed several policy instruments in order to "sterilize" capital inflows. These included the use of exchange certificates during July 1991-January 1994 which allowed the market a greater say in determining exchange rates while still allowing the monetary authority to control the general exchange rate trends. The exchange certificates served 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. The latter in turn stimulate capital inflows and lead to large quasi-fiscal deficits, originating from the difference between the return rates of the bonds issued and those of the Central Bank's own foreign reserves.

Other measures include the discouragement of short term capital inflows. Among them is the increase of withholding taxes for non export related dollar inflows from 3 to 10% in July 1993.

Both fiscal policy and commercial liberalization timetables have had to adapt in order to stabilize the recent capital inflows. On one hand, the commercial reforms were dramatically accelerated in 1991 because expectations of lower future import tariffs were resulting in massive reserve accumulations. On

⁴ See Zaidi, I. M. (1985).

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

It is important to point out that, to a large extent, these policy measures succeeded in controlling capital inflows. In fact, large appreciations have been avoided, as shown in Graph 2.1, at the same time that the inflation rate decreased from a historically high rate of 32.4% in 1990 to 22.6% in 1993.

4.2 FOREIGN DIRECT INVESTMENT

Both historically and in recent years, foreign direct investment (FDI) has been relatively sparse in Colombia compared to other Latin American countries. When compared to countries like Argentina and Chile, recent increases in direct investment into Colombia have been significant, but not nearly as large as those in the southern cone countries or in Mexico. One of the reasons for this is that the Colombian privatization process, described in Chapter 6, is relatively new, and advances have been limited up until now. Thus, one can expect that foreign investment inflows will continue to increase in coming years. Another factor which has limited the entry of FDI 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. Finally, it is worth mentioning security problems that have affected Colombia's image abroad, and a tradition of seclusion that lasted for various decades.

Furthermore, 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 three years, Colombia has received over US\$100 Million in investment inflows from the neighboring country, while Colombian investment in Venezuela increased from US\$5,643 thousand in 1992 to US\$23,479 T in 1994.

Still, the recent flows of FDI (Graph 4.1) 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\$ 1,060 Million in 1985, coincided with the most important period in the development of the *Caño Limón* field. As Graph 4.1 shows, FDI trends are largely determined by the trends of foreign investment in petroleum. It is interesting to note, however, that FDI 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 oil fields as *Cusiana*, *Cupiagua* and

Volcaneras. Furthermore, recent studies⁵ 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 FDI 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 Foreign Direct Investment in Other Sectors

Other sectors which have been favored recently by DFI can be seen in Table 4.1. It is interesting to note how much they have changed from year to year. In 1990, as in the past, the coal industry drew most investments followed by sectors surrounding the oil and mineral industry. This changed radically in 1991, when far more investment went to manufacturing sectors, US\$132 million, a change spearheaded by new investments in the automobile industry, especially by Japanese firms. In 1992, in turn, the financial sector picked up and represented 43.8% of total FDI for that year. In 1993, the four more important sectors for FDI were in order: manufacturing, financial, retail and construction. In Chapter 6 below, the financial boost in DFI will be treated fully when discussing the bank privatization process.

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, especially in the financial sector, and Panama.

4.2.3 The Stock Market

The principal stock exchanges in Colombia are the Bolsa de Bogotá, the Bolsa de Medellín, and the Bolsa de Occidente (Cali). The Bolsa de Bogotá is the oldest and that with the greater transaction activity.

The eighties were not a good decade for the Colombian stock exchange, as shown in Graphs 4.2 and 4.3. During that time, stock transactions got to be only 0.1% of GDP. This crisis ran parallel to the financial crisis of the early eighties that caused the nationalization of almost 50% of the banks. Both sectors were rife with irregularities and corruption.

After the crisis, the market's credibility was so hurt that it did not begin to recover until the early 90's boom. Among the causes for the recover of the stock market are the repatriation of capital from abroad because of the amnesty given by the government in 1991; the reforms aimed at liberalizing investments flows (both foreign and domestic)⁶; the tax reform of 1992 that removed capital gains and

⁵ See Lora, Eduardo, Perry, Guillermo and Barrera, Felipe (1993).

⁶ Resolutions 51 of October 1991 and 52 of December 1991.

share ownership taxes; the increase in direct foreign investment and other capital flows due in part to the privatization process and the authorization of new foreign funds; and, the fall in interest rates that made alternative assets unattractive. The political situation has also enhanced the confidence of investors, especially after the death of the drug baron Pablo Escobar and the decline of guerrilla and drug related violence.

The total value of stock transactions has increased twenty-fold over 1988-1993. In 1994 it is expected to reach US\$20 billion, a 63% increase with respect to the previous year. That places the country fifth in Latin America, after Mexico, Brazil, Argentina and Chile. The International Finance Committee's equity return index rose 38% in 1990, 191% in 1991 and 39% in 1992. During 1993, the stock market appreciated 33%. During 1984-1993, Colombia's equity return was ahead of Argentina, Venezuela and Brazil, but behind Chile and Mexico. There is still big room for market expansion in various sectors, as market capitalization represents only 25.6% of GDP in 1993, and 45.3% in 1994 (forecasted). The most attractive sectors are banking, retail and construction.

Despite the recent and continuing strengthening, Colombia's stock exchange must overcome problems as the small size of the market, illiquidity, limited stock selection, closed operating control, and information quality. As privatization programs continue, and new companies and shares are listed, the volume and value traded in the market will continue to improve. Also, the social security reform will drive up liquidity to the stock market as the private pension funds are expected to manage \$1.5 billion by the year 2000⁷. In turn, this rise in capital should contribute to overcome the concentration of shares and the lack of a diversified portfolio. Technological advances are taking place in trading systems for an uptodate and fast information service.

It is important to note that Standard & Poor's rates investment grade at BBB. The renewed confidence the stock market now enjoys will continue, to make it in the future an important channel to allocate national saving and a major engine of economic growth.

4.3 EXTERNAL DEBT: MAIN INDICATORS⁸

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 by the rest of Latin America during the 80's. 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 in total four syndicated credits were negotiated allowing Colombia to overcome the crisis without major problems.

⁷ Law 100 of December 1993 mandated that 13.5% of gross salary must be deposited in private pension funds.

⁸ From Castellanos, Jorge (1993).

A reason for Colombia's successful crisis overcome, besides lower debt levels, was its very diversified debt structure, the most diversified in Latin America at the time. As Table 4.2 shows, Colombia was never too dependant on commercial banks for financing, and it has been transforming its debt structure so as to be less dependant on them. This was done 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 Colombia's debt levels have never been too high, they have been stabilizing in the first two years of the 90's at around US\$14 billion (36% of GDP), and recently at US\$13 billion (20% of GDP).

4.3.2 Present Goals for Foreign Debt Management

Colombia's new foreign debt strategy is influenced by two major considerations. First is the 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, 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:

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 financing sources is that this translates into lower financing costs and savings for the country, as there must now be competition between the different sources.

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.

3. Improving the Current Debt Situation. The fulfilling of this goal involves not only prepaying 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 the development plans by preventing sudden increases in debt servicing charges. As can be seen in Tables 1.4 and 4.2, the Government is moving in this direction and was able to reduce public debt as a percentage of GDP from 36.8% in 1990 to 27.8% in 1993. It is expected that for 1994 this indicator reaches 21.9%.

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 in 1991 and 1992 in the internal market, and "Eurobonds" in 1993 and 1994 in the Euromarket. The National Government issued US\$125 million in 1993 and US\$250 million in 1994 of these bonds⁹. In the same way, the Government of Colombia issued ¥\$10 billion (US\$90 million) bonds in the Japanese market at the end of 1993. These "Samurai" bonds were used for debt prepayment. "Yankee" bonds were issued in February 1994 in the US stock market for US\$250 million by the Government of Colombia, and were used also for foreign debt prepayment. Return margins on these bonds have been the greatest obtained by any Latin American country.

⁹ Other public organisms like Ecopetrol, FEN, IFI and the Bank of Colombia have issued bonds in the Euromarket during 1993 and 1994 for a total of US\$530 million.

CHAPTER 5

STATE REFORM¹

Unlike 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 1.5.). At the same time, a privatization process is not a necessity for generating resources to cover fiscal gaps. The problem in Colombia, more than the size of the State, is its inefficient and often misguided performance. Therefore, in recent years, the government has taken actions to eliminate the deficiencies shown in the past.

5.1 CHANGES IN THE GOVERNMENT STRUCTURE

State participation 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 value added increased from 9% in 1950 to 21% in 1986. Still, the levels reached, with the exception of public investment as a share of 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 utilities like electricity, gas and water. The public sector represents a majority of the total only for the mining and utilities sectors mentioned above.

The State also had 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. This situation has been changing in the past 3 years as will be explained in Chapter 6. In the manufacturing industry the presence of the State is relatively small, representing only around 10% of the national total.

5.1.1 General Objectives for State Modernization

Even though the size of the State has not been a serious problem in Colombia, there was a general agreement that the performance of the public sector was much less effective and efficient than it should have been. As a result, the past administration took measures in various fields to correct this problem. The principal reforms were decentralization, the reduction of the official payroll, and the introduction of greater competition in areas that had long been served by State monopolies.

5.1.1.1 Decentralization

¹ See also Gaviria, César (1993) and Hommes, R., Montenegro, A. & Roda, P. (1994).

Since the early 80's, Colombia has undergone a rapid decentralization process. This policy aims at freeing the central government from a series of tasks that it does not, and often cannot, perform in an efficient way, and transferring 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's role will 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. They 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 (see Annex 1).

This is a basic transformation of the institutions that make up the State. In all cases, the transfer of tasks implies the liquidation or substantial reduction of several central institutions to avoid duplicity of functions and waste of resources.

5.1.1.2 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 was also implemented.

Payrolls are frequently excessive, partly because offering jobs in the public sector has been one of the traditional political mechanisms to obtain votes. For similar reasons, this type of expense is very inflexible downwardly.

5.1.2 Reforms

Decentralization and payroll reductions are not mutually exclusive. In fact, both will further the general goal of greater efficiency. With this in mind, the Colombian modernization initiative has been advancing at a steady pace.

It was not until the new Constitution was drafted in 1991 however, that the government firmly committed itself to eliminating the inefficiencies of the central bureaucracy. The executive had the power for a limited time to eliminate, merge and/or otherwise restructure all entities which it deemed necessary from the public sector. The reforms covered almost all public entities and included social, infrastructure, justice and security and environmental sectors among others.

5.1.2.1 Social sectors

In the past, over a dozen of inefficient and uncoordinated agencies managed central government co-financing of regional and social expenditures. After the reforms, only four funds are in charge of this task. These funds 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.

In the area of health services, the financial and administrative structure was altered so that large hospitals depend on the departments, while the municipalities are responsible for health posts. This means that municipalities generally attend minor cases and prevention programs, while the departments handle the major cases. The shifting of duties demanded that the restructuring of the National Health Service, that was designed to attend all kinds of cases, from vaccination to hospitalization, in 1993 by Law 60. To coordinate the changes resulting from Law 100 of 1993, the Social Security National Management was created (see below for Social Security reforms).

In education, the responsibility of hiring teachers and managing educational services was shifted from the Nation to the municipalities. This, in turn, forced a revision of the Ministry of Education's tasks. The Ministry is now in charge of teachers' quality and performance evaluation and the design of educational policies. Through the Social Mission and the General Law of Education of 1994 the Ministry will have the tools to improve the quality of the educational system, maintain the rates of assistance to schools, and help the departments and municipalities to manage their resources.

In 1991 the housing system was restructured so that the previous ICT was transformed into the Inurbe. The private sector performs now the construction, finance and housing trade, whereas the Inurbe manages the Family Housing Subsidy and provides technical assistance to the municipalities in urban reform topics. The Caja Agraria is in charge of the housing subsidy for rural areas.

5.1.2.2 Infrastructure

Perhaps the greatest amongst the reforms with respect 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, merged others, and placed entities like the "Aeronáutica Civil", which is in charge of controlling air traffic, under the new ministry. With the restructuring, 12,000 State jobs were eliminated. This contributed to increase the use of private companies in the construction and maintenance of public roads.

The Nation is responsible only for road construction of national importance, for general planning and control, and for credit handling. The roads essential to the economic liberalization strategy, especially the ones that communicate the interior of the country with the ports, have high priority. The Inviás (National Institute of Roads) is in charge of the execution of policies and on the hiring of private companies for road construction in charge of the Nation through the concession system (see Chapter 6). The regions will build and maintain their own roads. (At present, only 10% of the roads managed by the central authority are of national breadth).

The firm Puertos de Colombia (Colpuertos), in charge of handling exclusively the cargo at Colombian ports, was liquidated in 1991. Colpuertos was an example of State inefficiency, showing during the 80's seven years of consecutive losses and having a benefit scheme for its workers that exceeded by far the national standards. The new General Port Superintendence, under the Transportation Ministry, carries on the regulation and control of the ports. Mixed regional societies, with the participation of municipalities, the private sector and the Nation in a minimum share, handle the ports. The operational tasks are executed only by the private sector. As explained in Chapter 6, these changes brought considerable cost reductions for the use of the ports.

Ferrocarriles Nacionales de Colombia, the Colombian State railroad company, was also liquidated. Railroads' planning investments, policies and technical regulations are now in charge of the General Direction of Railroads. Ferrovías, a new State firm runs the rehabilitation, construction and maintenance of the lines. The private sector carries on the actual transportation activity, as well as the maintenance of trains and other equipment. However, additional changes on the railroad system are necessary, given that Ferrovías is in many cases a copy of the old State firm.

As for the aerial sector, the airports, terminals and airstrips will be transferred to the municipalities, departments and airport societies after the improvement of their finances. The private sector can also participate in the expansion of aerial infrastructure².

The electric sector, in turn, is becoming a pilot case for the new competitive scheme. The Energy Regulation Commission, a central entity, was constituted and commissioned with the planning of the sector, and the regulation of the prices, tolls, exchanges and transmission of energy. The Government controls now Interconexión S.A.-ISA, through the acquisition of energy firms' debts. ISA will be divided into two firms: one that conducts exclusively the generation of energy, and the other that manages the transmission and national interconnection of it. ICEL will concentrate on the supply of energy to remote areas. Competition between suppliers will increase, as regional and local entities in charge of distribution have greater autonomy in deciding who to buy energy from, including the private sector. This latter subject will be dealt fully in the next chapter. Finally, the Electric Law and the Residential Public Services Law, that set the regulatory principles for the commercial operation in the sector, were approved in 1994.

With respect to public services, three regulatory commissions, which function under the Ministries of Communication, Mines and Energy, and Development, were created to supervise telecommunications, energy, and water and basic sanitation, respectively. These commissions 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 at allowing Telecom to compete and adapt more efficiently in an increasingly open and dynamic sector. Private companies will compete with Telecom by offering local and national phone services, as

² See Chapter 6 for the private sector investment possibilities in the transportation sector under the current State policies and goals.

well as the cellular phone service.

5.1.2.3 Justice and Security

Due to the Colombian political situation, it was necessary to reform the judicial and the security systems. During the Gaviria administration, the number of judges, professional soldiers and policemen increased. At the same time, their salaries and endowments improved significantly to compensate the existing lag in these matters.

With respect to the State institutions, the government created the Attorney-General Office in 1992 to expedite criminal investigation and the accusation of transgressors. It also restructured the Justice Ministry to strengthen the battle against drug traffic.

The Defense Ministry was also reorganized and a Vice-Ministry was created to manage and control the expenditure and coordinate the dependent entities. In 1992, the reforms of the National Police, provided this institution with a greater administrative efficiency and gave new incentives to the policemen for the improvement of skills. The new National Police Commissioner is in charge of receiving citizen complaints about the Police.

5.1.2.4 Environmental reforms

To concentrate the efforts made by the Ministries of Agriculture, Health, Mines, Public Works, Defense and the National Planning Department in environmental matters, the government created the Environment Ministry in 1993. The new Ministry assumes the responsibilities of the former Inderena and clusters together the Autonomous Regional Corporations-CAR and other research institutions.

The National Environmental System distributed the national and local functions of the entities belonging to the Environment Ministry. The Ministry is in charge of natural resources conservation, research and public education. With the help of the community, the proctor will investigate the charges and assure a sustainable development.

5.1.2.5 Other reforms

ICA, a government agency involved in agricultural research and development, has been split into a public sector agency, responsible of epidemic prevention and control, and a mixed public-private sector agency, committed to agricultural investigation and technology.

SENA, the training and technical education service, has been restructured. SENA's regional learning centers have been given greater autonomy, allowing them to specialize according to the area that they serve. With these measures the SENA is expected to better accommodate the needs of the private sector and facilitate the process of industrial and agricultural adaption and conversion, crucial factors in today's rapidly changing economy.

The Colombian Institute of Science and Technology is now under the National Planning Department supervision and its functions were shifted to the administration of funds. The National System of Science and Technology created in 1990 abolished the National Institute of Technological Research, and promoted the creation of decentralized mixed corporations instead.

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 subdivided into three groups: free competition promotion, intellectual and other property rights protection, and consumer protection, which includes such things as antimonopoly legislation. These measures aim at reducing 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. At the same time, they help the private sector overcome the challenges and achieve the rewards implied by the liberalization and internationalization strategies.

Other reforms included the creation of the Foreign Trade Ministry, and the division of the former Proexpo into Bancoldex and Proexport (see Chapter 2), as well as the strengthening of the Labor Ministry's national planning functions.

Finally, the customs and tax administrations were merged into the DIAN. This measure streamlined and improved two government agencies which had long been known for their inefficiency and high levels of corruption. Not only it placed 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. In this regard, it is noteworthy that 75% of the revenues the Customs administration currently collects come from sales taxes. It is important to highlight that the National Tax Administration's payroll decreased by 2,400 employees over the past three years.

These reforms are 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 which facilitate corruption are eliminated. While it will take more time before the impact of these reforms is felt on State corruption, they have already helped reduce State inefficiency.

Another measure that improved State efficiency was Law 80 of 1993. This Law establishes the rules for State hiring and assigns responsibilities to the people or firms that intervene in the process. Outdated procedures as well as hiring through private concourse were eliminated, and variable limits to other procedures were set.

The 1993 reforms reduced the number of State employees by 22,642, added to 21,651 who had either voluntarily retired through a special government measure between 1991 and 1992 or got their pension. The total State employees retired during 1990-1994, 47,729, represent over 10% of the central State's payroll, and their pension cost over \$347 billion pesos. However, there was an increase of a similar magnitude in the State employment through the hiring of employees in the Attorney General Office, the National Police and the Defense Ministry.

5.2 FISCAL REFORMS

5.2.1 A Balanced Budget

The situation of the Colombian economy varied significantly during the decade of the eighties. An initial attempt at liberalizing imports during the 70's led to a sudden influx of foreign goods that displaced domestic industries and increased foreign currency outflows. Furthermore, the Latin American debt crisis led 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 was fiscal deficits which oscillated between 5.5 and 7.4% of GDP between 1981 and 1984. The first part of the decade was characterized by a fall in industrial production, while GDP grew only an average of 2.5% annually between 1981 and 1983 and foreign reserves fell progressively (Table 1.4).

The country then adopted a severe adjustment program following the advice of the International Monetary Fund. Thus, in 1985 a plan started under which the real exchange rate depreciated by 20%, public expenditure reduced, public sector salaries increased at a rate lower than the inflation rate and indirect taxes broadened. These adjustments not only helped fiscal accounts but also the current account, which went from registering a US\$2,826 million deficit in 1983, to a US\$463 M surplus in 1986.

During the 1990-1994 period, a balanced budget was also a priority to maintain macroeconomic stability. In fact in 1991 there was a fiscal surplus of 0.16% of GDP, and in 1992-1993 the deficit was less than 0.3% of GDP for the public sector as a whole. However, the Central Government has experienced a deficit since 1992 (excluding the resources of cellular phones licenses obtained in 1994). The decentralized public sector presented a surplus during 90-94. It improved even more its situation since 1992 due to the capitalization of the electrical sector, the recent increase in international coffee prices, the increase in public utilities rates and in contributions to the Social Security, and the greater transferences from the central government to the regional and local governments.

5.2.2 Tax Policy and Revenues

5.2.2.1 The 1992 Tax Reform

Economic liberalization was the focus of the past administration's economic policy. Its potential positive effects on efficiency and economic growth can be enormous in the long run. In the short run, however, the accompanying reduction of import tariffs had a very harmful effect on the State's revenues. As shown on Table 5.1, the percentage of State income originating from external economic activity went from 40.8% in 1980, to 29.7% in 1987, and to only 11.2% 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. As a result, the income tax, the sales tax and the gas tax regimes were modified as part of the 1992 tax legislation reform. At the same time, the tax evasion legislation was strengthened.

With respect to income taxes, the principal changes of the 1992 tax reform were the broadening of the tax base and the equalization of the tax treatment for foreign investors. All industrial and commercial State companies are now taxable, as are mixed-economy and non-profit corporations. The special tax on dividends and participation 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 are exempt from income and remission taxes, as an incentive for greater transfers of technology into Colombia. Finally, a special, temporary surcharge on income taxes of 7.5% effective till 1997 was put into place, although 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 are subject to a 14% tax except the following: 1) basic consumption goods (agricultural goods in a natural state, powder or pasteurized milk, vegetable oils, coffee, drugs for humans, etc); 2) beer, liquor and cigarettes, which would be subject to departmental taxes in the 30-50% range; 3) services, such as health and certain types of transportation and public services other than telecommunications. In addition, as an incentive to investment, the sales tax on capital goods is now transferable into a tax credit. The *ad valorem* gasoline tax was set at 27% and it is planned to increase gradually until 1996, when it will reach 35%. Hydrocarbons and other minerals as oil, gas, coal and ferronickel, are now taxed.

A significant reform in the area of State revenue collection was the merge of the tax and customs administrations into the DIAN, described in section 5.1 above. The simplification of the administrative processes for tariff declaration and the modernization of the DIAN improved the collection of taxes. Random investigation, sanction and control mechanisms were strengthened to lower tax evasion.

As part of the general decentralization effort, the reform advanced the program of fiscal decentralization, establishing a general framework of regional taxes. Regional entities received in this way more autonomy and more responsibility and accountability 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.

5.3 LABOR LEGISLATION REFORMS

Colombian labor legislation 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. That made it difficult for the firms to adjust their working forces to changing situations. As a reaction to these restrictions, companies had found ways of contracting workers that allowed to avoid these regulations but that greatly increased the instability of employment, thus deteriorating workers' conditions and companies' productivity. Not only were these policies responsible for the high rate of labor turn over 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.

These problems were solved by the new labor legislation and especially by Law 50 of 1990. An important change regarded the compulsory saving or severance. Previously, all salary increases affected the saving amount, even if part of it had been already used by the worker. This increased labor costs tremendously due to inflation, especially in the case of employees who had worked in a company for a

³ For further information on the tax regime for foreign investors see National Planning Department of Colombia and KPMG Peat Marwick (1993).

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. As discussed in Chapter 4, the severance funds are expected to boost the stock market.

5.3.1 Salaries and Contracts

Colombia's labor market is not very unionized. 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 became considerably weaker over the last decade.

Market forces play the vital role in the determination of salaries. The Government only sets the minimum wage and wages for public workers. Minimum wage has influenced in the past average wages in the construction and in the non-skilled formal urban sectors. The influence of minimum wages has been lesser in average wages of traditional agriculture and public sectors, and almost negligent in modern agriculture and manufacturing industry. For the latter sector, there is a high difference between the minimum wage and the average wage, and the majority of the contracts are settle on a two year basis, with adjustments made more often with respect to past inflation.

Salary adjustments usually occur once a year. In the case of collective bargaining, salaries are adjusted every two years. While the situation of the labor market affects 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. These include: 15 working days of paid vacation per year, a premium of half a salary in June and another half in December, and a severance or compulsory saving for the worker. The severance is equivalent to one month of salary per year worked and is given to the worker when he or she leaves the firm, to purchase housing, or to finance higher education. The employer must pay 12% annual interest on the severance and deposit it in a private severance fund if the contract was made after January 1st 1991.

There are other payments which must be made to Social Security entities by the firms. These contributions as a percentage of the workers wages are now 12.5% to the Social Security (to which the worker must also contribute, see below), 3% to the Colombian Institute of Family Welfare, 2% to the SENA (the government technical education and training service), and 4% to Family Subsidy Institutions (Cajas de Compensación). Total benefits are between 44 and 50% of the basic salary. Although this is a high level, 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.

The new legislation introduces other changes to the labor market. Among them are the elimination of forced reintegration and the pension-penalty for workers who have serviced over 10 years, the extension of the maternity leave to 12 weeks (as per ILO recommendations), and the flexibilization of contracts for periods lower than one year. There is also an explicit definition of the responsibilities and benefits of workers and employers to avoid misunderstandings. It is possible now to use premiums and bonuses to encourage productivity without considering them as part of the wage (i.e. without affecting severance and

pensions contributions). The new labor legislation also allows firms to pay an "integral salary" for workers with high level salaries (over 10 minimum wages). This integral salary includes all benefits mentioned above except the vacations, in order to settle all labor costs for the firm. There were also some reforms on the creation of unions and on collective bargaining processes to update Colombian legislation on these issues. In summary, the new labor legislation makes the labor day more flexible, especially for new enterprises⁴.

5.3.2 Social Security

Following the State reforms, one of the areas that underwent the greatest transformation was 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". Law 100 and Law 60 of 1993 reformed both the pension and the health systems to accommodate the changes in the population's age structure and its necessities. These laws also corrected inefficiency and solidarity problems of the previous systems, and extended Social Security coverage.

In the previous system, Social Security recipients were divided into two broad categories. The first one was composed by those who worked in the private sector and were affiliated to the Social Insurance Institute (Instituto de Seguros Sociales or ISS), to which they contributed throughout their working lives and, in return, received health benefits, a disability and life insurance, and a pension upon their retirement. The second one was made up by public sector workers, whose pensions came from Social Prevision Funds to which they needed not to contribute, so that about 80% of their pension costs were covered directly by the State. They received also a broad range of health and other benefits from the State through the institutions they worked for. It should be noted that this latter category was in fact composed by a multitude of different Social Security systems given that individual public institutions did not have often a unique pension system. Not surprisingly, these many different regimes were full of inequalities and, as a general rule, the privileges they offered exceeded by far those offered by the ISS.

The new system seeks to equalize the regime for all Social Security recipients, thus eliminating the tremendous inequalities described above. Under the current Social Security system, private capitalization funds are allowed to compete with the ISS. Public workers can now choose between the ISS and the private capitalization funds. The pension system changed from a pay-as you go system to one of capitalization. A final but important goal of the new system is the expansion of Social Security's coverage, given that only about 25% of Colombia's total population was covered by the previous systems in 1990. By 2005 at least another 30% of the population should have Social Security.

5.3.2.1 Pensions

One of the reasons that made government spending cuts unsuccessful in curbing the public sector

⁴ See Reyes, Alvaro (1994) for more details on the new labor legislation.

deficit in the mid 80's was that while real salaries were cut and the payroll expansion was stopped, expensive pension schemes were introduced in most State companies. Corruption and injustice reached such high levels that, there were public sector companies with pension schemes that allowed a worker to retire, with full privileges, after working for only 12 years, no matter his age. Pensions became public sector companies' greatest expenditure requirements and many traditionally efficient and even profitable institutions succumbed to these costs or were on the verge of doing so.

The inequalities of the public sector Social Security systems were not the only financial trouble. The ISS had also lost most of its capitalization characteristics as a result of both financial mismanagement and excessively low contribution levels, both because of low requirements (6.5% of worker's wage) and because of evasions. ISS became a system of simple distribution and its reserves were rapidly depleted. That is to say that current retiree's pensions were paid with current affiliates' contributions, and before the reforms in 1993, the ISS would have started using its reserves in 3 years.

The changing nature of the Colombian work force, made also the previous system unsustainable in the long run. Some numbers alone demonstrate the demographic changes currently taking place in Colombia which threatened 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. It is expected for 2020 that the ratio between affiliates and each retiree continue to drop to 5. 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 previous 6.5% contribution rate increasingly obsolete and increasing the costs of the pension system on the central government. That is why the Social Security system was reformed.

Among the changes made is the increase of the contribution requirement to a level of 13.5% of the worker's wage since 1996 (the actual level is 12.5%). The firm pays 75% of this contribution, while the worker pays the rest. Independent workers pay the full amount of the contribution to the Social Security.

There is also a dual system of Social Security, one managed by the ISS and the other by private capitalization funds. The ISS administers the average premium pension scheme. The benefits are characterized by constant contribution rates. The workers know in advance their pensions. Pensions are equal to 65% of the average real wage of the last 10 contribution years. The premium increases 3% for workers contributing more than 1,000 weeks, and 2% for those contributing more than 1,200 weeks, without exceeding 85% of the wage nor 20 minimum wage. If the yield of the private funds is less than 5% annually, the average premium scheme is competitive with the private capitalization funds.

In the private capitalization funds, every person has an individual account where the capital from the contributions increases to cover the pension in the future. The pension received is a function of the yield of the fund. The workers could retire if they can guarantee a pension equivalent to 110% minimum wage. To increase the pension, the worker should work up to 60 years for women and 62 for men. The State guarantees a minimum pension for workers older than these ages if they have contributed more than 1,150 weeks. The workers can make additional contributions to their account if they desire so. They can withdraw the balance of their accounts that exceeds the capital necessary to finance 70% of the base

income. In case of death or disability the workers or their dependents will receive between 75% and 100% of the average wage of the last 10 years when they made contributions. There is a pension bonus for the workers that want to switch from the average premium pension scheme to the private capitalization funds, that recognizes the contributions made in the past to the ISS. Women below 35 and men below 40 years old, have an incentive to have their pensions handled by private capitalization funds.

The private funds are regulated by the Financial Superintendency. Among the requirements are a minimum capital of US\$4 million, a maximum asset investment according to their equity, and a minimum yield determined by the yield of the bonds and stocks in the market.

In the new system, solidarity, equity and efficiency were also taken into account to increase the goodness of Social Security. With respect to solidarity, the workers with wages higher than four minimum wages, contribute with an additional point to the Social Security. In addition, the State contributes with the same amount collected by this mean to the Solidarity Fund to subsidize the workers that cannot assume completely their contribution. The State guarantees also the minimum pension and the program for elderly people below the poverty line.

Equity has increased given that all workers, public and private, receive the same benefits due to the unification of the different pension sub-systems. However, during the transition time there will be different benefit schemes in order to guarantee the acquired rights of the workers.

Efficiency will improve also through the competition of the public and private sectors, and the liquidation of insolvent public funds. The higher efficiency may reduce the administrative costs of the system as a whole.

While the change to a capitalization system involves a certain amount of fiscal expenditures in the medium run, as capitalization funds receive the amounts that workers have already "accumulated" in the ISS, it is a sound investment in the long run, for pensions are handled more efficiently and national saving rises.

5.3.2.2 Health

The most important move in this area is the creation of a Social Security Health System in 1993 by Law 100. The system works as a sort of national health insurance and is based on three principles: universality, solidarity and efficiency.

To achieve universality the system is compulsorily and includes family coverage. Through this project, it is expected that almost the entire Colombia's population will be covered by the year 2001, with the most needy being subsidized by the State as well as being aided by the contributions of their fellow citizens. The Mandatory Health Plan (MHP) insures the prevention, diagnosis, treatment and rehabilitation of illnesses for the population. There is also a Basic Care Plan whose services are free of charges, that specializes on the development of prevention plans and the improvement of public health. Among the services rendered by this plan are immunizations and vaccinations, health services in schools, contraception information and performance of certain related services, nutritional information, campaigns against alcohol, tobacco and other drugs consumption, issuance of regulatory measures to improve health conditions, and

prevention of AIDS.

Universality cannot be achieved without solidarity, however, for the whole of society have to contribute to the system, each person in quantities proportional to his or her capacity to do so. A system of subsidies was therefore put into place to aid those with lower economic capabilities that could not afford the MHP. All workers contribute with 12% of their wages to the health system, from which 1% goes to the Solidarity and Guarantee Fund⁵. The Government as well as other entities (Family Subsidy Institutions) also contribute to this fund.

As for the principle of efficiency, the institutions belonging to the health system are now divided into two groups: the Health Promoting Entities (Entidades Promotoras de Salud-EPS) and the Health Services Provider Institutions (Instituciones Prestadoras de Servicios de Salud-IPS). Both the EPS and the IPS have now their functions well delimited increasing in this way efficiency⁶. Also through the competence for the provision of health services between public and private institutions inside the EPS and the IPS efficiency rises. In addition, the project includes the concept of choice as vital both in guaranteeing the beneficiaries' satisfaction and in multiplying the system's efficiency.

Efficiency is also achieved through decentralization and the resulting increased dynamism and accountability. Law 60 of 1993 states the functions and determines the amount and destination of funds for the national, departmental and municipal levels of health institutions according to the volume of health services provided. As the funds for the decentralized organizations are greater, their responsibilities will also increase.

With these reforms the health system becomes one where subsidies are given to demand rather than to supply as in the past. With this change, it is expected that inefficiency decreases and that the covering of health be guaranteed to the entire population. However, control of medical costs will be determined by the ways in which the EPS and the IPS make their contracts and interact⁷. It is important to note that Government health expenditure rose by 41.4% between 1990 and 1994 (from 1.4 to 2%) and it is expected to increase by 56% in real terms by 2000, duplicating the resources of the Social Security Health System between 1995 and 2000.

⁵ The employer is responsible for 2/3 of the contribution to the Health System (or 8% of the worker wage), while the worker is responsible for the rest. Independent and contracting workers, as well as workers with "integral wages" must pay the totality of the contribution to the Health System.

⁶ The EPS are institutions in charge of financial intermediation that coordinate affiliation, registration and collection of the contributions. The IPS instead are doctors, hospitals, etc., in charge of providing medical services. The direction of the health system is in charge of the National Social Security Health Council (Consejo Nacional de Seguridad Social en Salud).

⁷ For further discussion on this topic see Gutierrez et al. (1994).

CHAPTER 6

SECTORS WITH PROMINENT PERSPECTIVES FOR INVESTMENT¹

6.1 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. 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 the said year to 87 in 1988. In 1983, 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 Coporo fields, these perspectives have improved even more and oil reserves could reach 3.900 million of barrels.

The State's own petroleum operation started in 1951 with the creation of the Colombian Petroleum Company (ECOPETROL), a State commercial firm operating under the Ministry of Mines and Energy. Ecopetrol is responsible for the investigation, exploration, development, transportation, refining and marketing of crude oil and some of its derivatives. It is likewise responsible for the domestic availability of fuels and oil derivatives. The firm currently provides direct employment to 12,000 people and indirect employment to another 50,000.

The production of crude is divided up as follows: in 1993 Ecopetrol directly produced 93,688 barrels per day. Private companies produced 35,921 barrels per day under the concession system (which is now being phased out). Under Association contracts, they produced 323,744 barrels per day, 60% of which (some 194,246 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 is exported by the Associates. Ecopetrol exported approximately 82,490 barrels a day of its own crude in 1993.

6.1.1.1 Cusiana, Cupiagua and Other Recent Discoveries

Up until 1992, Colombia had proven petroleum reserves of 1.8 billion barrels, which would have ensured its self-sufficiency only until 1996. This 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

¹ For further information on regulations governing foreign investment see National Planning Department and KPMG Peat Marwick (1993) and National Planning Department and CONPES (1993).

fields have radically changed Colombia's oil and energy outlook, as well as the perceived value of its exploration areas².

Cusiana and Cupiagua hold oil reserves amounting to 2,100 million barrels. Furthermore, these fields contain very "light" crude, which allows it to be sold at a premium because of its lower refinery costs. Cusiana has already gone into production. During the second semester of 1995, the well will be producing 185 thousand barrels per day, the goal for phase I of the project. This quantity will rise to 500 barrels per day in 1998 and will be maintained at that level until the year 2002.

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 hold around 6,000 million barrels in reserves both from oil and gas.

6.1.2 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. In addition, a privatization process is currently under way, whereby the formerly bureaucratic, intervention-minded State is transformed into a manager/director State.

6.1.2.1 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 88.7 million hectares of sedimentary basins, Ecopetrol has reserved 4.2 million hectares for its own exploration (4.8%), while the 74 currently active Association Contracts cover a total of 7.9 million hectares (8.9%), and the 11 Concession Contracts cover 183 thousand hectares (0.2%). This means that 86.1% of Colombia's sedimentary basins are open to new contracts. The presence of Japanese and other foreign capital undertakings in this area is very attractive from the Colombian Government's point of view.

The foreign companies' own crude can be marketed or processed directly by the companies, with the exception of the share 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\$4.6 billion, a large portion of which will go to materials and engineering, which represent further business opportunities.

6.1.2.2 Downstream

² See country map for the location of the oil fields.

Among Ecopetrol's different projects there is the construction of a refinery to process heavy crude. This project, on which the basic engineering is now completed, requires certain adjustments with respect to location and structure, especially because a greater size is desired. Recently, Ecopetrol decided that this project should be carry out by the private sector. Considering the ample supply of crude with low transportation costs and a large and growing domestic market³, this project has enormous potential for private entrepreneurs. 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 industry⁴. 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 Ecopetrol provides any oil processing plant with sufficient, timely supplies. Furthermore, the Government will keep an eye over unfair competition practices in the international market, such as "dumping". These and other clear and necessary "rules of the game", are currently a top priority, as Colombia welcomes greater levels of foreign investment in this area and makes them clear that dealings between the Government and investors will be based on fair and stable norms.

³ Colombia imported US\$238 million worth of gasoline in 1991, US\$276 M in 1992, and US\$262 M in 1993.

⁴ One of the most attractive projects in this area is the construction of a plan to process olefins and aromatic oils. It has been estimated that sales (domestic and external) could amount to US\$ 569 M in 1996 and US\$ 724 M by the year 2010.

6.2 NATURAL GAS⁵

Colombia has ample natural gas reserves. In 1993, the estimation of gas was ~~6,675~~ giga standard cubic feet (or 6.6 TCF) including the discoveries of the Cusiana and Cupiagua oil wells. The Volcaneras field has around 4 or 5 trillion cubic feet (TCF) in reserves. 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 the reserves will increase over coming decades as oil exploration 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. 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 the end of 1997.

The construction of 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 current financial constraints that the broad investment program has placed on the State. The companies obtaining the concessions of the major pipelines will act as transporters of the gas and will sell it to the private distribution firms in each city. The price of the gas will be determined by the price at the well, and by the transportation cost.

The construction of the Guajira-Barrancabermeja duct, one of the most important stretches of the national network, was contracted with Enrom from the U.S.. This pipeline will cover the departments of the Guajira, Cesar, Magdalena and Santander. The pipeline from the West is also going to be assigned under the BOMT system in March 1995. It will cover cities as Manizales, Pereira, Armenia and Cali. The pipeline from the Center-East region will be administer by Ecogas, the new mixed capital firm in charge of the government gas project that will be created during the first semester of 1995⁶. It will connect the cities of Barrancabermeja, Neiva, Bosconia and Bogota. Medellin will be connected to the major grid through the concession system. See Country map for the location of these cities.

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 already interconnected through gas pipes, which serve 30 municipalities with an approximately coverage level of 60%. In Bucaramanga and Neiva coverage levels have reached 95%. The private sector will invest around US\$3,977 M for the construction of the pipelines and the maintenance of them in the next four years.

⁵ See also Ministry of Mines and Energy, Ecopetrol and the National Planning Department (1993).

⁶ Ecopetrol, FEN and the private sector will be the owners of Ecogas.

6.3 COAL INDUSTRY

6.3.1 Introduction

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

With the energy crisis of the 1970's, Colombia saw an opportunity to become a significant player in the new and promising international coal market. Accordingly, Carbones de Colombia S.A. (CARBOCOL), was founded in 1976, with the purpose of centralizing the responsibility into a single entity of Colombia's government policy in the coal sector.

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

New mining projects will be carried out under exploration and exploitation contracts with private firms. The government will make no direct investments, leaving the private sector to explore and exploit at its own risk. The State will receive royalties or some other form of compensation for the exploitation of its coal resources, such as investment-free stock participation, contracting premiums, profit shares, 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.

6.3.2 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\$545 Million FOB, equivalent to 7.6% of the world's supply in the said year. Export levels in 1994 were of similar magnitude and represented 6.2% of total exports for the said year. At present, Colombian exports go in their majority to the European market (53.7% to Central and North Europe and 21.4% to Mediterranean Europe). 19.5% of exports in 1994 went to the US and Canada, and only 2.2% was exported to the Far East. ~~These volumes are equivalent to 11% of Europe's coal demand, and only 0.26% of Far Eastern demand.~~

The international thermal coal market has entered into its maturity stage and shows sustained growth. Between 1990 and the year 2000, the world demand for thermal coal will grow from 190 million tons a year to 330 million. Much of this growth will be centered in the Far East market, currently one of the largest and fastest growing in the world. The increase on the international trade of this energy product over the next 10 years demonstrates the strength and promise of this market. Colombia's medium term strategy is to increase its share aggressively, without lowering prices below the current levels, which reached in average US\$29.6 per metric ton in 1994. Colombia expects to export 37 to 45 million tons by

the year 2000, equivalent to 11.3 % of the market by the said year. It also expects to increase the share of sales to the Far East from 2.2% to 6% of total Colombian exports.

6.3.3 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 respect to location, assessment and evaluation of reserves, the country has now identified coal deposits throughout its territory. These deposits are in La Guajira, Cesar, Córdoba, South and North Santander, Antioquia, Boyacá, Cundinamarca, Valle, Chocó and Cauca. A production of 50 million tons per year could be sustained for three centuries.

Colombia has the potential to produce 38 million tons per year. It is feasible to achieve an export target of 40 million tons by the year 2000 with the development of new mining areas or the expansion of existing operations, as is the case of Cerrejón Norte, where the production potential 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 Colombia's coal reserves, this scenario is completely feasible.

6.4 PRIVATIZATION

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 operate traditionally in competitive, private sector areas. The State, for a variety of reasons, is currently a partial or total owner of these companies. 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. Private entities could get involved through the development of new projects in these areas.

The most important privatization initiatives currently taking place in Colombia are described below.

6.4.1 Financial Sector

In 1982, the Colombian financial system underwent a crisis which forced the State to intervene various institutions in order to control the damage that a banking disaster would have caused, and return some of the system's strength. 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 sector overcame gradually the crisis 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 banks, however, have already achieved acceptable levels, and their performance in recent years has been outstanding.

Government's intention was to return the banks to the private sector once the crisis had passed. In 1989, the 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. At the same time, 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. The new policy's priority is to return the banks to the private sector and ensure that they continue to operate. Sale prices correspond now to expectations of future income flows and are set by the market (although the government sets a minimum sale price). The recovery of the investments made by the public treasury at the time of the interventions is thus only a secondary objective. Furthermore, democratizing the property structure became less important.

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 assure 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 buyers. 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), "Banco del Comercio" (US\$349 million assets) and "Banco de Colombia" (US\$400 million assets) have been completed. Certain traditionally State-owned banks, such as the "Bancafé" 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), are also being considered for privatization. The shares of the Government in Bancoldex, the new export-import bank, are also going to be sold in 1996.

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 operations. The enactment of this reform removed restrictions on foreign investment in the sector, and opened new spaces for the development of financial firms such as fund management firms and stock brokers. Furthermore, the regime regulating asset transfers, merges, liabilities and contracts between financial intermediaries became 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 privatization process, "Banco de los Trabajadores" and "Banco Tequendama", were bought by Venezuelan financial entities. A partial list of the financial institutions to be sold during 1995-1996 is included in Table 6.1.

6.4.2 The IFI firms

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

IFI's role as an industrial promotor lost credibility with time. The temporary nature of its capital contributions 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, agro-industrial and mining activities. In the future, every IFI investment will function exclusively as a seed capital and the rules for the retirement of IFI from a corporation shall be made clear from the beginning.

IFI sold its shares in several firms of national relevance, such as Sofasa (the Colombian assembly company of Renault automobiles) in 1988, Papelcol (a major paper producer) in 1990, and Alcalis Betania (a chemical producer) in 1994. Several other smaller companies have also been put on sale through the Colombian stock exchange. During the 1990-1994 period, 22 firms were privatized, one was liquidated, 4 finished the liquidation process and 2 accounting adjustments were made to adjust the investment made by the IFI. The privatizations represented USD\$156 million for IFI. There are other larger IFI direct or indirect investments in companies like Cerromatoso, Monomeros Colombo-Venezolanos, and Propal that are currently being valued or offered for sale. A list and description of the firms to be privatized is included in Table 6.2.

6.4.3 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 was issued which substantially changed 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 the government. Under the new regime, the private sector will be able to promote, develop and operate free zones anywhere in Colombia, so long as the area has been geographically bounded. The surface of the free zone should be no less than 50 acres. Free zones should not operate in the same area of commercial and/or service activities for which they are intended, and they 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 are 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. In addition, negotiations of all kind of foreign exchange will be allowed within each zone. They will not have to exchange their currency through the banking system.

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

With respect 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. Passenger vehicles, yachts or other vessels for tourist zones will also be tariff free. Finally, 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 in 1993.

6.5 PUBLIC UTILITIES

6.5.1 Electricity⁷

The government's plan for the expansion of the electric sector seeks to increase the installed generation capacity by 2700 MW by the year 2000, and around 5900MW during 2001-2007⁸, in order to effectively cover the country's energy needs and avoid future crises like the one experienced during 1992. Table 6.3 shows the most possible scenario for the expansion of the electricity generation capacity proposed by the government. To meet the expansion targets, 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. In Table 6.4 there is a list of the potential electricity generation projects for the private sector.

6.5.1.1 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

⁷ See also Ministry of Mines, Ministry of Finance and National Planning Department (1993) and Conpes, Ministry of Mines and National Planning Department (1995).

⁸ The actual capacity is 10079 MW from which 78% are hidraulic and 22% thermic. There are also 150MW that could be imported from Venezuela.

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 still 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.

6.5.1.2 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 profitable right now to produce electricity 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.

6.5.1.3 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 assets can now be sold to cover financial obligations. The firms will continue to provide public services, but will now do so with private participation.

6.5.1.4 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 transparency of the regulatory framework.

As a result, several measures are being taken 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 developed. These rules will also ensure that electric generation takes place under fair and competitive conditions. The Domiciliary Public Services Law and the Electricity Law approved in 1994, will strengthen the process by making the regulatory framework not only stable but also transparent. The division of Electric Interconnection S.A., ISA, in the coming future into ISA-T, in charge of electric transmission, and ISA-GEN, in charge of electric generation, will contribute to consolidate the institutional transformation of the electrical sector and let the entities specialize and monitor better each task.

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 and providing returns on their investments. The price paid include the fixed investment cost and a variable operating cost for the energy delivered. It 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. PPA's must clearly establish conditions such as the place of delivery, the term of the contract, price formulas on power and energy, and payment mechanisms. Termobarranquilla, a project contracted through PPA's, is expected to be finished between the first quarter of 1996 and the fourth quarter of 1997.

PPA's, in turn, will be insured through double-billing systems (in which revenues from consumption go to the producer, and other revenues go to public utilities), through pledges of income from large consumers, and through banks or the State supported, National Electrical Financial Company (FEN) guarantees. This will ensure that contracts between private suppliers and public utilities are stable and transparent in the long run.

There are currently a wide variety of thermal power plant projects throughout the country. Several of them are in conjunction with coal mining projects and all are in areas with ample coal reserves and good local markets. There is a preference to expand the thermal electrical generation over the hydraulic to avoid the dependence on climate conditions. For further information, contact Ecopetrol.

6.5.2 Telecommunications

Decree 1900 of 1990 defined the restructuring of the Colombian telecommunications sector and allowed the creation of private firms to handle the cellular phones, value added 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. That has been especially true 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 by 1996. By that year, Colombia will have 5.9 million lines that corresponds to 16.7 phones per 100 inhabitants. Concessions for national long distance services to be carried out by private or public firms (national or foreign) should start on January of the said year. In a 3 year period, companies with a 51% share of the State will provide the international long distance service through concessions authorized by the Communication Ministry.

Decree 741 of 1993 established the procedure for the bidding process of cellular phones assignments. There are three zones for the provision of the service: the Atlantic Coast, the West and the East regions. In each zone two concessions were granted, one to a private firm and another to a mixed capital firm. Cellular phone service started in June 1994. It is expected to have 580 thousand users by the year 2000. The excellent results in this field have proved the goodness of the concession system to stimulate competence and guarantee optimal supply of quality and use of technology.

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.

6.5.3 Garbage Collection

Municipal garbage collection firms have traditionally been inefficient, mainly due to corruption. 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. This has limited the efficiency with which resources are used. The contracts' terms have also been 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.

6.6 TRANSPORTATION

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, as is the fact that a major part of the country's productive activities are located at the interior of the country. There presently exist major government initiatives with respect to roads, railroads, ports and air transport to facilitate a successful internationalization of the country.

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 expedition. 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 Gaviria administration defined as a priority a highway system of 6,300 km. It involved the building and the improvement of roads that connected the main consumer regions with the ports and the Colombian borders. Among the most important highways planned and constructed are the Magdalena Medio Troncal, the Llano Marginal, the Villavicencio-Bogotá Road, the Medellín-Turbo Road, the Road Plan for the Atlantic Coast, the West Troncal, the Coffee Axle and the Coffee Road. To complete the 12,000 km main network, the regions are in charge of constructing and maintaining the regional roads.

Many of the main roads in charge of the State will continue to be contracted with private sector firms through the concession system, as it has been done since 1993. The firms could either simply work for the State or take over roads entirely, receiving tolls as the return for their investment. A partial list of road construction projects to be carried out by the private sector can be seen in Table 6.5.

6.6.2. Ports

With the reform of the country's sea terminals in 1991, the private sector gained complete access to its operational structure. It also competes on the handling of the ports with the association of other partners. In fact, the private sector is now in charge of rendering port services, mooring, loading and unloading of merchandise, storage, etc.. At the same time, through the "Regional Port Societies", entities that can be conformed by public, private or mixed capital, the building, maintenance and administration of port terminals is guaranteed. So far, there are five Regional Port Societies that administer the ports of Santa Marta, Barranquilla, Cartagena, Buenaventura and Tumaco, with a private capital share of almost 70%. Tariffs are set freely by the economic agents, though there is some State surveillance. These companies receive 20 year concessions, that can be extended, in 20 year blocks, an indefinite amount of times.

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

Since October 1993, all ports belonging to the Nation are in the hands of their new administrators and operators, carry on visible benefits. Rates dropped 52% and the average ship stay decreased from 6 to 3 days since it began to be administered by private agents. Productivity increased 60% compared to that of 1989. Almost 380 private port operators have already been inscribed.

Despite these changes, it is necessary to reduce even more operational costs to make freight charges and port fees competitive with respect to other Latin American countries. The greater efficiency and competitiveness will result from higher investments of the private companies in machinery and in the maintenance of the ports. Other factors that would contribute to efficiency are a higher rotation of containers in the new Cartagena container terminal, and the construction of other container terminals along the Magdalena river and Armenia. The government could also stimulate productivity by continuing its substantial investments in port dredges and confluent highways and railways.

6.6.3 Railroads

The Colombian railroad system is outdated. The State railroad corporation, Ferrocarriles Nacionales, had not shown good financial results for many years. It was subject to enormous pressures from labor organizations and to government policies which forced it to participate in economically unmanageable operations. Ferrocarriles Nacionales fell into a serious crisis and was liquidated in the late eighties. Recently, the State realized 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.

In 1989, Ferrovías, a State company in charge of the rehabilitation and maintenance of the lines started its operations. The private sector works through contracts with Ferrovías for the construction of railroads and it is paid for through tolls. Private firms are also in charge of the transportation activity, and the maintenance of trains and other equipment⁹.

Ferrovías is going to undergo a restructuration in the coming future and hand over more of its activities to the private sector. The existing problems are mainly due to the duplication of some of the Ferrocarriles Nacionales inefficiencies. Among these activities are the purchase of raw materials, the running of the workshop, the operation of equipment, and the management of contracts and its real state. The restructuration also includes the reduction of the payroll and the adoption of a concession system as in the case of the ports. With this change, Ferrovías will only be in charge of railway regulation, and there will be more coordination among the operation of the trains and the maintenance of the lines.

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

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

Bogotá - Santa Marta Line:

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

The Pacific Railroad:

Several routes along this line, which includes the essential Buenaventura - Cali - Yumbo track, were already contracted with the Railway Transport Society from the West for passenger transportation. The 304 kms Buenaventura - Zarzal - Cartago line, is also administered by the same company for cargo transportation. The latter part of the line has yet to be rehabilitated.

La Caro - Belencito Line:

In 1992 the line was rehabilitated substantially. Since 1993, it is under STF administration and transports around 165,000 tons per year.

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.

⁹ So far there are four mixed societies to handle the operation of the railroads. These firms are: Sociedad de Transporte Ferroviario (STF-S.A.), Sociedad de Transporte Ferroviario de Occidente, Cooperativa Cotransferros in Antioquia, and Sociedad del Tren Sabanero.

Medellín - Barrancabermeja:

This line is operated by Cotransferros. They are also in charge of the Bucaramanga - Barrancabermeja track, but have not started yet operations on it.

There are other projects that are being studied at present. These are the Dorada - Santa Marta line, the Zipaquirá - Bogotá and Facatativa - Bogotá lines, and the cooperation with the Bogotá Municipality for the Metro Bus. Finally, there exists the possibility of operating a tourist train along the line Bogotá - Villeta, as the one that the Savanna Train Society administers in the Bogotá Savanna.

6.7 AGRICULTURAL EXPORTS

6.7.1 Bananas and Other Fruits

Colombia's climate and topography are particularly favorable for the cultivation of a very wide variety of fruits, with the advantage of low production costs.

Bananas hold the most important place among the fruits. 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 are among the first places of the so called "minor exports", with 10.7% of the total for this group, equivalent to US\$425 million in 1993, (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 export transportation costs.

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 by certain large local marketing companies. Japan and other Asian countries are growing markets for exports of bananas, and other Colombian fruits.

Besides bananas, other fruits such as strawberries and mangoes have adapted extremely well to Colombian conditions. These fruits have reached 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 their cyclical conditions.

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

Fruit exports, made by over 50 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. The new forms of presentation broaden the market for these products, since they make them easier to market and to transport. These exports have shown a rate of growth close to 35.4% per year, from US\$3.4 million in 1985 to US\$38.3 million in 1993.

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

With respect to fruit and its derivatives, there are wide opportunities for foreign investors who can contribute with a better knowledge of consumer markets. In particular, there is great potential in the production and export of fruit-based products with a greater domestic value added component.

6.7.2 Flowers

One of Colombia's most successful export sectors is that of flowers. This industry started in the early 1960's, making good use of Colombia's comparative advantage given to Colombia over the main world supplier of flowers, the Netherlands. On the plains of the Bogotá savanna, it is possible to cultivate flowers the whole year round, with no need for hothouses, allowing for substantial cost reductions. Another advantage is the availability of skilled and relatively cost competitive labor.

Colombia succeeded in rapidly consolidating an efficient marketing and shipping system. It won the U.S. flower market, and became practically the sole supplier in some specific varieties like carnations. Although Colombia may not keep up with Dutch technology with respect to the generation of new varieties, nurseries are excellent from a technical standpoint, and are particularly effective in adapting and breeding imported species.

In 1975, Colombia's flower exports totalled almost twenty million dollars. By 1993, they reached US\$ 380 million (see Graph 6.2). The most important market for Colombian flowers is the United States, which buys over 80% of the production. Colombia has also achieved important advances in penetrating the European market, despite the tariff disadvantages it faced with respect to other producer countries, such as the Netherlands and Israel. The customs exemption granted by the European Union to Colombian flowers up to 1996 (in consideration of Colombia's hard struggle against the drug traffic), opened up promising possibilities for broadening Colombia's position in the European market.

6.7.3 Farm-Bred Shrimps

Colombia's entry into the farm-bred shrimp market only goes back to the mid-80's. However, the country has already shown its wide potential among the Latin American producers. The main producer in the region is Ecuador, with 73,000 metric tons in 1993. Other shrimp producers in the world are Indonesia, Thailand, China, and the Philippines. In 1993, Colombia produced 6,600 metric tons with a productivity per hectare per year of 2.3 metric tons. Production of farm-bred shrimp in Colombia has maintained a substantial rate of productivity growth with perspectives of increasing in the future. Exports have risen from US\$600,000 in 1985 to US\$46.5 million in 1994 (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 farm-bred shrimp to Spain at higher unit prices. In 1994, close to 62% of Colombia's shrimp exports went to Europe, from which Spain represented 70%, France 20% and Belgium 10%. The West European market is particularly attractive in the medium and long term since it is the region, within the industrialized world, with the lowest per capita consumption and it presents the highest possibilities for expansion.

Given that shrimp fishing has reached its maximum levels of exploitation over the world, almost the entire growth of production in the future will come from farm-bred shrimp. In Colombia, there is ample availability of land suitable for shrimp production, breeding experience, and good transportation facilities. These factors are clear advantages for foreign investment in this field.

There is not a problem finding buyers for Colombia's current levels of production, in part because it still has a marginal share of the world market. The next challenge for Colombian producers is the marketing, especially the development and sale of products with a higher value added. This will call for sizable investments in packaging and processing plants for new presentations. The Colombian shrimp companies could only make these investments to a limited extent, considering the large sums of capital involved. One formula which may give good results is the association of Colombian producers and processors with importers and agents in developed countries. The latter are fully familiar with the market and the tastes of the final consumer in each country, and at the same time have greater financial solvency.

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Table 1.1

SOCIAL INDICATORS

	Colombia	Latin America & Caribbean	Developing Countries	Industrialized Countries
Per Capita GNP				
1992 (US Dollars)	1,330	2,690	1,040	22,160
% Change 1980-1992 (Ave.)	1.4	-0.2	0.9	2.3
Population (Millions)				
1992	35.8 *	450	4,240	1,210
Demographic Growth Rate (%)				
1960-1992	2.3	2.3	2.2	0.8
1992-2000	1.6	1.7	1.9	0.6
Life Expectancy at Birth (years)				
1960	56.6	56.0	46.2	69.0
1992	69.0	67.7	63.0	74.5
Infant Mortality Rate (per 1,000 births)				
1960	99	105	149	35
1992	30	47	69	13
Adult Literacy Rate (%)				
1970	78	76	46	
1992	87	86	69	96

*: 1993 Census

Sources: UNDP, Human Development Report 1994
World Bank, World Development Report 1994

Table 1.2

COLOMBIA: GDP BY ECONOMIC ACTIVITIES
1970-1994p

Sector	Average Annual Growth (%) *				
	1970-1975	1975-1980	1980-1985	1985-1990	1990-1994p
Agriculture	4.43	4.28	1.49	4.52	1.76
Mining	-3.27	-0.81	15.56	19.99	-0.49
Manufacturing Industry	7.42	4.58	1.15	4.77	2.95
Coffee Harrow	4.96	6.51	-0.67	4.32	-2.32
Other	7.84	4.26	1.46	4.84	3.70
Electricity, gas and water	11.06	6.48	3.24	5.83	3.80
Construction	4.92	5.43	7.78	-3.14	6.81
Retail	7.01	4.40	1.33	3.53	3.75
Transportation	7.42	7.48	2.38	2.93	4.69
Financial	5.25	5.37	2.54	5.19	6.90
Communal Services	6.61	6.59	3.09	4.57	5.19
Total GDP	5.93	5.06	2.32	4.63	3.83

Sector	Share (%) *					
	1970	1975	1980	1985	1990	1994p
Agriculture	25.33	23.89	22.69	21.86	21.79	19.83
Mining	2.66	1.71	1.27	2.34	4.64	3.86
Manufacturing Industry	21.39	23.22	22.38	21.21	21.39	20.39
Coffee Harrow	3.27	3.16	3.34	2.89	2.85	2.21
Other	18.12	20.06	19.04	18.32	18.54	18.19
Electricity, gas and water	0.73	0.94	0.99	1.04	1.10	1.09
Construction	3.46	3.34	3.35	4.36	2.97	3.28
Retail	12.46	13.27	12.68	12.12	11.53	11.33
Transportation	7.76	8.42	9.31	9.37	8.65	8.82
Financial	14.24	13.96	13.97	14.18	14.59	16.17
Communal Services	11.44	11.96	12.68	13.21	13.20	13.71
Total	100.00	100.00	100.00	100.00	100.00	100.00

*: Over 1975 Constant Productions

p: Preliminary

Sources: DANE, National Account Statistics, Table 13.2

DNP: Macro Unit, January 1995 Estimations

Table 1.3

**COLOMBIA: ANNUAL GROWTH OF GDP BY ECONOMIC ACTIVITY
1990-1994e**

	1990	1991	1992p	1993e	1994e
Total Agricultural	5.83	4.16	-1.85	2.70	2.13
Mining	5.92	-0.64	-2.76	-0.64	2.16
Manufacturing	4.23	0.82	5.89	1.90	3.27
Coffee Harrow	21.87	-7.21	30.70	-19.10	-7.20
Other	1.95	2.06	2.42	5.65	4.70
Electricity, Gas and Water	3.77	3.06	-6.08	11.70	7.37
Construction	-13.07	0.25	8.36	7.00	11.97
Retail	2.82	0.63	4.33	5.00	5.10
Transportation	3.74	3.44	5.24	4.00	6.09
Financial	6.20	4.94	4.06	7.08	11.69
Communal Services	2.75	0.85	3.84	6.41	9.86
Total	4.28	2.00	3.83	5.27	5.69

p = preliminary

e = estimated

Sources: DANE: National Account Statistics

DNP, Macro Unit: January 1995 Estimations

Table 1.4

COLOMBIA: SOME ECONOMIC INDICATORS (US\$ MILLION & %)
1970-1994p

	1970	1975	1980	1985	1990	1991	1992	1993	1994p
Fiscal Deficit/GDP*	2.20	3.23	2.31	4.38	0.33	-0.16	0.30	0.28	2.58
GDP % Growth	6.21	2.32	4.09	3.11	4.28	2.00	3.83	5.27	5.69
Inflation	6.80	22.90	26.50	22.30	32.40	26.80	25.10	22.60	22.60
Real Exchange Rate Index (1986=100)	n.a.	87.54	73.10	80.01	111.51	108.28	102.76	103.36	95.88
Public Social Expenditure/GDP	n.a.	n.a.	4.66	4.87	4.39	4.24	5.51	5.96	n.a.
Current Account	-291	-127	104	-1,586	543	2,347	922	-2,081	-3,036
Net Reserves	152	547	5,416	2,067	4,501	6,420	7,713	7,869	8,002

* Note: a negative number indicates a surplus

Sources: Banco de la República, Principales Indicadores Económicos 1923-1992, and January 1995 Estimations
Dane: Cuentas Nacionales
Contraloría General de la Nación: Informe Financiero and Confis

Table 1.5

**TOTAL GOVERNMENT EXPENDITURES (% OF GDP)
1970-1993**

Country	1970	1975	1980	1985	1990	1991	1992	1993
Argentina	11.11	19.58	14.00	17.68	na	na	na	na
Brazil	13.16	11.26	20.14	25.31	33.92	25.04	na	na
Colombia	0.00	12.52	12.40	13.70	15.50	16.70	21.80	18.00
Chile	19.10	34.32	28.01	30.40	20.48	21.41	21.07	na
Mexico	11.63	14.69	16.78	24.86	17.37	na	na	na
Peru	17.49	21.54	19.28	17.41	13.23	10.41	12.00	na
Venezuela	18.74	23.29	21.95	21.07	22.38	23.80	22.08	22.19

Sources: International Monetary Fund (1994) Financial Yearbook Statistics
For Colombia: Contraloria General de la Nación, Informe Financiero

Table 1.6

COLOMBIA: FOREIGN DEBT INDICATORS
1970-1994e

	1970	1975	1980	1985	1990	1991	1992	1993e	1994e
Foreign Debt/GDP (1)	24.7	27.3	19.8	40.8	43.6	41.2	34.6	34.2	32.5
Public	18.3	18.9	12.9	31.0	36.8	35.6	28.4	25.0	20.1
Private	6.3	8.4	6.8	9.8	6.8	5.6	6.2	9.2	12.4
Debt Servicing/Exports	27.8	22.5	18.9	49.8	52.9	49.7	52.7	36.3	40.9
Public	15.6	14.1	12.6	38.3	44.5	43.8	47.5	29.6	28.6
Private	12.2	8.4	6.3	11.4	8.4	6.0	5.2	6.7	12.3

e: Estimated

(1): GDP in dollars computed using the ave. annual exchange rate and the Representative Exchange Rate (TRM) since 1992

Sources:

For GDP DANE and DNP: Macro Unit, January 1995 Estimations
 All the other variables: Banco de la República: Tables 5.4.1, 5.6.1, 5.8.1; "Principales Indicadores Económicos: 1923-1992", and January 1995 Estimations

Table 2.1

COLOMBIA: BALANCE OF PAYMENTS (US\$ MILLION)
1970-1994e

	1970	1975	1980	1985	1990	1991	1992e	1993e	1994e
I. Current Account	-291	-127	104	-1,586	543	2,347	922	-2,081	-3,036
A. Balance of Trade	-20	297	13	109	1,971	2,960	1,234	-1,657	-2,551
1. Exports of goods (FOB)*	776	1,712	4,296	3,782	7,079	7,508	7,263	7,429	8,545
2. Imports of goods (FOB)	796	1,415	4,283	3,673	5,108	4,548	6,029	9,086	11,096
B. Balance of Services	-297	-472	-74	-2,156	-2,455	-2,310	-2,046	-1,562	-1,327
1. Financial	-181	-263	-211	-1,384	-2,080	-1,832	-1,804	-1,541	-1,713
2. Non-Financial	-116	-209	137	-772	-375	-478	-242	-21	386
C. Transfers	26	48	165	461	1,027	1,697	1,734	1,138	843
II. Capital Account	334	112	945	2,220	-2	-782	4	1,908	3,154
A. Long Term Capital	232	302	815	2,350	196	145	165	905	3,810
1. Investment	37	31	48	1,015	480	514	800	1,092	2,099
Direct	40	33	51	1,016	484	433	740	754	1,446
Portfolio	-3	-2	-3	-1	-4	81	60	338	653
2. Debt Contracted	195	272	807	1,341	-203	-369	-635	-187	1,754
3. Contributions to Int'l Organizations	0	-1	-40	-6	-81	0	0	0	-43
B. Short Term Capital	102	-190	130	-130	-198	-927	-161	1,003	-656
III. Counterparts **	21	0	24	39	-14	-51	-56	225	5
IV. Errors and Omissions	-25	39	168	0	98	362	297	154	47
V. Change in Gross Reserves	39	88	1,241	285	626	1,876	1,167	206	170
VI. Reserves									
A. Net Reserves	152	547	5,416	2,067	4,501	6,420	7,713	7,869	8,002
B. Gross Reserves	258	553	5,420	2,313	4,595	6,500	7,728	7,932	8,102

e: estimated

*: Includes gold

**: Includes valuation changes and special drawing rights

Source: Banco de la República: Tables 5.1.1. & 5.4.1 and January 1995 Estimations

Table 2.2

COLOMBIA: COMPOSITION OF EXPORTS
1985-1994p

Commodities	Value Million of US\$ - FOB		Share (%)		Annual Ave. Growth (%)
	1985	1994p	1985	1994p	1985-1994p
Coffee	1,702	2,108	45.0	24.2	2.4
Petroleum & Derivatives	409	1,323	10.8	15.2	13.9
Coal	126	543	3.3	6.2	17.6
Ferronickel	55	114	1.5	1.3	8.4
Gold	365	271	9.7	3.1	-3.3
Non-traditional	1,125	4,363	29.7	50.0	16.3
Total	3,782	8,722	100.0	100.0	9.7

p: Preliminar

Sources: Banco de la República: Table 5.4.1 and January 1995 Estimations

Table 2.3

COLOMBIA: NON-TRADITIONAL EXPORTS
US\$ Million FOB
1990-1993p

Commodities	1990	1991	1992	1993p	Ave. Annual Growth (%) 1990-1993p
AGRICULTURAL:	818.2	1,103.0	1,095.6	1,062.7	9.1
Bananas	318.0	404.9	407.3	425.4	10.2
Flowers	228.9	279.6	339.7	379.5	18.4
Fish, Crustaceans & Molluscs	111.9	147.3	124.7	121.0	2.7
Cotton	46.6	69.9	56.3	9.8	-40.5
Fruits, Veggies & Roots	27.0	38.9	47.9	38.3	12.4
Others	85.8	162.5	119.7	88.7	1.1
INDUSTRIAL:	1,714.1	2,271.0	2,271.9	2,492.2	13.3
Food and Tobacco Products	269.0	254.3	345.1	334.1	7.5
Yarns & Fabrics	166.4	132.3	134.6	147.5	-4.0
Clothing	405.4	629.7	498.7	584.9	13.0
Rubber and Plastics	71.3	50.8	63.7	68.7	-1.2
Leather & Leather Goods	170.8	243.2	208.3	241.8	12.3
Wood & Wooden Goods	9.9	17.6	18.7	18.9	24.0
Paper and Printed Items	123.4	175.5	184.0	198.5	17.2
Chemicals	235.2	345.0	389.8	441.0	23.3
Non-Metallic Minerals	76.1	120.9	105.0	109.5	12.9
Iron and Steel	69.7	107.3	101.7	90.8	9.2
Machinery & Equipment	74.5	115.3	152.5	155.3	27.7
Transportation Materials	9.5	17.6	24.1	43.6	66.3
Optical, Film & Other Products	12.0	12.7	12.9	17.0	12.3
Others	20.9	48.9	32.7	40.7	24.8
MINERAL:	132.0	169.1	197.2	429.4	48.2
Emeralds	112.9	142.8	179.7	399.6	52.4
Others	19.1	26.3	17.5	29.8	16.1
TOTAL:	2,664.2	3,543.1	3,564.7	3,984.3	14.4

p: Preliminar

Source: Banco de la República

Table 2.4
Colombia's Main Trade Partners
1990-1993p
Shares (%)

Country/Region	1990	1991	1992	1993p	Ave. Annual Growth (%) 1990-1993p
EXPORTS (FOB)	100.0	100.0	100.0	100.0	1.87
Andean Countries (1)	5.6	11.6	14.9	16.4	45.45
Other LAIA (2)	4.1	4.3	4.6	4.2	2.60
Central American & Caribbean	7.8	10.1	6.4	6.9	-2.19
United States & Puerto Rico	44.5	38.4	39.4	39.9	-1.80
Canada	1.0	0.9	0.8	0.6	-13.53
EEC (3)	25.5	25.0	25.7	22.9	-1.71
EFTA (4)	2.6	3.3	2.2	2.3	-1.98
Rest of European	0.8	0.9	0.5	0.5	-11.16
China	0.0	0.3	0.1	0.1	23.05
Asia	0.6	0.7	0.8	1.3	30.18
Japan	3.7	3.2	2.9	3.3	-1.32
Middle East	0.6	0.9	1.1	1.0	21.49
Africa	0.1	0.1	0.2	0.3	62.75
Oceania	0.1	0.1	0.1	0.1	2.25
Other Countries (5)	2.9	0.4	0.3	0.2	-62.02
IMPORTS (FOB)	100.0	100.0	100.0	100.0	23.69
Andean Countries (1)	9.4	9.7	10.3	13.7	39.98
Other LAIA (2)	10.3	10.9	10.9	10.2	23.58
Central American & Caribbean	3.3	4.4	4.4	2.7	15.52
United States & Puerto Rico	36.7	36.2	37.6	35.5	22.38
Canada	3.0	2.7	2.8	2.0	7.96
EEC (3)	19.5	18.8	17.9	17.3	18.91
EFTA (4)	4.1	4.3	3.8	3.4	16.32
Rest of European	0.7	0.5	0.6	0.8	26.67
China	0.0	0.1	0.3	0.3	135.23
Asia	1.5	1.7	2.2	2.8	50.23
Japan	8.9	9.1	7.9	9.7	27.19
Middle East	1.0	0.4	0.5	0.8	14.70
Africa	0.5	0.5	0.3	0.5	18.98
Oceania	0.3	0.3	0.2	0.1	-8.45
Other Countries (5)	0.7	0.4	0.2	0.3	-10.39

p: Preliminar

(1): Bolivia, Ecuador, Peru, Venezuela, Colombia (free trade zones)

(2): Latin American Integration Association: Includes Argentina, Brazil, Chile, Mexico, Paraguay, Uruguay, plus Andean Countries

(3): European Economic Community: Germany, Belgium and Luxembourg, Denmark, Spain, France, Greece, Ireland, Italy, Netherlands, Portugal, United Kingdom

(4): European Free Trade Association: Austria, Finland, Iceland, Norway, Sweden, Switzerland

(5): Azerbaijan, Bosnia Herzegovina, Slovakia, Canal Islands, Kazajstan, Kirghuzia, Macedonia, Moldavia, Tadjikistan, Turkmenistan, Uzbekistan, Panama Canal Zone, Other Countries

Source: DIAN: Informe Estadístico de Comercio Exterior 1990-1994

Table 2.5

COLOMBIA: IMPORTS BY USE OR ECONOMIC DESTINATION
1985-1994e

Commodities	Value (US\$ Million CIF)		Share (%)		Ave. Annual Growth (%)
	1985	1994e	1985	1994e	1985-1994e
Consumption Goods	389.1	2,096.2	9.4	17.8	20.6
Non-Durable	177.6	729.8	4.3	6.2	17.0
Durable	211.5	1,366.3	5.1	11.6	23.0
Raw Materials & Intermediate Prod.	2,434.1	5,098.3	58.9	43.2	8.6
Fuels	481.3	433.8	11.7	3.7	-1.1
For Agriculture	173.3	355.8	4.2	3.0	8.3
For Mfg. Industry	1,779.5	4,308.8	43.1	36.5	10.3
Capital Goods	1,307.5	4,611.2	31.7	39.0	15.0
Construction Materials	256.6	143.3	6.2	1.2	-6.3
For Agriculture	15.0	63.1	0.4	0.5	17.3
For Mfg. Industry	672.6	2,687.9	16.3	22.8	16.6
Transportation Equipment	363.3	1,717.0	8.8	14.5	18.8
Others		3.4	0.0	0.0	
TOTAL	4,130.7	11,809.2	100.0	100.0	12.4

p: Preliminar

Source: Banco de la República: "Principales Indicadores Económicos 1923-1992"
 and January 1995 Estimations

Table 2.6**COLOMBIA'S AVERAGE TARIFF STRUCTURE (%)
1990-1993**

Commodities	1990a	1991b	1992c	1993d
CONSUMER GOODS	51.67	21.42	17.41	17.06
Durable	52.69	20.61	17.23	16.98
Non-durable	49.74	22.93	17.74	17.20
INTERMEDIATE GOODS	33.48	12.04	9.97	9.90
Hidrocarbons	25.68	11.93	8.00	7.83
Agriculture	22.95	12.28	8.99	8.81
Industry	33.93	12.03	10.03	9.96
CAPITAL GOODS	27.66	12.50	10.30	8.27
Construction Materials	39.68	15.43	12.44	12.46
For Agriculture	20.52	9.35	10.44	10.46
For Industry	24.56	11.43	9.48	9.32
Transportation Equipment	32.83	15.05	11.67	11.52
OTHERS	27.41	15.50	8.61	8.28
TOTAL	36.28	14.35	11.79	11.57

a: 13% surcharge. Decree 3104

b: 8% surcharge. Decree 2515

c: Decree 255

d: Decree 165

Source: Torres, Luis A. (1994) Apertura y Protección: criterios para una reforma arancelaria, Coyuntura Económica, December

Table 3.1

THE ANDEAN GROUP 1991-1994p*
US\$ Thousand and %

January-June 1991

Exporter Country	Destination Country					Andean Group	Share
	Bolivia	Colombia	Ecuador	Peru	Venezuela		
Bolivia	0	12,191	312	23,338	1,079	36,920	5.43
Colombia	3,602	0	56,474	79,101	178,377	317,554	46.70
Ecuador	222	12,801	0	12,440	2,760	28,223	4.15
Peru	10,475	51,391	18,659	0	30,232	110,757	16.29
Venezuela	441	147,202	16,565	22,287	0	186,495	27.43
Andean Group	14,740	223,585	92,010	137,166	212,448	679,949	100.00

January-June 1992

Exporter Country	Destination Country					Andean Group	Share
	Bolivia	Colombia	Ecuador	Peru	Venezuela		
Bolivia	0	13,230	929	30,231	7,052	51,442	5.36
Colombia	7,092	0	82,766	141,440	229,104	460,402	47.98
Ecuador	579	16,087	0	47,746	5,329	69,741	7.27
Peru	12,763	46,241	24,918	0	51,687	135,609	14.13
Venezuela	326	181,785	21,979	38,196	0	242,286	25.25
Andean Group	20,760	257,343	130,592	257,613	293,172	959,480	100.00

January-June 1993

Exporter Country	Destination Country					Andean Group	Share
	Bolivia	Colombia	Ecuador	Peru	Venezuela		
Bolivia	0	10,359	4,681	29,834	764	45,638	3.53
Colombia	5,879	0	95,626	104,659	326,885	533,049	41.23
Ecuador	604	57,581	0	70,725	5,315	134,225	10.38
Peru	28,099	39,608	23,055	0	33,762	124,524	9.63
Venezuela	384	398,649	12,717	43,684	0	455,434	35.23
Andean Group	34,966	506,197	136,079	248,902	366,726	1,292,870	100.00

January-June 1994

Exporter Country	Destination Country					Andean Group	Share
	Bolivia	Colombia	Ecuador	Peru	Venezuela		
Bolivia	0	24,926	5,760	51,993	1,127	83,806	5.38
Colombia	10,054	0	134,555	96,469	297,611	538,689	34.55
Ecuador	1,212	94,536	0	87,512	5,021	188,281	12.08
Peru	32,819	44,516	27,964	0	48,389	153,688	9.86
Venezuela	662	497,352	66,322	30,279	0	594,615	38.14
Andean Group	44,747	661,330	234,601	266,253	352,148	1,559,079	100.00

p: Preliminary

*: Data from Non-Fuel FOB exports

Source: JUNAC: Informativo Andino

Table 3.2

TRADE WITH MAJOR LATIN AMERICAN ECONOMIES
(% Share in Total Colombian Trade)
1990-1993p

Country	1990	1991	1992	1993p
A. EXPORTS (FOB)				
Argentina	0.4	0.5	1.3	0.9
Brazil	0.4	0.7	0.8	0.8
Chile	2.4	2.5	1.5	1.3
Mexico	0.6	0.7	1.0	1.1
Venezuela	3.0	5.9	8.5	9.7
B. IMPORTS (CIF)				
Argentina	2.4	2.9	2.8	2.2
Brazil	3.3	3.4	4.2	4.6
Chile	1.7	1.1	1.3	0.8
Mexico	2.1	3.0	2.6	2.6
Venezuela	5.8	6.2	6.5	9.8

p: Preliminary

Sources: DANE, DIAN, Ministry of Foreign Trade

Table 4.1

FOREIGN DIRECT INVESTMENT STOCKS IN NON-OIL SECTORS

US\$ Million

1989-1993

Sector	1989	1990	1991	1992	1993
Agricultural	17.1	22.4	23.9	29.3	42.2
Mineral	1,535.7	1,584.0	1,541.2	1,616.7	1,622.7
Manufacturing	1,367.3	1,485.3	1,617.3	1,687.1	1,885.1
Public Services	0.0	0.0	0.0	0.1	0.1
Construction	-19.0	22.7	21.7	41.0	59.9
Retail	156.7	168.8	176.2	195.6	226.9
Transportation & Communication	33.8	33.8	33.5	40.1	45.9
Financial	173.8	178.6	182.8	336.4	495.6
Social & Communal Services	1.1	1.2	1.7	2.1	3.5
Others	3.3	3.3	3.7	4.1	7.1
Total	3,269.8	3,500.1	3,602.0	3,952.5	4,389.0

Shares (%)

Sector	1989	1990	1991	1992	1993
Agricultural	0.52	0.64	0.66	0.74	0.96
Mineral	46.97	45.26	42.79	40.90	36.97
Manufacturing	41.82	42.44	44.90	42.68	42.95
Public Services	0.00	0.00	0.00	0.00	0.00
Construction	-0.58	0.65	0.60	1.04	1.36
Retail	4.79	4.82	4.89	4.95	5.17
Transportation & Communication	1.03	0.97	0.93	1.01	1.05
Financial	5.32	5.10	5.07	8.51	11.29
Social & Communal Services	0.03	0.03	0.05	0.05	0.08
Others	0.10	0.09	0.10	0.10	0.16
Total	100.00	100.00	100.00	100.00	100.00

Source: Banco de la República, Table 5.7.1

Table 4.2

COLOMBIA: PUBLIC FOREIGN DEBT, PARTICIPATION BY SOURCE

US\$ Million
1970-1994p

	1970	1975	1980	1985	1990	1991	1992	1993	1994
Multilateral Organisms	467	890	1,572	3,451	6,021	6,174	5,886	5,633	5,437
Foreign Governments & Agencies	667	939	1,059	1,963	2,707	2,571	2,165	1,803	1,499
Commercial Banks and Investors	164	589	1,662	4,164	5,583	5,360	5,017	4,952	4,728
Bonds	21	52	31	17	275	359	419	776	1,310
Total Public Foreign Debt	1,319	2,470	4,324	9,595	14,586	14,464	13,487	13,164	12,974

Shares (%)

	1970	1975	1980	1985	1990	1991	1992	1993	1994
Multilateral Organisms	35.41	36.03	36.36	35.97	41.28	42.69	43.64	42.79	41.91
Foreign Governments & Agencies	50.57	38.02	24.49	20.46	18.56	17.78	16.05	13.70	11.55
Commercial Banks and Investors	12.43	23.85	38.44	43.40	38.28	37.06	37.20	37.62	36.44
Bonds	1.59	2.11	0.72	0.18	1.89	2.48	3.11	5.89	10.10
Total Public Foreign Debt	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

Source: Banco de la República: Table 5.6.4 and January 1995 Estimations

Table 5.1

COLOMBIA: CENTRAL GOVERNMENT INCOME STRUCTURE (%)
1980-1993

Income (1)	1980	1985	1990	1991	1992	1993
I. Current Revenues	85.0	69.3	73.4	73.2	57.9	80.4
A. Taxes	82.5	62.9	65.5	67.6	54.6	77.2
1. Domestic Economic Activity	41.7	42.6	43.3	51.6	43.4	58.0
Income and Complementaries	25.3	19.3	25.2	33.9	26.9	33.6
Sales Tax on Domestic Goods	9.0	14.6	12.5	12.9	12.3	19.7
Fuel Tax	5.2	5.6	4.3	3.9	3.4	4.4
Others	2.3	3.0	1.2	1.0	0.8	0.3
2. External Economic Activity	40.8	20.3	22.2	15.9	11.2	19.2
Taxes and Fees on Imports	19.9	18.4	21.0	14.9	11.2	19.2
Coffee Taxes	0.0	1.9	1.3	1.0	0.0	0.0
Others	20.9	0.0	0.0	0.0	0.0	0.0
B. Non-Tax	2.5	6.4	7.8	5.6	3.3	3.2
1. Transfers from Coffee-Growers & Ecopetrol	0.0	0.0	0.0	0.0	0.0	0.0
2. Others	2.5	6.4	7.8	5.6	3.3	3.2
II. Capital Resources	15.0	30.7	26.6	26.8	42.1	19.6
A. Domestic Credit	0.1	19.5	3.9	0.4	7.8	9.8
B. External Credit	10.7	11.0	14.2	9.3	11.0	1.4
1. IDB Resources	1.1	0.8	0.1	0.7	1.1	0.2
2. IBR Resources	1.9	3.5	0.3	1.8	1.3	0.4
3. Commercial Banks	7.6	5.3	0.7	0.1	3.5	0.0
4. Debt Refinancing Loans*	0.0	0.0	6.4	3.9	1.4	0.0
5. Others	0.1	1.4	6.8	2.7	3.6	0.7
C. Treasury Balance Resources	4.2	0.3	2.5	2.5	1.3	1.7
D. Other Capital Resources	0.0	0.0	6.1	14.6	22.0	6.8
Total	100.0	100.0	100.0	100.0	100.0	100.0
Current Revenues/GDP	10.7	9.4	11.8	13.4	13.3	14.2
Capital Resources/GDP	1.9	4.2	4.3	4.9	9.6	3.5
Total Income/GDP	12.5	13.5	16.1	18.3	22.9	17.7

(1): Acknowledge income

* Includes the Jumbo, Concorde, Challenger and Hercules Credits

Sources: Contraloría General de la Nación, Informe Financiero

DANE: Cuentas Nacionales; DNP: January 1995 Estimations

Table 5.2

COLOMBIA: CENTRAL GOVERNMENT EXPENDITURE STRUCTURE (%)
1980-1993

Expenditure (1)	1980	1985	1990	1991	1992	1993
I. Functional	55.9	55.9	50.9	59.0	54.8	61.1
A. Personal Services	14.8	14.9	14.4	13.0	11.0	15.5
B. General Expenditures	5.1	3.4	3.0	3.4	3.4	5.2
C. Transfers	36.0	37.7	33.4	42.6	40.4	40.4
II. Debt Servicing	10.6	12.5	20.1	19.5	18.7	19.8
A. Domestic	5.6	2.3	2.5	3.3	2.7	4.7
B. External	5.0	10.2	17.6	16.2	16.0	15.1
III. Investment	32.8	30.9	28.6	21.1	26.5	19.1
A. Direct	5.6	3.0	11.4	na	na	na
B. Indirect	27.2	27.9	17.2	na	na	na
IV. Contributions to Regions	0.7	0.7	0.4	0.4	0.0	0.0
A. Functional	0.2	0.3	0.2	0.0	0.0	0.0
B. Investment	0.5	0.3	0.1	0.4	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0	100.0
Functional Expenditure/GDP	6.9	7.7	7.9	9.9	11.9	11.0
Debt Service/GDP	1.3	1.7	3.1	3.3	4.1	3.6
Investment/GDP	4.1	4.2	4.4	3.5	5.8	3.4
Total Expenditure/GDP	12.4	13.7	15.5	16.7	21.8	18.0

(1): Drawings & reserves

Sources: Contraloría General de la Nación, Informe Financiero
DANE: Cuentas Nacionales; DNP: January 1995 Estimations

Table 5.3

**COLOMBIA: CENTRAL GOVERNMENT EXPENDITURE STRUCTURE,
FUNCTIONAL CLASSIFICATION (%)
1980-1993**

Expenditure	1980	1985	1990	1991	1992	1993
I. General Services	26.8	32.7	34.9	46.8	37.2	37.4
A. State Administration	12.0	16.9	20.3	33.4	25.7	18.9
B. Public Safety	8.6	9.0	8.0	7.7	6.6	10.0
C. National Defense	6.2	6.8	6.7	5.6	5.0	8.6
II. Economic Services	24.9	19.4	16.6	8.3	18.7	9.2
A. Natural Resources	3.8	8.2	3.5	1.9	1.5	1.9
B. Electricity, Gas and Water	5.9	0.8	2.3	1.1	12.3	1.1
C. Industry, Trade and Tourism	0.9	2.7	4.1	0.8	0.6	0.8
D. Transportation	12.8	6.7	4.8	3.4	3.7	4.7
E. Communications	0.2	0.1	0.4	0.2	0.0	0.1
F. Science and Technology	1.3	0.9	1.5	1.1	0.6	0.7
III. Cultural and Social Services	37.7	35.5	28.3	25.3	25.3	33.2
A. Education	19.3	19.3	14.0	12.4	10.6	13.7
B. Health	6.6	4.9	5.1	4.6	4.0	5.7
C. Culture, Sports and Recreation	0.7	0.5	0.4	0.4	0.3	1.0
D. Urban and Rural Management	2.6	1.5	2.0	1.6	1.7	1.3
E. Social Security and Assistance	8.4	9.3	6.8	6.3	8.6	11.5
IV. Others	10.6	12.5	20.2	19.5	18.8	20.1
A. Public Debt	10.6	12.5	20.1	19.5	18.7	19.8
B. Others	0.0	0.0	0.0	0.1	0.1	0.3
Total	100.0	100.0	100.0	100.0	100.0	100.0
General Services/GDP	3.3	4.5	5.4	7.8	8.1	6.7
Economic Services/GDP	3.1	2.7	2.6	1.4	4.1	1.7
Cultural & Social Services/GDP	4.7	4.9	4.4	4.2	5.5	6.0
Others/GDP	1.3	1.7	3.1	3.3	4.1	3.6
Total/GDP	12.4	13.7	15.5	16.7	21.8	18.0

Sources: Contraloría General de la Nación, Informe Financiero

DANE: Cuentas Nacionales; DNP: January 1995 Estimations

Table 6.1

FINANCIAL SECTOR ASSETS TO BE PRIVATIZED & SOLD

ENTITY	STOCKHOLDERS	% TO BE SOLD	ENTITY IN CHARGE	DATE	VALUE Million Pesos
Banco Popular	Nation	89	Fogafin	March 95	320,000
Concasa	Bancafé	31	Fogafin	March 95	50,000
Banco Tequendama	Fogade of Venezuela	100	Venezuela's Nation	April 95	100,000
Latincorp	Fogade of Venezuela	100	Venezuela's Nation	2nd sem. 95	n.a
Latinoamericana de Seguros	Fogade of Venezuela	100	Venezuela's Nation	2nd sem. 95	n.a
Leasing Arfin	Fogade of Venezuela	100	Venezuela's Nation	2nd sem. 95	n.a
Leasing del Comercio	Fogade of Venezuela	100	Venezuela's Nation	2nd sem. 95	n.a
Bancafé	National Coffee Fund	To Be Defined	National Coffee-Growers Comm.	2nd sem. 95	n.a
Bancoldex	Nation	To Be Defined	Fogafin	1996	n.a
Banco Central Hipotecario	Instituto de Seguros Sociales	To Be Defined	Fogafin	1996	n.a

Source: Finance Ministry

Table 6.2

**INDUSTRIAL PROMOTION INSTITUTE (IFI) ASSETS
TO BE PRIVATIZED**

ENTITY	AREA	IFI INVESTMENT* USD	IFI STOCK %	SITUATION
MONOMEROS COLOMBO- VENEZOLANOS	Fertilizers and Other Chemicals	8,319,460	33.44	To be sold during second semester 1995
PROPAL**	Paper		33.68	Valuation of the firm
CERROMATOSO	Ferronickel	57,018,463	47.69	Possibility of selling ADR's in the NY stock market or selling shares to Gencor
CATSA	Agro-Industry	564,294	40.16	Definition in April 1995 of a selling price according to the results of the valuation
QUIBI	Farmaceuticals	276,581	20.73	Possibility of selling the shares to a third party during the first quarter of 1995
INTELSA	Telecommunication Equipment	26,860	15.71	In process of revaluation
PESTOLU	Fishing and Shellfish	196,124	64.07	Rented for a 3 year period since November 1994. IFI wants to reduce its share to 51%

*: Dec. 1994 values adjusted by inflation; converted to dollars using the annual average Representative Exchange Rate for 1994: \$826.52 pesos per USD

** : IFI participation in Propal is through IFI-Leasing S.A.

Source: Instituto de Fomento Industrial (1995) Privatización de Inversiones 1990-1994, Bogotá, February, mimeo.

Table 6.3

**Electrical Generation Expansion Projects Planned by the State
1995-2000**

Project	Type	Capacity (MW)	Estimated Operational Date (quarter/year)
Termobarranquilla	Gas	507	I/96 to IV/97
Termovalle	Gas	232	III/96
Paipa IV	Coal	150	III/97
Thermic*	tbd	400	I/98
Termocesar	Coal	300	II/99
Porce II	Hydraulic	392	III/99
Urrea	Hydraulic	340	IV/99
Miel I	Hydraulic	375	I/2000
Total		2696	

*: The private investors should decide the location, type of fuel, and size of this project.

Source: Conpes, Ministry of Mines and National Planning Department (1995)

Table 6.4

**Potential Electrical Generation Projects
to Be Carried out by the Private Sector**

Project	Type	Capacity (MW)
Minesa	Gas	100-300
Termopacifico	Coal	400
Termocali	Gas	150
Termocafe	Gas	135
La Dorada	Gas	25
EPM and Private	Gas	150
Refinery Magdalena Medio	Fuel Oil	80
Petrosur	Fuel Oil	60-90
Energy Initiatives-BP	Gas	100-500
Enka	Gas	20
Hidrotun	Hydraulic	40
Rubiales	Heavy Crude	50-200
Tulua	Hydraulic	10
Las Flores II	Gas	50-100
Proelectrica	Gas	50-100
Ingenio del Cauca	Sugar Cane Bark	10
Ovejas/Girardota	Hydraulic	20
Chevron/Wartsila	Diesel Crudo	50
Amoco	Gas	150
Sindicato Antioqueño	Coal	90
Patíco-La Cabrera	Hydraulic	17
Total		1757-2637

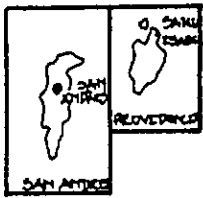
Source: Conpes, Ministry of Mines and National Planning
Department (1995)

Table 6.5

**PUBLIC ROADS CONSTRUCTION PROJECTS
TO BE CARRIED OUT THROUGH THE CONCESSION SYSTEM**

Project	Length Km	Planned bid Opening date	Cost US\$ M
Chusacá-Girardot new road	55	October 95	95
Briceño-Tunja second lane	95	October 95	136
Girardot-Ibagué new road and second lane	40	October 95	57
Bogotá-Puerto Salgar new road	154	October 96	98
La Paila-Cartago-Pereira second lane	73	na	130
Medellín-La Pintada second lane	73	na	131
La Sabana peripheral new highway	30	na	63
Buga-Buenaventura second lane	119	October 96	86
Santander-Popayán second lane maintenance	77	October 96	33
Medellín-Santafé de Antioquia Tunnel	3	na	29
Cali-Palmira-Buga second lane	70	na	84
Bello-Barbosa second lane	32	na	23
Bucaramanga-Cúcuta road maintenance	195	na	81
Total	1,016		1,046

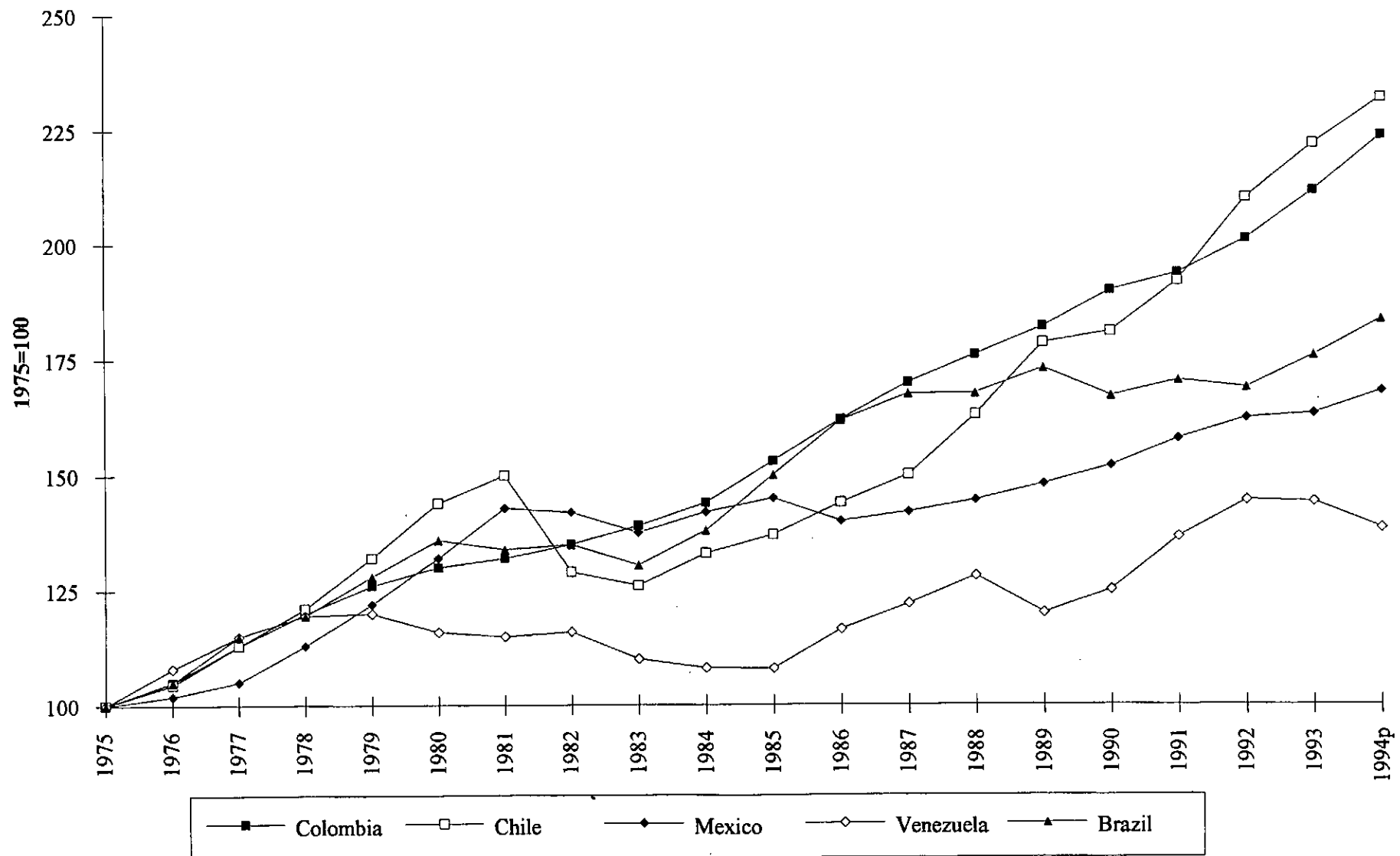
Sources: National Planning Department and CONPES



COLOMBIA - COUNTRY MAP

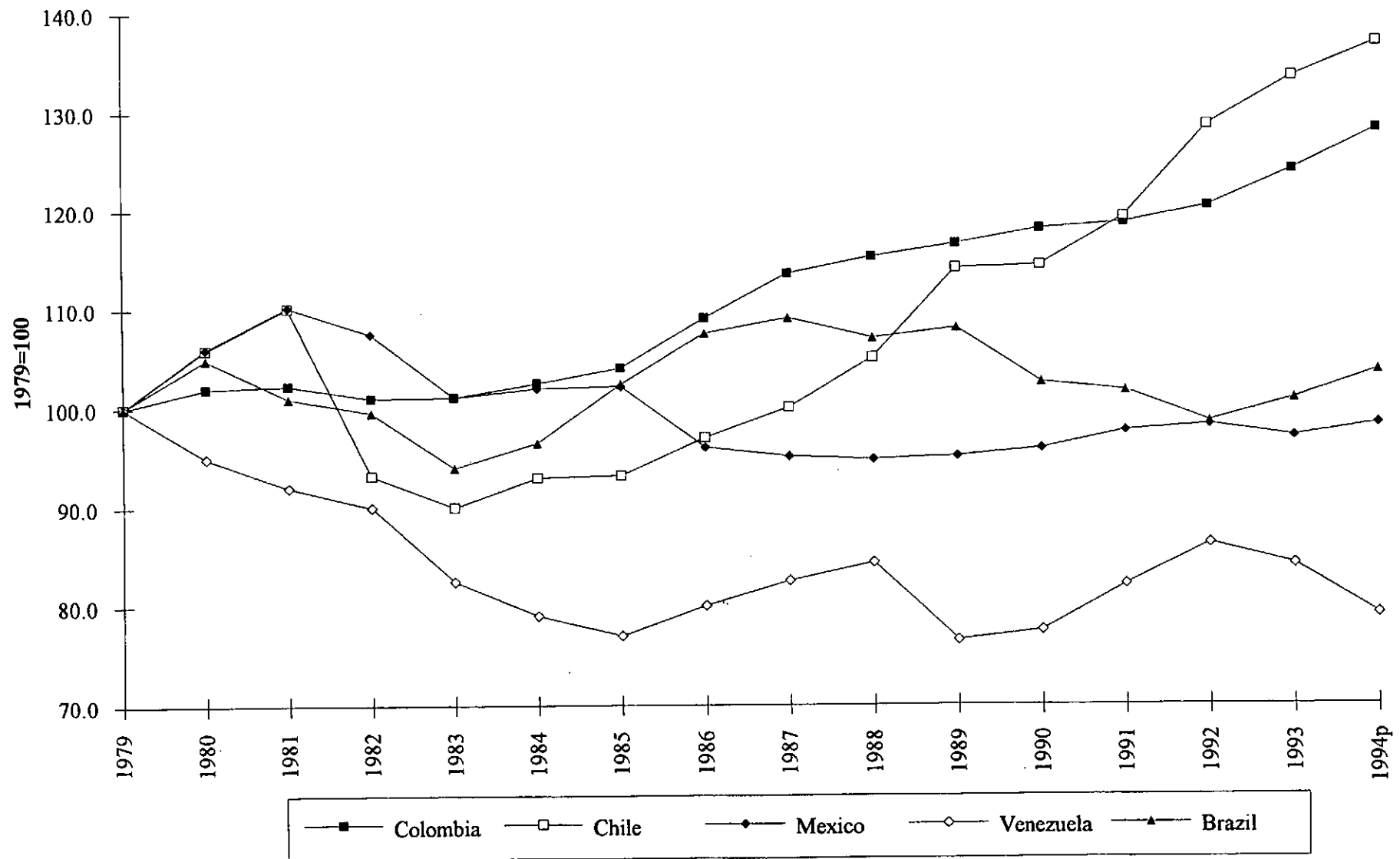


Graph 1.1
GDP Growth Index for Some LA Countries
1975-1994p



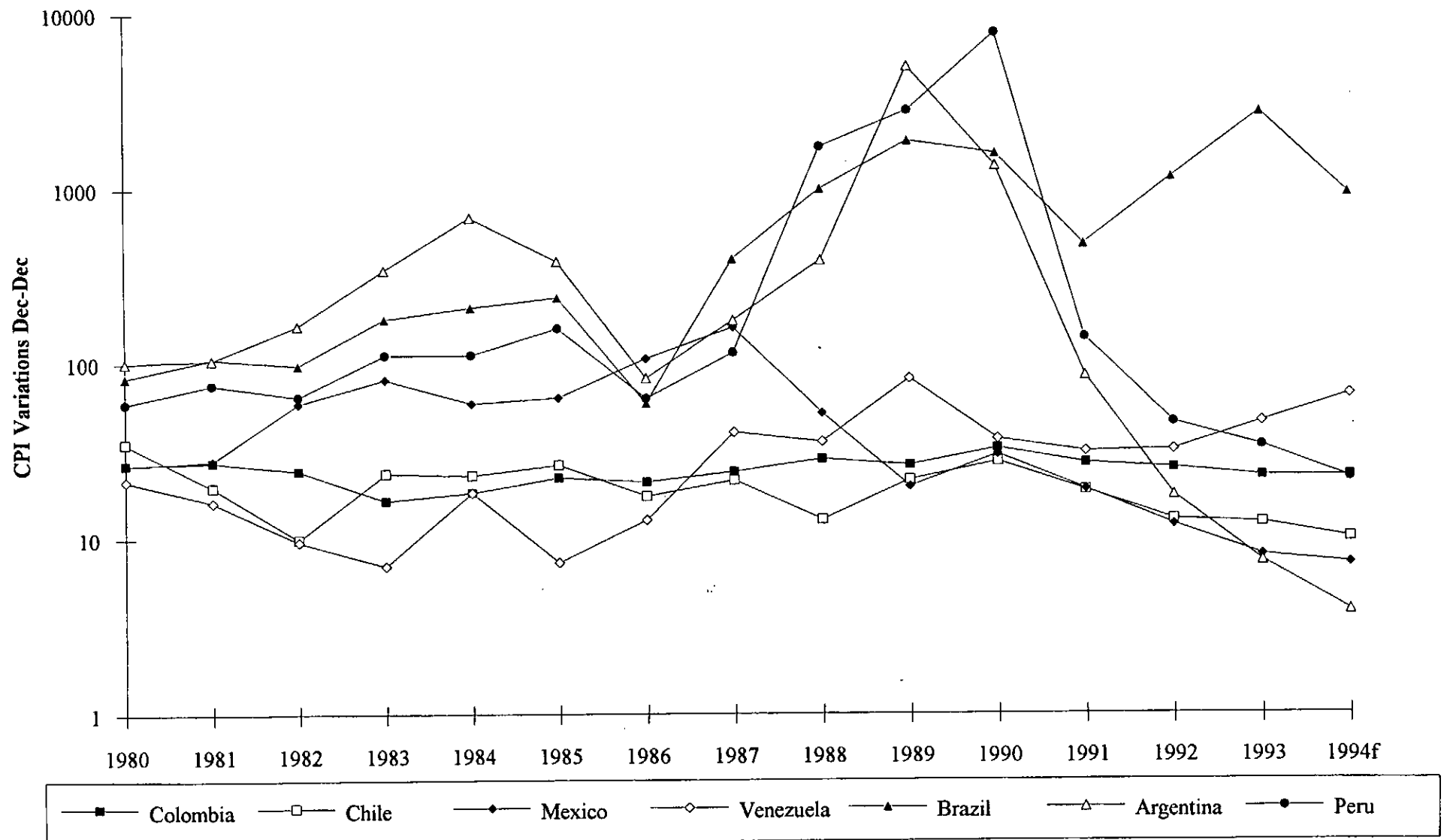
Sources: UN, CEPAL.

Graph 1.2
Per Capita GDP Index for Some LA Countries
1979-1994p



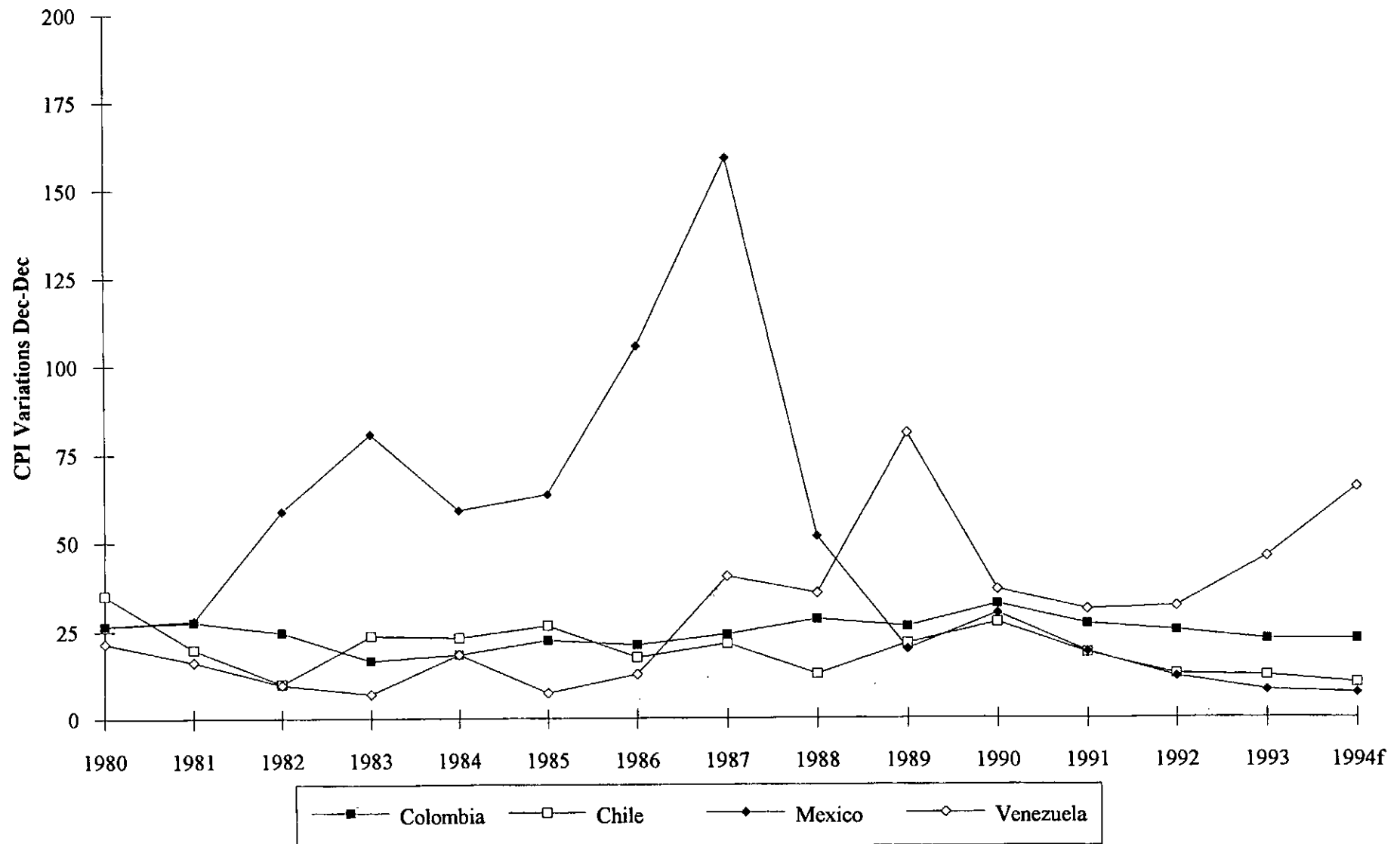
Source: CEPAL

Graph 1.3a
Annual Inflation
1980-1994f



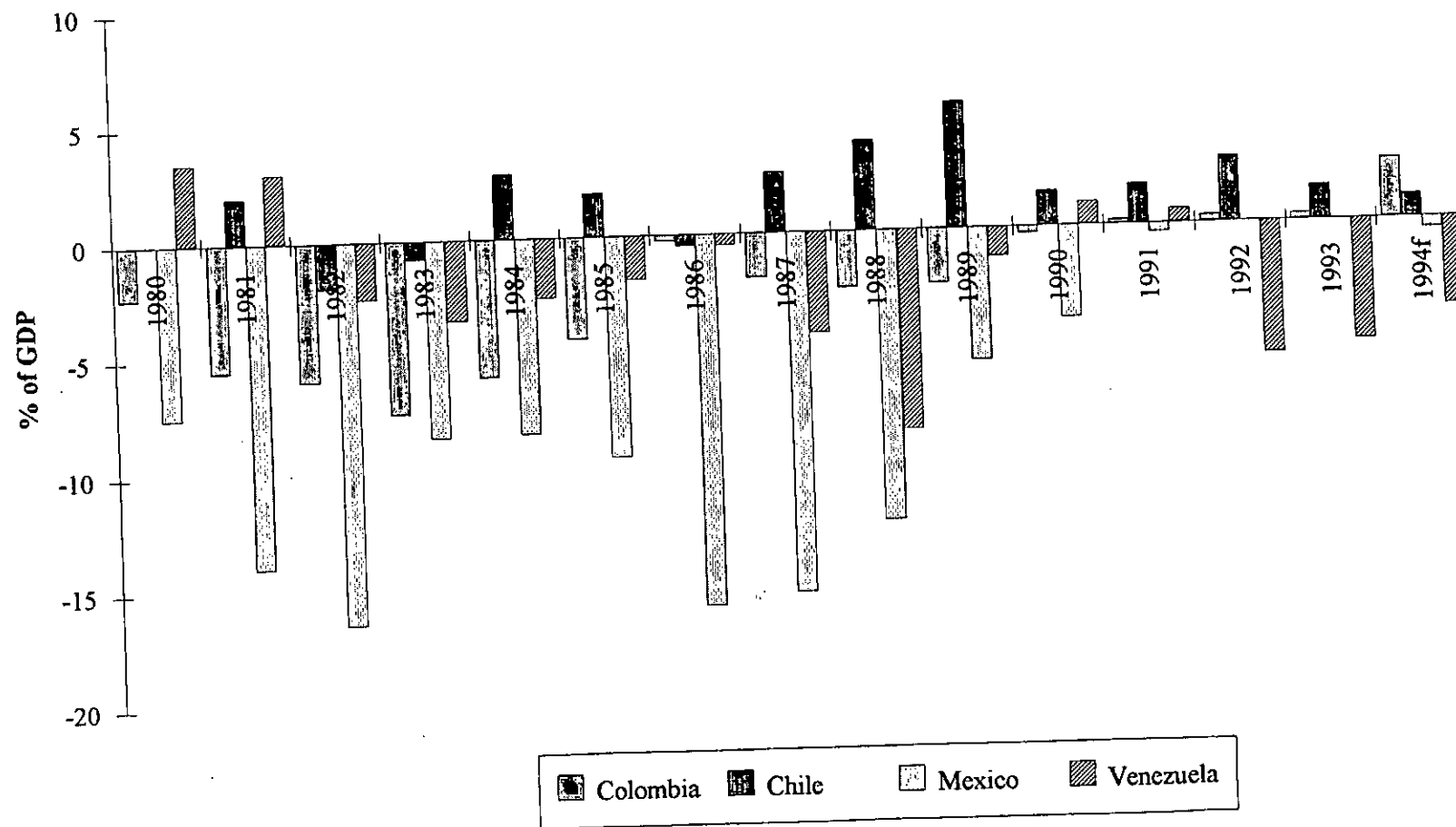
Sources: CEPAL, UN, Salomon Brothers

Graph 1.3b
Annual Inflation
1980-1994f

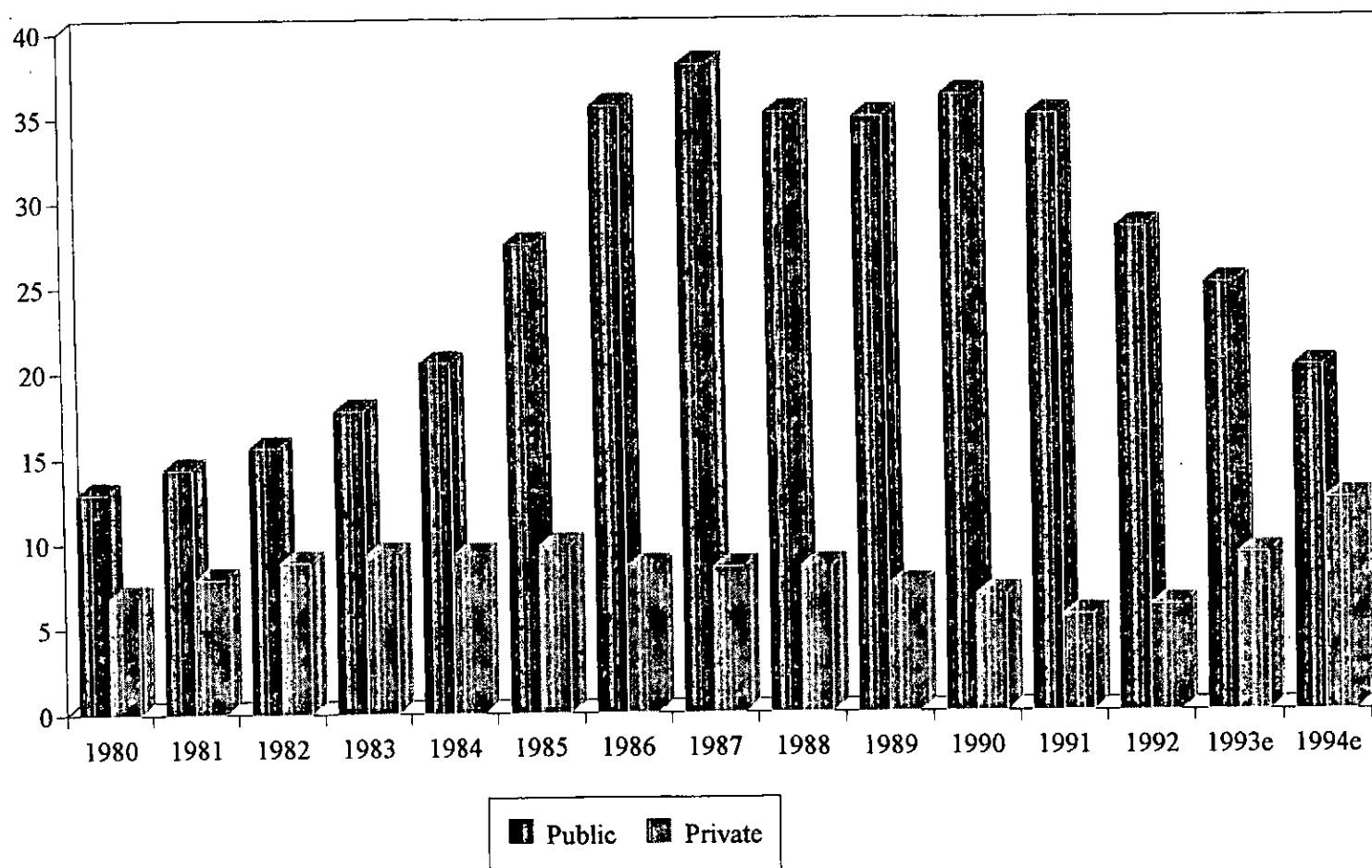


Sources: CEPAL, UN, Salomon Brothers

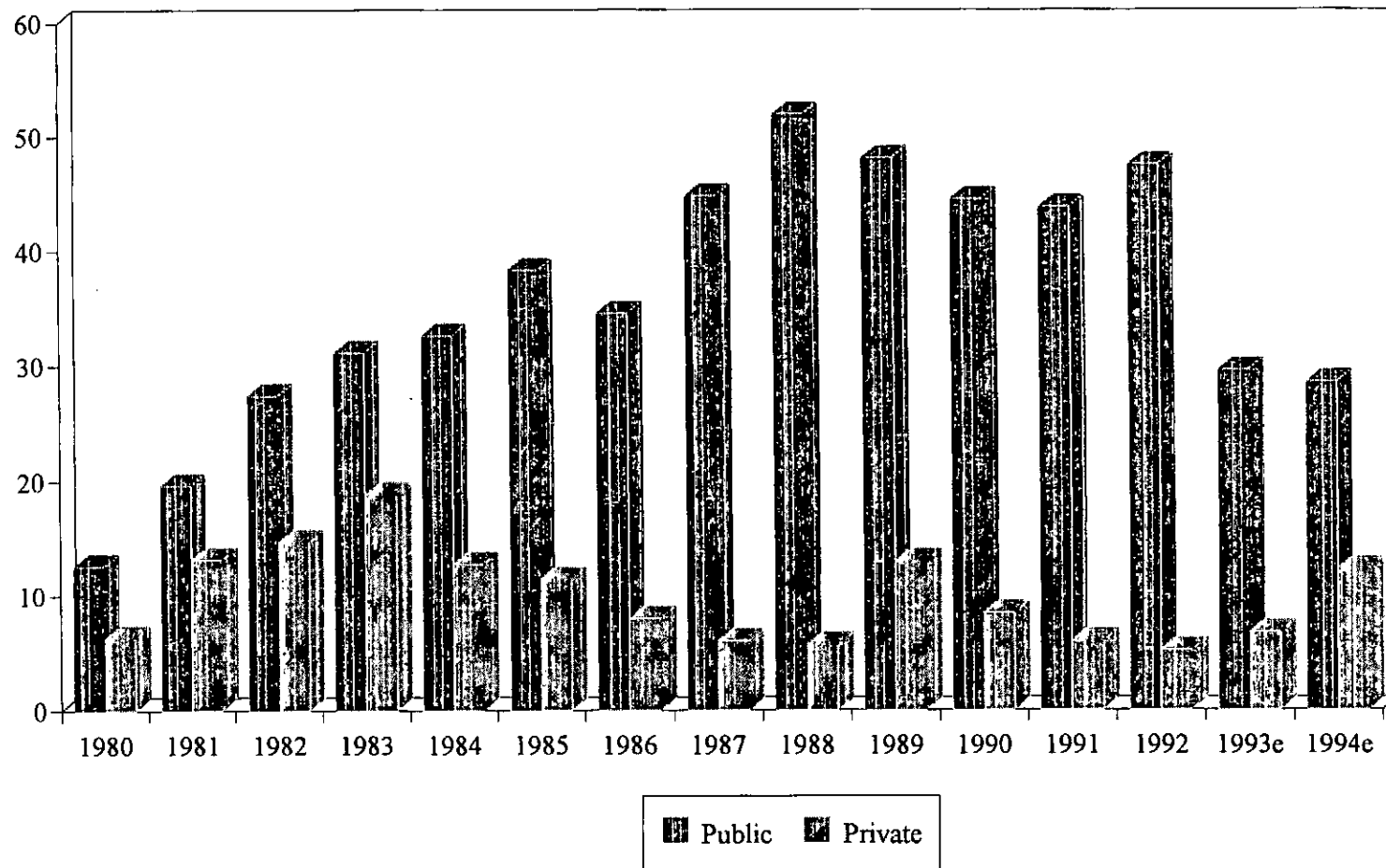
Graph 1.4
Fiscal Deficit for Some LA Countries
1980-1994



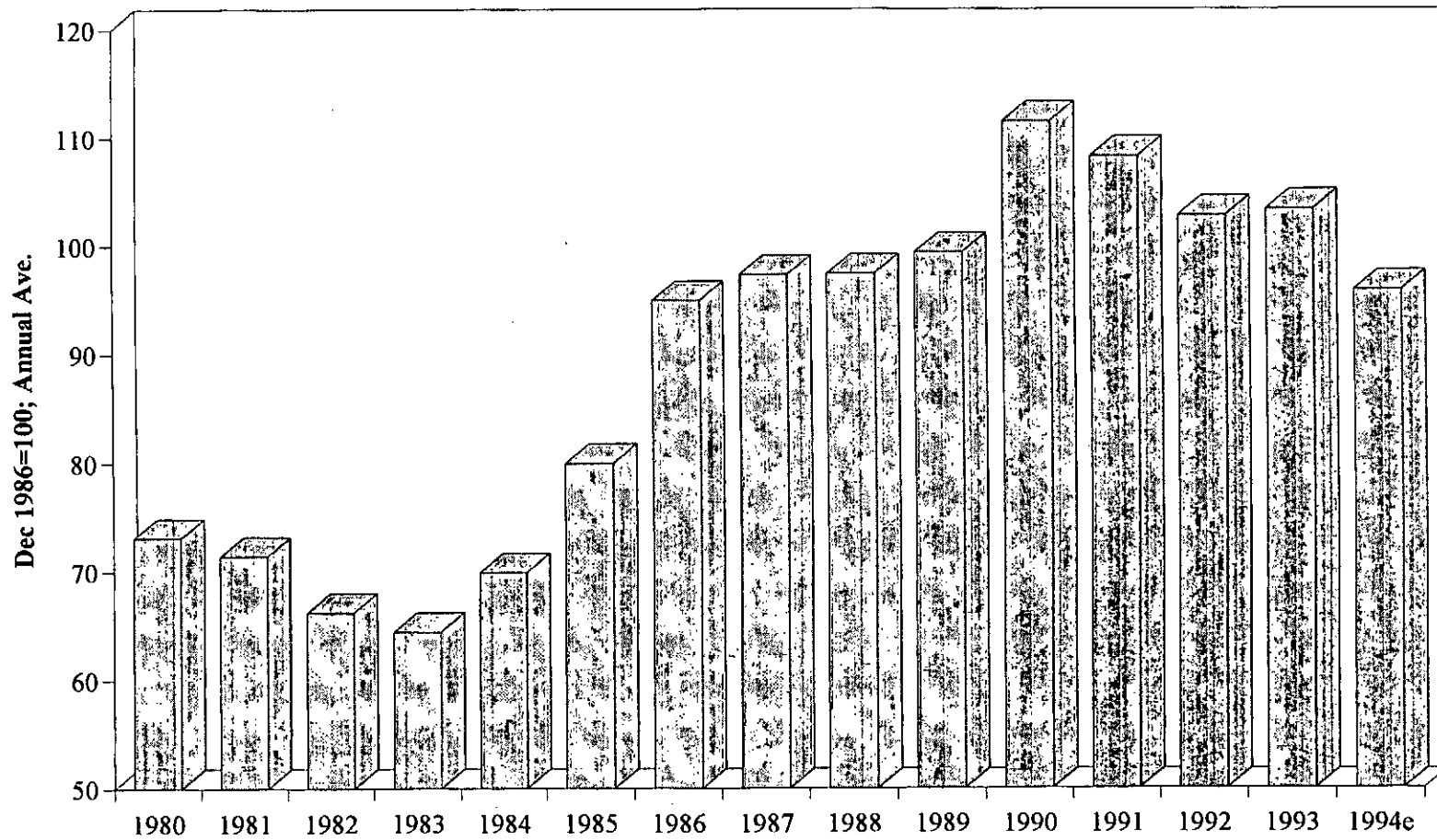
Graph 1.5
Colombia's Foreign Debt as a Percentage of GDP
1980-1994e



Graph 1.6
Colombia's Debt Service as a Percentage of Exports
1980-1994e

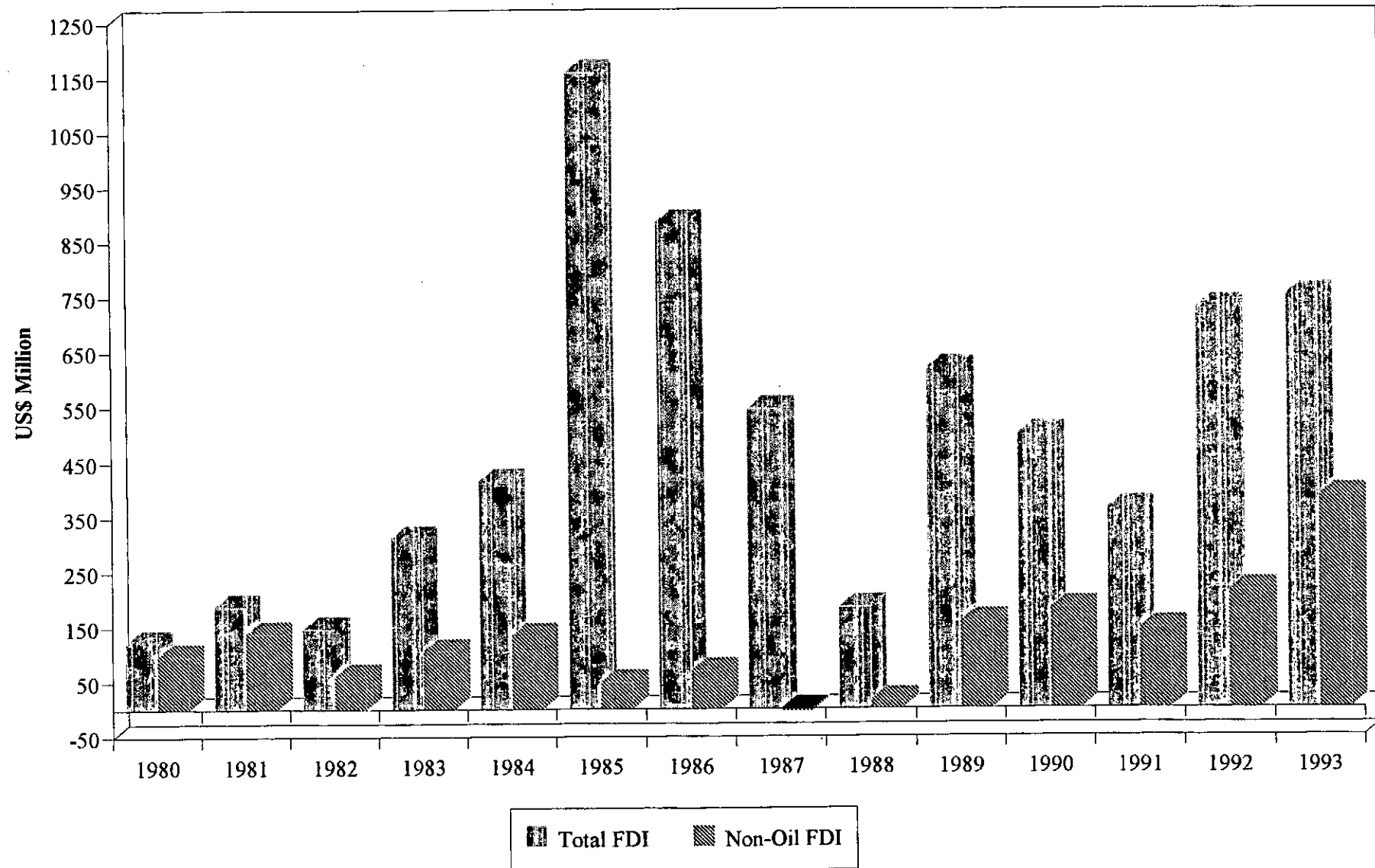


Graph 2.1
Colombia's Real Exchange Rate Index
1980-1994e



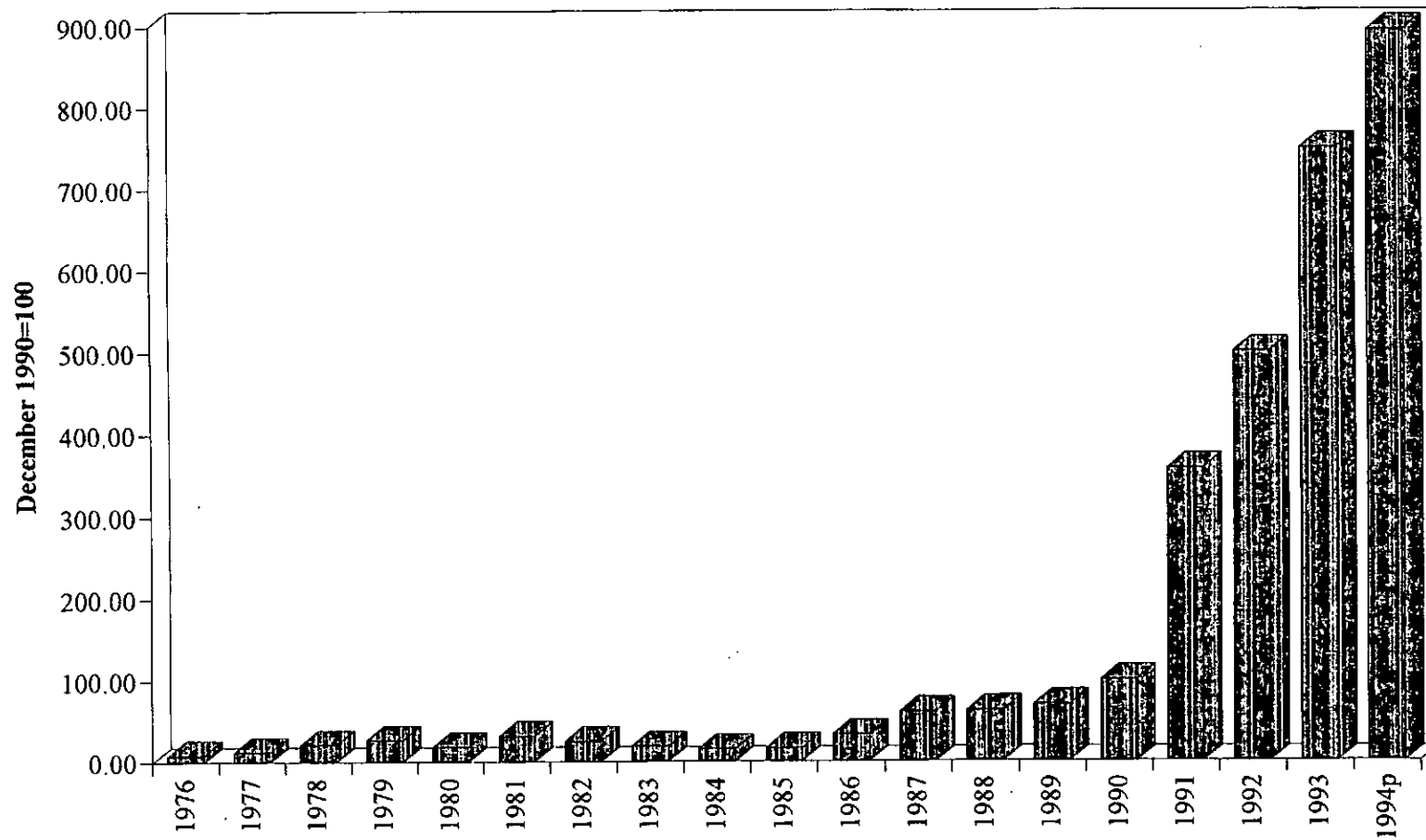
Source: Banco de la República, January 1995 estimation.

Graph 4.1
Foreign Direct Investment Flow in Colombia
1980-1993

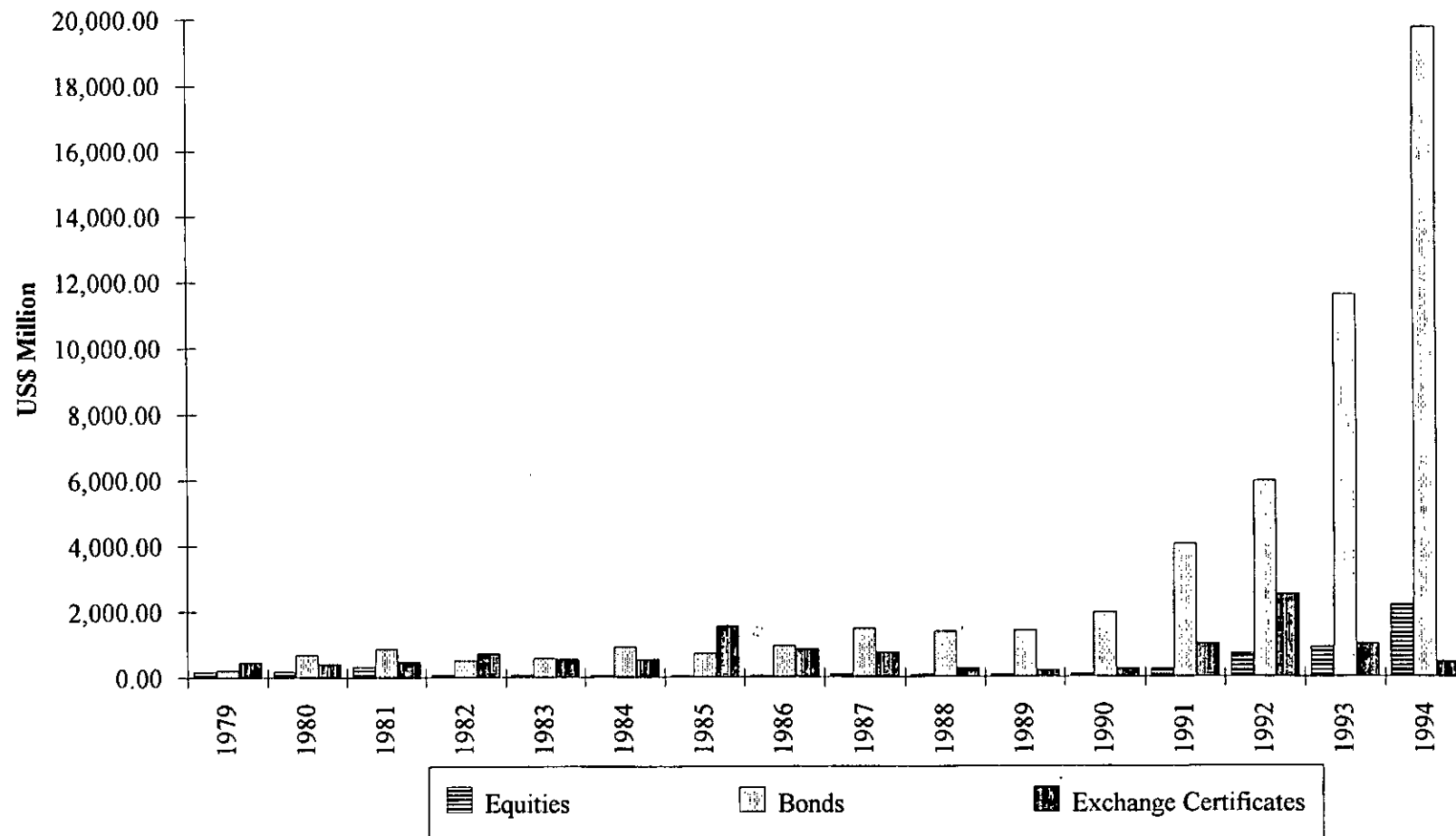


Source: Steiner, R. and Giedion, U. (1994)

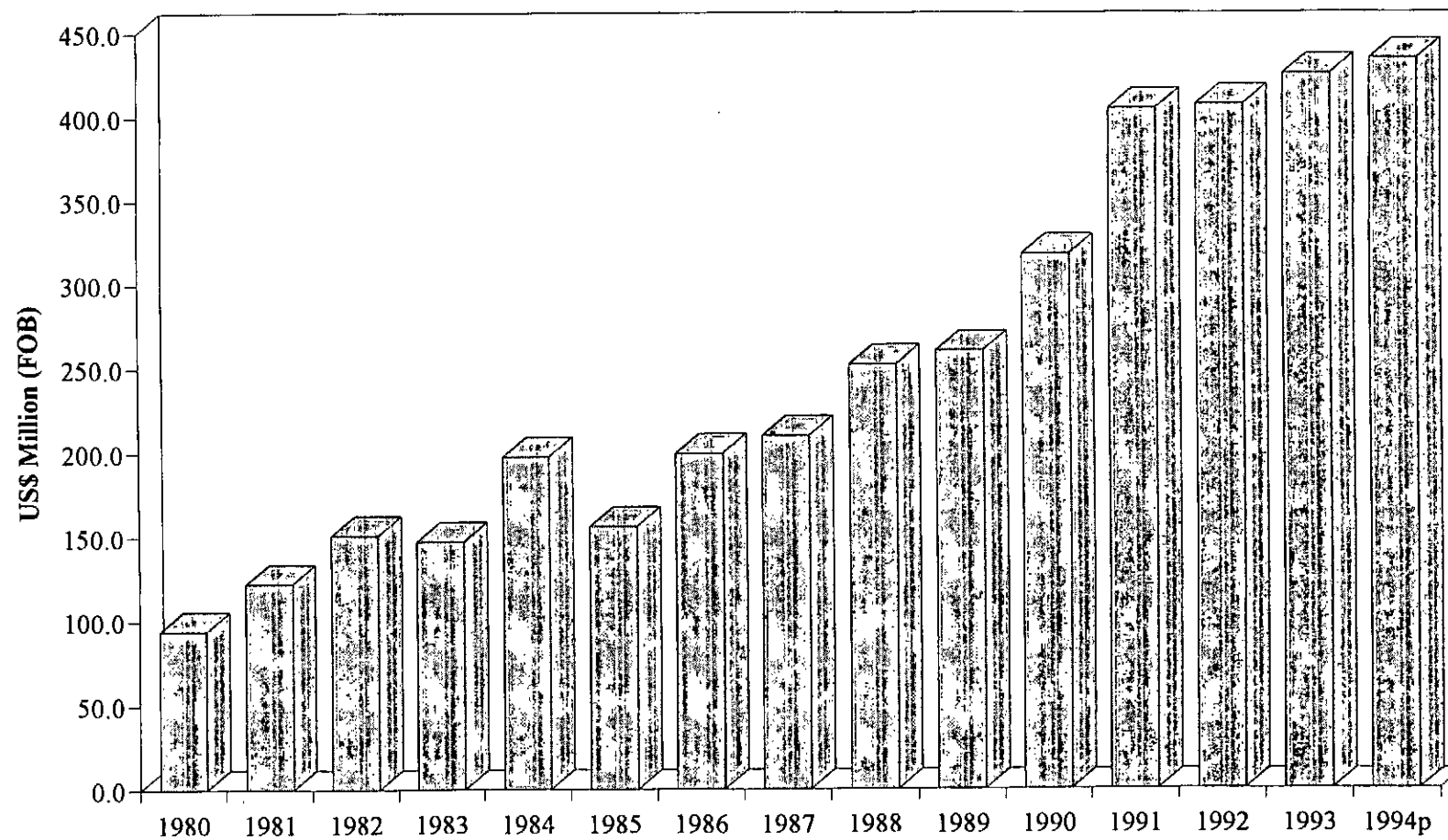
Graph 4.2
Bogota Stock Exchange Index
1976-1994



Graph 4.3
Stock Exchange Transactions
1979-1994

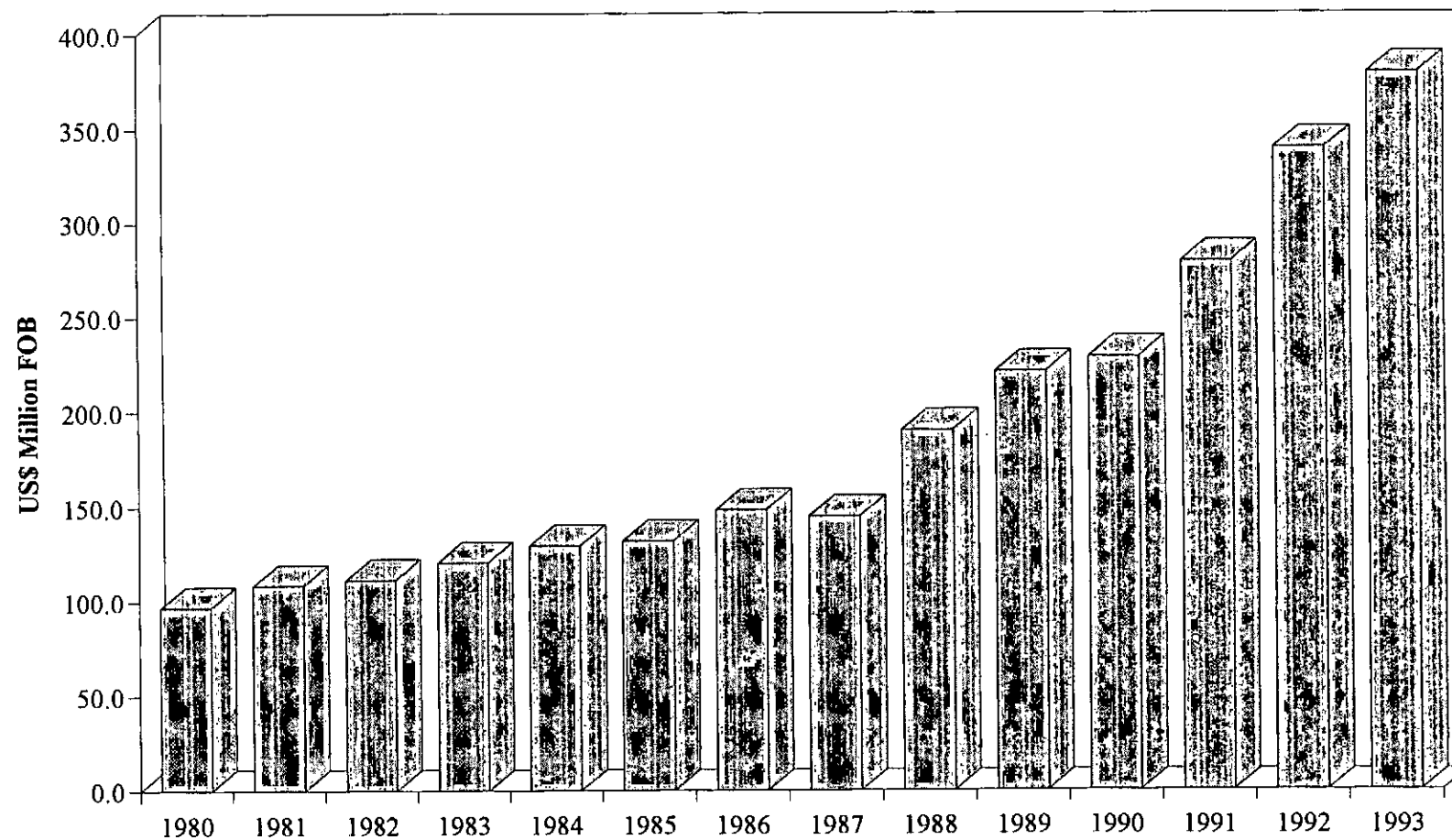


Graph 6.1
Colombian Banana Exports
1980-1994



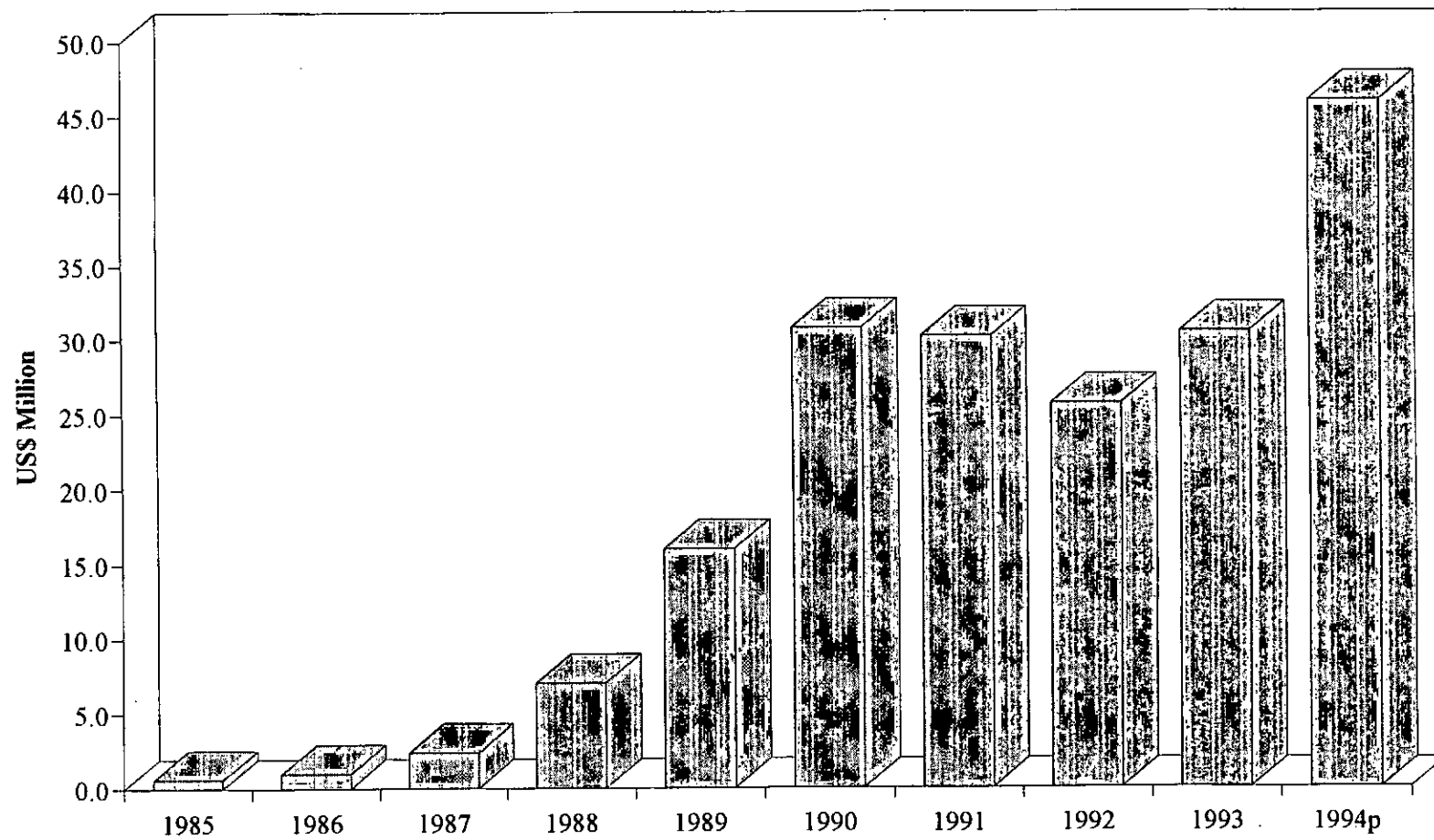
Source: Banco de la República

Graph 6.2
Colombian Cut Flower Exports
1980-1993



Source: Banco de la República

Graph 6.3
Colombian Exports of Farm-Bred Shrimp
1985-1994p



Source: Acuanal (1994)

Annex 1
DISTRIBUTION OF FUNCTIONS IN THE COLOMBIAN PUBLIC SECTOR

SECTOR	NATION	DEPARTMENT	MUNICIPALITY
HEALTH	<p>Develop general policies</p> <p>Support programs financially</p> <p>Regulate and advise</p> <p>Promote research and prevention programs</p> <p>Administer the Institute of Family Welfare funds</p>	<p>Administer regional, university, and specialized hospitals. The hospitals will have administrative autonomy</p> <p>Finance programs with transferances from the Nation and own resources</p> <p>Manage some campaigns in the areas of health and prevention of illnesses</p>	<p>Administer local services health posts and centers</p> <p>Health centers would have administrative autonomy whenever this is possible. Where it is 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 goals</p> <p>Advise 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>Advise 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>Issue technical and control goals</p> <p>Advise and evaluate other levels</p> <p>Establish the criterion to set rates</p> <p>Define credit and cofinancing policies to reduce regional deficits</p>	<p>Advise municipalities technically</p> <p>Help municipalities in the financing of projects and/or the administration of services</p>	<p>Plan, program, finance and execute aqueduct and sewage projects</p> <p>Operate, maintain and administer systems</p> <p>Create firms or contract with the private sector for the building and administration of works, individually or in association with other municipalities</p> <p>Guarantee the provision of sanitation services. Set rates</p>

SECTOR	NATION	DEPARTMENT	MUNICIPALITY
HOUSING	<p>Define housing and urban development policies</p> <p>Support municipalities through cofinancing credits and subsidies</p>	<p>Possibility of 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 firms</p>
ROADS	<p>Plan, program, construct and maintain (through concessions if desired) national roads</p> <p>Define technical regulations for the construction and maintenance of other roads</p> <p>Advise, 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>Possibility to associate themselves with sectional entities or municipalities</p> <p>Manage the 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 country's interconnection rates</p> <p>Regulate, advise, evaluate and control territorial and private entities in their investment projects</p>	<p>Offer distribution at a sectional level</p> <p>Guarantee regional interconnection</p> <p>Administer regional entities which will be formed with the dissolution of ICEL</p> <p>Provide energy to non-interconnected zones through alternative generation mechanisms</p> <p>Possibility to associate with other departments, municipalities or private entities</p>	<p>Guarantee distribution at a local level</p> <p>Construct the necessary infrastructure (extend the network)</p> <p>Possibility for larger municipalities to generate, transmit and distribute energy</p> <p>Possibility to associate with other territorial entities or with the private sector</p>