

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

INVESTMENT POLICY REVIEW

COLOMBIA



UNITED NATIONS

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Investment Policy Review

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Geneva, July 2006

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PREFACE

The UNCTAD Investment Policy Reviews are intended to help countries improve their investment policies and to familiarize governments and the international private sector with an individual country's investment environment. The reviews are considered at the UNCTAD Commission on Investment, Technology and Related Financial Issues.

The Investment Policy Review of Colombia was initiated at the request of the Ministry of Trade, Industry and Tourism. UNCTAD missions to the country received the complete cooperation of all relevant senior officials and ministries of the Government of Colombia and the Permanent Mission of Colombia to the United Nations at Geneva.

The views of the international donor community in Colombia, the international private sector and domestic business were canvassed at various stages of the project.

The report has also benefited from the contribution of a number of experts within and outside Colombia. National experts included, María Lucía Guerra, Mauricio Reina and other researchers in Fedesarrollo, and Andrés García Flóres, Luis Fernando Salazar and Michael Felsmann. International experts included Harvey Arbeláez, Carlos García Fernández, and James Kenworthy. The UNCTAD staff members involved were Rory Allan, Shuvojit Banerjee, Khalil Hamdani, Fiorina Mugione, Ian Richards, Taffare Tesfachew, and Luis Toral. Chiraz Baly, Maria Cristina Capelo, Jérôme Daellenbach, Alicia Gonzales Vera, Christian Helmers, Cristina Martinez Montaña, Julian Schwab, and Lang Dinh provided research assistance. Eugenia Borisoff and Elisabeth Anodeau-Mareschal provided production support. It was edited by Mónica Varela, María Claudia Díaz and Mark Bloch.

The project was financed by the United Nations Development Programme, the Ministry of Trade, Industry and Tourism of Colombia and the UNCTAD development account.

It is hoped that the analysis and recommendations of this review will promote constructive dialogue among the key stakeholders within the country, contribute to an improvement of policies and promote wider awareness of Colombia's investment environment.

Geneva, July 2006

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ABBREVIATIONS

ATPDEA	United States-Andean Preferential Trade Agreement
BIT	Bilateral investment treaty
CAN	Community of Andean Nations
CERT	Tax refund certificate
CONPES	National Economic and Social Policy Council
COINVERTIR	Former Colombian investment promotion agency
CREG	Energy and Gas Regulatory Commission
DTT	Double taxation treaty
ECLAC	Economic Commission for Latin America and the Caribbean
EPZ	Export processing zone
EU	European Union
FARC	Fuerza Armadas Revolucionarias de Colombia
FDI	Foreign direct investment
FTA	Free trade agreement
FTZ	Free trade zone
G-3	Group of Three (Colombia, Mexico and Venezuela)
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GFCF	Gross fixed capital formation
GNP	Gross national product
IADB	Inter-American Development Bank
ICSID	International Centre for the Settlement of Investment Disputes
ICTs	Information and communication technologies
IPA	Investment promotion agency
LSC	Legal stability contracts
MFN	Most favoured nation
MIGA	Multilateral Investment Guarantee Agreement
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
OPIC	United States Overseas Private Investment Corporation
PROEXPORT	Colombian export promotion agency
R&D	Research and development
REI	Special Investment Network

RICYT	Network on Science and Technology Indicators
RTA	Regional trade agreement
SCM	Subsidies and Countervailing Measures
TNC	Transnational corporation
TRIMs	Trade-related Investment Measures
TRIPS	Trade-related Intellectual Property Rights
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
VAT	Value-added tax
WIPO	World Intellectual Property Organization
WTO	World Trade Organization

COLOMBIA



Key economic and social indicators

Indicator	1970	1980	1990	1995	2000	2001	2002	2003	2004
Population (million)	22.6	28.4	35.0	38.6	42.3	43.0	43.7	44.6	45.3
GDP at market prices (US\$ billions)	7.2	33.4	40.3	92.5	83.8	81.7	80.6	80.0	97.4
Annual GDP growth (in per cent)	7.0	4.1	6.0	5.2	2.9	1.4	1.6	4.0	4.0
Inflation (in per cent)	6.8	26.5	29.1	21.0	9.2	8.0	6.3	7.1	5.9
GDP per capita (\$)	319	1 174	1 152	2 399	1 981	1 899	1 843	1 794	2 150
GDP by sector (per cent):									
Agriculture	25.7	19.9	16.7	15.3	14.0	14.0	13.6	12.3	12.6
Industry	28.3	32.5	37.9	31.7	30.3	30.0	30.3	29.4	33.9
Manufacturing	21.2	23.9	20.6	15.9	15.8	15.5	15.7	14.1	14.7
Services	46.0	47.6	45.4	53.0	55.6	56.0	55.9	58.3	53.4
FDI inflows (\$ million)	43	157	500	968	2 395	2 525	2 115	1 762	2 739
Exports of goods and services (percentage of GDP)	14.3	16.2	20.6	14.5	21.5	20.8	19.7	21.4	19.1
Imports of goods and services (percentage of GDP)	15.8	15.6	14.8	21.0	19.4	21.6	21.2	22.5	21.2
Gross capital formation (percentage of GDP)	20.3	19.1	18.5	25.8	13.7	15.1	15.2	14.9	14.8
Adult illiteracy rate (percentage of people aged 15 and above)	22.2	16.0	11.6	9.9	8.4	8.1	7.9	6.0	..

Sources: UNCTAD, FDI/TNC database, World Development Indicators, World Bank (2003), Economist Intelligence Unit.

INTRODUCTION

Colombia is a middle-income developing country, with a diversified economy and several urban and industrial poles. The country has enjoyed growth for almost 50 years, has soundly managed its economy and is a democracy. It has modern, large companies, new export sectors and a small but educated middle class. Furthermore, it benefits from being astride two oceans and close to the United States. However, compared to its competitors, its science and technological capacities are lacking, its infrastructure is poor and there remains a sense of insecurity, despite recent government successes.

Chapter I examines FDI trends and their impact. FDI inflows have grown in recent years. They have been driven forward by the 1991 *Apertura* or 'opening' phase of liberalization, the Andean regional integration process and a large privatization programme in the mid-1990s. Nevertheless, inflows remain below the Latin American average, in part because of the adverse security situation in the country. Most FDI has been in natural resource extraction and services (including privatization and infrastructure opportunities). FDI has played a part in diversifying the economy away from commodities towards technology-based exports and has introduced new technology and skills. The United States is the principal home country but FDI sources are diversifying towards Europe and Latin America.

Chapter II reviews Colombia's investment framework, which has improved over the last decade, placing itself on a par with other countries on the continent. However, the Chapter argues that more needs to be done for Colombia to compete effectively for investment at the international level. It notes that most of the economy is open to entry, although the validity of certain restrictions should be clarified. National treatment is practised. The Chapter nevertheless raises concerns over standards of dispute settlement and compensation for expropriation and notes the absence of investment treaties that could improve these areas. Colombia has recently introduced an innovative approach to legal stability contracts. The Chapter notes that the corporate tax regime is uncompetitive and that reform of this tax regime should be considered as a priority. It proposes further flexibility in the labour laws, greater independence in utilities' regulation and the mandating of higher standards of corporate governance. It also calls for a simplification of commercial laws, a consolidation of the commercial code and a stronger commercial justice system.

Chapter III addresses strategic issues in Colombia's approach to FDI. Colombia's effort to raise competitiveness through the *Colombia Compite* and the *Agenda Interna* framework should be praised. Efforts to attract and benefit from FDI should be more clearly conceptualized as part of the *Colombia Compite* programme. In order to attract FDI to support technological upgrading attention also needs to be paid to policies in the field of skills development and the science and technology base. The need to improve the infrastructure is recognized and FDI can directly assist in selected areas. The priority given to negotiating improved trade access with the United States seems appropriate, especially when taking into account Colombia's objectives and the potential role of FDI. The 2005 merger of the investment and export promotion arms into one institution produced initial good results. However, given the need to focus investment promotion activities, the institution requires further strengthening. The Chapter proposes the strengthening of the investment promotion agency to complement the competitiveness policies. Institutions in the competitiveness network already perform some of the classic functions (after-care, suppliers and linkages programmes) of an investment agency. Thus, the investment promotion agency can be small and focus only on FDI generation and image building. It should be charged with soliciting transnational corporations (TNCs) that can become leaders of an integrated value chain to give a cutting edge to local supplier development, to supporting overseas expansion of investment in Colombia's brands, and to raising competition in concentrated domestic markets by facilitating foreign entrants.

Chapter IV highlights the main conclusions and recommendations.

I. FOREIGN DIRECT INVESTMENT: TRENDS AND IMPACT

A. Economic backdrop

In 2005 Colombia was the fifth largest economy in Latin America with a GDP of \$102.5 billion and, with 45 million inhabitants, the third largest population after Brazil and Mexico.¹ For much of the period since 1945 Colombia has sustained economic growth through a skilled labour force, sound economic management and a wealth of natural resources. This stability was maintained throughout the 1980s external debt crisis that affected much of Latin America, and enabled Colombia to grow almost three times faster than the continental average during the same period. As a result, its inhabitants enjoy a GDP per person of \$2,277 (2005). This places the country firmly in the middle-income category, although behind the continental average of \$3,695.

Sitting astride two oceans, the country benefits from a strategic geographic location suitable for both trade to the region and to the United States. This is reinforced by its policy of actively promoting participation in regional trade agreements (RTAs). Currently, it is member of the Community of Andean Nations and part of seven bilateral trade agreements and two trade preference schemes. It is also in the process of ratifying a Free Trade Agreement (FTA) with the US. This preferential market access makes it an important regional export-hub for the Andean Region, Central America and the Caribbean.

While mainly a resource-based economy, Colombia has succeeded in diversifying from the export of its traditional commodities (minerals, coffee and sugar) to other products such as flowers, chemicals, food and tobacco products, clothing, leather and leather goods. However, levels of investment have not been sufficient to bring widespread technological modernization or commensurate infrastructure development.

The current administration's goal has been to consolidate a sound macroeconomic climate. An austerity plan has been introduced, reducing public expenditure and reforming tax, pension and labour laws, with consequent improvements in government finances. (Nevertheless, Colombia faces a debt burden estimated at 48 per cent of GDP.) In addition, the *Democratic Security Policy* (see Box I.1) has led to tangible improvements in public order, has dealt a significant blow to guerrilla finances and improved business and consumer confidence. GDP growth registered 3.6 per cent in 2004, reaching 5.1 per cent in 2005.

B. FDI trends

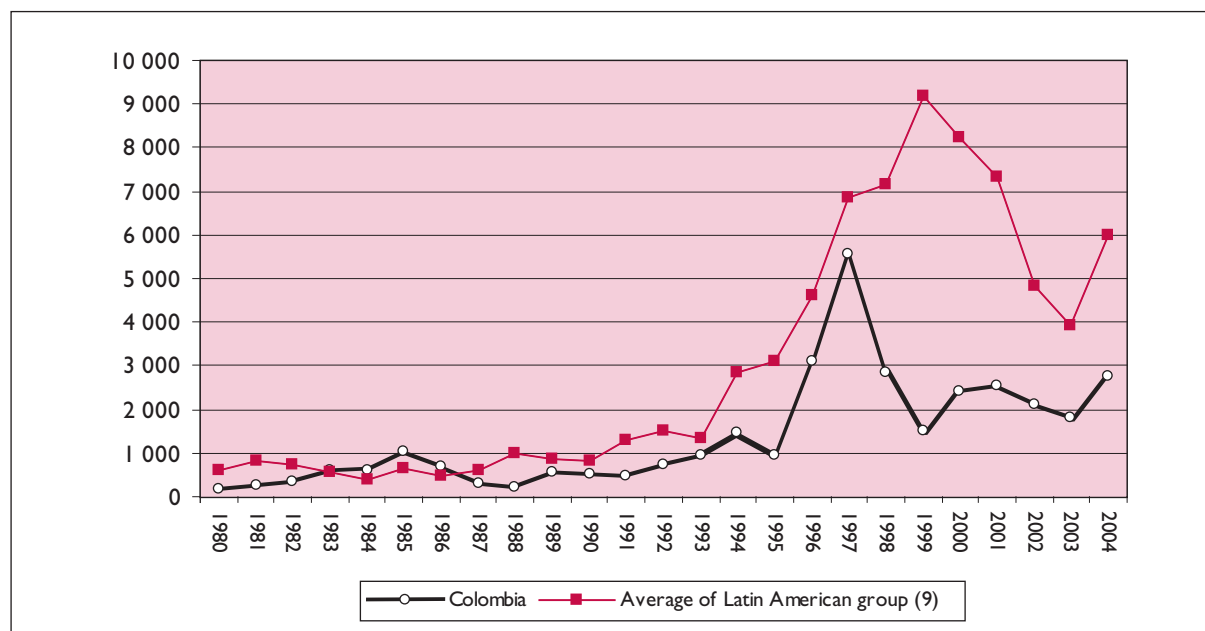
I. FDI size and growth

Figure I.1 shows Colombia's foreign direct investment (FDI) inflows since 1980.² Prior to this, inflows were negligible, averaging \$50 million in the 1970s, due mainly to restrictive legislation. However, as the graph shows, inflows grew steadily in the 1980s. In 1991, Andean Pact countries collectively liberalized their FDI regimes and eliminated the discrimination between foreign and national investors. At the same time, Colombia initiated its own liberalization process which is known as *Apertura* or *Opening*. This further opened the foreign investment regime and led to privatization and fiscal and foreign exchange reforms. As a result of these reforms and higher levels of oil-related investment, inflows started growing at a faster rate than before, although below the regional average. This faster growth in inflows was sustained by the resulting increase in the size of the economy and consumer market.

¹ Preliminary data.

² Due to the restriction imposed by the methodological change in the registration of FDI flows, figures prior to 1994 exclude the oil sector.

Figure I.1. FDI flows: Colombia vs. selected countries in Latin America, 1980-2004³
(\$ millions)



Source: UNCTAD and Central Bank of Colombia, 2004.

The mid-to late-1990s saw a privatization programme that led to a one-off influx of foreign investment over a four-year period, peaking at \$5.6 billion in 1997. Several state assets were privatized, primarily in the power sector, but also in manufacturing, banking, and, to a lesser extent, in water and sanitation. Sectors that were not fully privatized include oil, fixed-line telecommunications, banking, airlines, shipping and insurance. Since Colombia has always had a smaller state sector than other Latin American countries, investments entering Colombia during this period remained lower than the continental average.

Table I.1 shows that the drop in FDI inflows between 1997 and 1999 should be seen as a return to the post-1991 pattern of steadily increasing non-privatization investment.

The latest data available shows FDI flows growing in 2005 at their highest levels since 1997. In 2005, FDI grew 227 per cent year-on-year to \$10.2 billion. Even excluding SABMiller's purchase of Bavaria which accounted for \$4.7 billion, FDI reached 5.5 billion, the second largest amount recorded after 1997. These figures are encouraging and can be linked to economic recovery, improved security and policy reforms of the FDI regulatory framework that have increased investor confidence.

However, as Table I.2 shows, Colombia's performance demonstrates unfulfilled potential when compared to other countries in Latin America. In the past four years, FDI inflows per person have been below those of Argentina, a long way below those of Brazil and even further below those of Chile. On both a per capita basis and in relation to size of the economy, Colombia's recent FDI inflows are below the Andean regional average and markedly below those of Chile.

³ Simple average for nine countries in Latin America (Argentina, Brazil, Bolivia, Chile, Colombia, Ecuador, Mexico, Peru and Venezuela).

Box I.1. Security risk in Colombia

Colombia has experienced internal political violence since 1948. Up until the early 1990s, the two left-wing guerrilla groups, the Fuerza Armadas Revolucionarias de Colombia (FARC) and the Ejército de Liberación Nacional (ELN) were active but did not pose a serious challenge to democracy and the constitutional order.

However, in the second half of the 1990s, the FARC started to finance its operations through drug trafficking, kidnapping and extortion. Also, right-wing paramilitaries fought for territorial control of several regions, including the oil-producing districts of Arauca and Santander. In addition, organized crime, notably drug trafficking, became a significant problem. However, the latter only accounted for 25 per cent of all kidnappings, the rest being carried out by guerrilla groups.

This deterioration in the security situation has become an explicit development constraint for Colombia. The need for protection has increased the cost of doing business in the country and security issues have negatively affected FDI inflows into Colombia:

- *Resource-seeking FDI* has been hampered by attacks on infrastructure and lack of security in oil extraction and mining areas.
- *Domestic market-seeking FDI* has suffered from lower GDP growth rates due to security problems. It has been estimated that the conflict was taking 1.5 to 2 per cent off Colombia's annual growth rate even before its intensification in the late 1990s.

In 2000, the government introduced the *Democratic Security Policy*, which increased military spending from 3 to 5 per cent of GDP. This yielded positive results. The number of attacks on civilian targets decreased by 80 per cent between 2002 and 2003; the number of homicides decreased by more than 20 per cent during the same period reaching the lowest level since 1986; the number of internally displaced persons decreased by 50 per cent; and finally, the number of municipalities without military or police presence decreased from 157 in 2002 to 18 in 2003. Improved security encouraged growing numbers of travellers on main roads at holiday times for the first time in years. The challenge in the short-term is to further reduce violence and in the medium-term to rebuild the country's image as a safe location for investment.

Source: Colombia: Country Profile, Economist Intelligence Unit, 2005 and National Planning Department, 2004.

Table I.1. FDI flows to the Andean community by destination, 1990-2002
(\$ millions)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Bolivia	27	52	93	124	130	393	474	731	949	1010	725	662	721
- Privatization	..	..	9	12	0	66	31	0	10	148	0	..	..
- Oil	..	..	84	66	63	125	53	299	544	449	412	531	463
- Other	..	..	..	46	67	202	390	492	395	413	313	131	258
Colombia	500	457	729	959	1 446	968	3 112	5 562	2 829	1 468	2 280	2328	2 264
- Privatization	117	105	27	4	681	138	1476	3180	470	292	..	..	..
- Oil	270	264	440	557	135	151	778	382	91	-551	-384	521	424
- Other	113	88	262	398	630	679	858	2 000	2 268	1 727	2 664	1 807	1 840
Ecuador	126	160	178	474	576	452	500	724	870	648	720	1 330	1335
- Privatization	..	..	..	8	92	20	20	58	..	..	..	..	..
- Oil	90	124	146	395	368	320	302	555	754	615	680	1 120	1063
- Other	36	36	32	71	116	112	178	111	116	33	40	210	272
Peru	41	-7	152	686	3 107	2558	3 471	2 140	1 644	1 939	662	1 064	1 943
- Privatization	0	3	208	317	2 578	946	2 460	421	462	301	229	267	..
- Oil	39	9	119	9	310	173	132	89	141	282	35	5	3
- Other	2	-19	-175	360	219	1 439	879	1 630	1 041	1 356	398	792	1 940
Venezuela	451	1 916	629	372	813	985	2 183	5 536	4 495	3 290	4 464	3 448	1 800
- Privatization	10	2276	30	32	15	21	2090	1505	174	37	..	..	..
- Oil	0	0	0	0	195	539	1087	3 080	1790	1919	1206	2016	532
- Other	441	-360	599	340	603	425	-994	951	2 531	1 334	3 258	1 432	1 268
Andean Community	1 145	2 578	1 781	2 615	6 072	5 356	9 740	14 693	10 787	8 355	8 851	8 832	8 063

Source: ECLAC, Information Centre of the Unit on Investment and Corporate Strategies, Division of Production, Productivity and Management, and ECLAC/UCLA (2002). *Statistical Abstract of Latin America* on the basis of figures provided by the Andean Community and the central banks of the member countries.

Table I.2. Comparative performance of Colombia with selected countries, 1991-2004
(\$ and percentage)

ABSOLUTE PERFORMANCE																	
Countryname	FDI Stock																
	Millions dollars					Per \$ 1000 GDP					As per cent of GFCF (%)					Per capita (Dollars)	
	Average (1991-1995)	Average (1996-2000)	Average (2001-2004)	2004	Average (1991-1995)	Average (1996-2000)	Average (2001-2004)	Average (1991-1995)	Average (1996-2000)	Average (2001-2004)	Average (1986-1990)	Average (1991-1995)	Average (1996-2000)	Average (2001-2004)	2004	2004	
Colombia	912	3 081	2 293	22 278	24	76	52	12	14	32	27	7	8	18	19	496	23
Argentina	3 781	11 561	2 614	53 697	111	319	69	8	16	40	18	5	9	22	12	1 399	35
Bolivia	169	811	424	6 884	23	101	49	11	28	99	53	9	18	52	37	764	74
Brazil	2 202	24 000	16 839	150 965	14	141	94	4	4	36	33	2	2	19	17	821	25
Chile	1 666	5 667	4 684	54 464	118	377	294	27	30	74	61	13	13	32	28	3 378	58
Ecuador	371	692	1 350	12 482	33	58	106	12	23	35	53	6	12	19	24	957	42
Mexico	6 808	12 873	17 685	182 536	76	132	171	15	19	29	28	8	11	14	14	1 727	27
Peru	1 304	2 001	1 613	13 310	55	80	60	1	28	36	27	0	13	16	15	483	20
Venezuela	943	4 192	2 161	43 575	45	178	85	8	16	44	22	4	9	20	11	1 658	41
Andean Community of Nations (CAN)	3 699	10 777	7 840	98 529	37	99	66	8	20	39	28	4	10	19	16	816	32
Latin America group* (9 countries)	18 157	64 878	49 663	540 190	46	152	109	8	14	36	30	4	7	18	16	1 162	29
Latin America and the Caribbean	22 389	83 042	63 514	730 627	48	163	117	9	15	41	32	4	7	18	16	1 319	34
Latin America and the Caribbean excluding Brazil and Mexico	13 379	46 169	28 990	397 126	60	191	112	12	21	53	37	7	12	30	24	1 503	47

Source: UNCTAD, FDI/TNC database (WIR 2003).

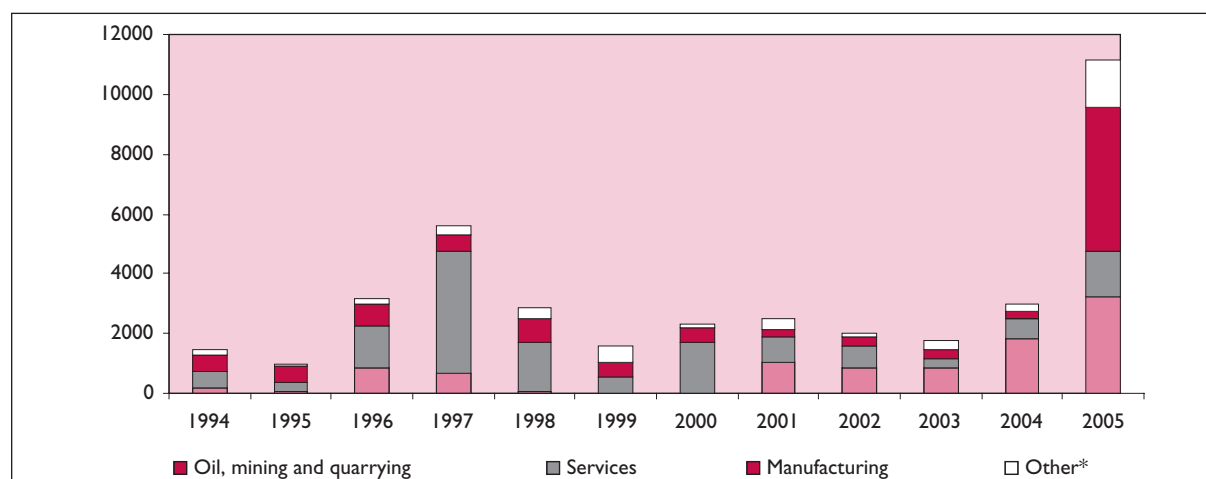
* Latin America group: Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Peru and Venezuela.

a) Data 2002 of FDI as percentage of GFCF of Ecuador and Venezuela are missing.

2. FDI by sector

FDI has been attracted principally to three sectors: manufacturing, natural resources and public utilities.⁴ Figure I.2 shows some success of Colombia's efforts over the past decade to diversify through consistent investment in sectors outside natural resource extraction. The large investment in services in the late 1990s is due to the privatization programme, a sector that was hitherto dominated by state-owned enterprises.

Figure I.2. Colombia: pattern of FDI inflows by sector, 1994-2005
(\$ millions)



Source: Central Bank of Colombia, 2005.

* Includes agriculture and others not classified.

Manufacturing FDI has been stable and has focused on chemicals, metal and food products and – from the 1990s onwards – the manufacturing of mineral and non-metal products. A number of foreign manufacturing firms are established in Colombia, catering both to the domestic and Andean markets. They operate in automotive assembly, food, beverages, tobacco, hygiene and cleaning products, chemicals and pharmaceuticals.

In services, a good proportion of investment inflows related to privatization. As noted earlier, Colombia began its privatization programme with fewer assets in state hands when compared with regional peers. Nevertheless, privatization has opened important state sectors to private investment, e.g. electricity, oil refining, telecommunications and airport services. For FDI, the privatization programme was especially important in providing opportunities in electricity generation and banking. The largest transaction was the privatization of the Bogotá Energy Company (EEB) in 1997 for \$2.2 billion. Between 2000 and 2002, electricity, gas and water investments contributed 7.9 per cent of total FDI inflows. In 2000 alone, the utilities sector's contribution to total FDI flows reached 50.5 per cent.⁵

In 2003, with the need to redress public finances firmly in mind, the government announced a programme to divest about \$10 billion of State assets over the next five years. Mainly affecting banking and energy transmission, this will be one of the most significant programme of its kind in Latin American history if it reaches its target. Ten per cent of proceeds will be spent on regional and municipal infrastructure. In addition, the government hopes to generate \$6.5 billion over the next years by encouraging private sector investment in roads, ports, electricity and gas infrastructure concessions. Such models of public-private partnerships are increasingly the government's favoured option for infrastructure development.

⁴ Changes in data collection methodology do not permit consistent statistics to be presented for the period prior to 1994.

⁵ 2000-2002 average based on the Central Bank's Balance of Payments data. The value for 2002 is preliminary.

Table I.3. Largest TNCs in Colombia, 2003
(\$ millions)

	Affiliate	Home country	Activity	Sales	Year of establishment
1	Exxon Mobil de Colombia S.A.	USA	Distribution	1 317.4	1918
2	Texas Petroleum Co. Colombia	USA	Energy, oil, gas	692.0	1926
3	Citibank Colombia S.A.	USA	Banking	532.9	1929
4	BP Exploration Co. (Colombia) Ltd.	UK	Oil exploration and extraction	510.9	1986
5	General Motors Colmotores S.A.	USA	Automobile assembly	497.6	1956
6	BBV Banco Ganadero S.A.	Spain	Banking	442.5	1996
7	Drummond Ltd., Sucursal Colombia	USA	Coal	411.2	1987
8	Emgesa S.A. ES.P.	Spain	Generation electricity	312.0	1997
9	Bellsouth	USA	Mobile phone	373.6	1994
10	SOFASA S.A.	France	Automobile assembly	354.9	1969
11	Oleoducto Central S.A. Ocesa	Canada	Gas pipeline	174.0	1994
12	Nestlé de Colombia S.A.	Switzerland	Food and beverage	310.9	1944
13	COMCEL Comunicacion Celular SA	Canada	Mobile phone	317.0	1994
14	Colgate Palmolive & Cia.	USA	Hygiene products	264.2	1943
15	Panamco Colombia S.A.	Mexico	Bottling	367.1	1939
16	Banco Santander Colombia S.A.	Spain	Banking	292.0	1997
17	Banco Standard Chartered Colombia	UK	Banking	54.0	1995
18	Monomeros Columbo Venezolanos	Venezuela	Chemicals, fertilizers	95.0	1968
19	Occidental de Colombia Inc.	USA	Oil exploration and extraction, and gas	79.7	1969
20	Colombiana Kimberly Colpapel S.A.	USA	Paper and packaging	202.4	1967
21	Smurfit Carton de Colombia S.A.	Ireland	Paper and packaging	-	1990
22	Hewlett-Packard Colombia Ltda.	USA	Computers	77.9	1995
23	Productos Familia S.A.	Sweden	Hygiene products	145.0	1985
24	Cristaleria Peldar S.A.	USA	Bottling	16.9	1962
25	Bel Star S.A.	Peru	Cosmetics	149.0	1987
26	Compania de Galletas Noel S.A.	France	Food and beverage	294.0	1999

Source: Revista Cambio – Confecamaras (2003), “Las 1000 empresas más grandes de Colombia”.

3. FDI by geographical zones

In Colombia, FDI inflows (excluding oil) are concentrated mainly in the Santanderes region, largely due to the attraction of the capital Bogotá (see Table I.4 although the data is complicated by occasional net outflows).⁶

Table I.4. Distribution of registered FDI (% share) by Colombian regions, 1994-2003
(Percentage)

Regions	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	Average 1994-2003
Altiplano - Santanderes	84.7	79.0	77.7	72.7	89.7	55.2	20.6	89.3	39.9	125.7	73.5
Atlantic Coast – Caribbean, Pacific	0.6	3.8	7.5	2.9	1.3	16.6	51.9	15.3	48.9	-43.7	10.5
Cauca Valley	5.6	8.3	6.2	21.6	1.9	6.6	37.2	2.8	2.0	7.8	10.0
Zona Cafetera	10.3	8.2	8.5	2.7	7.0	21.6	-9.7	-7.4	9.2	10.1	6.1
Orinoquía	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Others	-1.2	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

*Based on registered FDI flows that exclude the oil sector.

Source: Central Bank of Colombia, 2003.

FDI inflows to the other regions have in many cases been smaller and more volatile, as shown by the uneven performance of the regions bordering the Atlantic Coast.

In the Pacific region, Cauca and the Cauca Valley have received low levels of FDI, except in the FDI booms of 1997 and 2000. At the same time, within this region, the Cauca Valley accounted for 97 per cent of total inflows, the reason being that it contains Cali, Colombia's third largest city and an important centre for agribusiness.

The coffee growing zone's share of total registered FDI has been small but stable. Its reduced share in 1997 and 2000 can be put down to a preference among investors to diversify as well as fluctuations in coffee prices. Within this region, Antioquia attracted 90 per cent of total FDI inflows. The region's main city, Medellín, is Colombia's second largest and a principal manufacturing and industrial centre, as well as a commercial flower growing area.

Although the data on FDI inflows is sketchy, available figures show that Colombia has attracted FDI in several agricultural areas, industrial cities, commercial centres and ports outside the capital. FDI is likely to have been more widely spread than in the Andean countries. For example, in Peru 80 per cent of the total FDI was invested in the capital, Lima.⁷

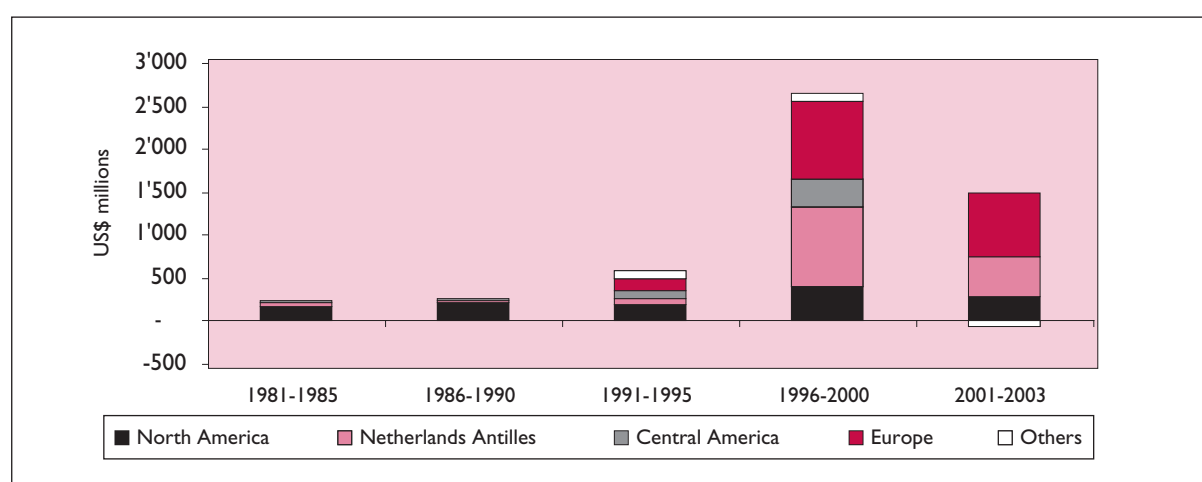
⁶It is important to note that the regional analysis is based on registered FDI that excludes the oil sector. Thus, the oil zones (like Orinoquía and others) are not prominent in the regional distribution figures.

⁷UNCTAD (2000). *Investment Policy Review of Peru*. United Nations publication sales no. E.00.II.D7. Geneva.

4. Sources of FDI

Until the mid-1990s, North American investors (Figure I.3), principally from the United States, invested the largest amounts in Colombia, mostly in the oil and manufacturing industries. Latin American investors grew in importance during the 1990s (47.1 per cent of the total during the period 1996-2000), although typically through offshore centres such as the Netherlands Antilles, making the exact origins of this investment difficult to trace. Andean countries accounted for 0.7 per cent of FDI in the same period.

Figure I.3. Registered FDI distribution in Colombia by country of origin.
Annual averages in defined periods
(\$ millions)



Source: Central Bank of Colombia, based on registered FDI. 2004 figures are not yet available.

A marked recent trend has been the growth in FDI inflows from Europe. European investors' share of total FDI inflows into Colombia grew from 22.9 per cent in the first half of the 1990s to 47.1 per cent between 2001 and 2004. The largest European investor was Spain, followed by the United Kingdom and the Netherlands. Spanish investment consisted mainly of purchasing or expanding existing companies in the electricity, energy, communications and financial sectors. For example, in the financial sector, Spain established its presence in the domestic market through the entry of Grupo Santander and BBVA.

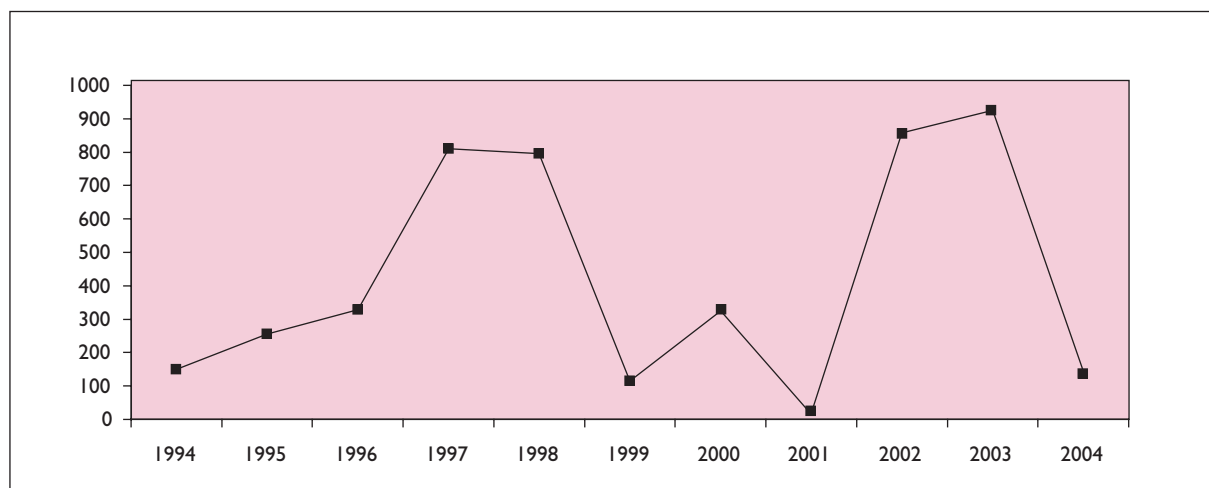
5. Colombia's outward investment

Compared to other Community of Andean States (CAN) countries, outward direct investment from Colombia, has been significant but volatile. In the period 2000-2004, it averaged \$456 million annually, only just below Venezuela's average of \$544 million and well ahead of other CAN members.⁸ In 2005, outward direct investment reached \$4,541 million in the financial sector, mainly due to Bavaria's acquisition of 15 per cent of SABMiller shares.

The dip between 1999 and 2001 coincides with a recession in Colombia and a serious drop in investor confidence in neighbouring countries. The latter was triggered by economic difficulties in Venezuela and the currency volatility experienced by Ecuador prior to its decision to adopt the dollar.

⁸ UNCTAD FDI/TNC database.

Figure I.4. Colombia's outward investment, 1994-2004
(\$ millions)



Source: Central Bank of Colombia, 2004.

Colombian investment abroad has been aimed mainly at neighbouring countries. Therefore, the creation of a free trade area between Colombia, Venezuela, Ecuador and Bolivia and Peru gave rise both to significant export expansion by many Colombian companies and, with an increasing knowledge of these markets, to a move from exports to direct investment.

Panama and Venezuela were the principal investment destinations, with 28 and 17 per cent of total outward stock in 2002 respectively. In most cases, Colombia's outward investment to the region was used to establish manufacturing plants, acquire local companies and purchase distribution channels (see Box I.2). However, much of the outward investment to Panama could be a case of round-tripping of domestic capital being re-invested in Colombia from offshore sources.

Box I.2. Regional investment by leading Colombian firms in the food industry

A number of Colombian firms have seized the opportunity of liberalization to expand abroad. Several companies in the food sector, led by Nacional de Chocolates, have successfully penetrated other markets by exporting their own products and investing directly in countries such as Mexico and Ecuador. Nacional de Chocolates owns more than 20 leading Colombian food companies, generating 12 per cent of manufactured food production and representing close to 4 per cent of the national food industry.

The company started its expansion abroad by exporting production surpluses. However, over time it has turned regional expansion into a strategic objective. Currently, the company's exports account for more than 20 per cent of its total sales and reach more than 60 countries in the world. Although there is a different strategy for each product, the Andean Region, Central America, the Caribbean countries, Mexico and the United States are the main target markets. In Mexico and Ecuador, the company set up local affiliates to create a distribution and service platform for the company's products and sustain a regional brands consolidation strategy. The local affiliates have nurtured local distributors, dealers and subcontractors to improve sales. This investment has had several positive results. Local affiliates have provided better knowledge of the two markets, and of distribution channels and local competition. They have also helped the company to meet the demand in each country more effectively. Finally, the affiliates have improved customer service.

Source: UNCTAD.

C. FDI impact

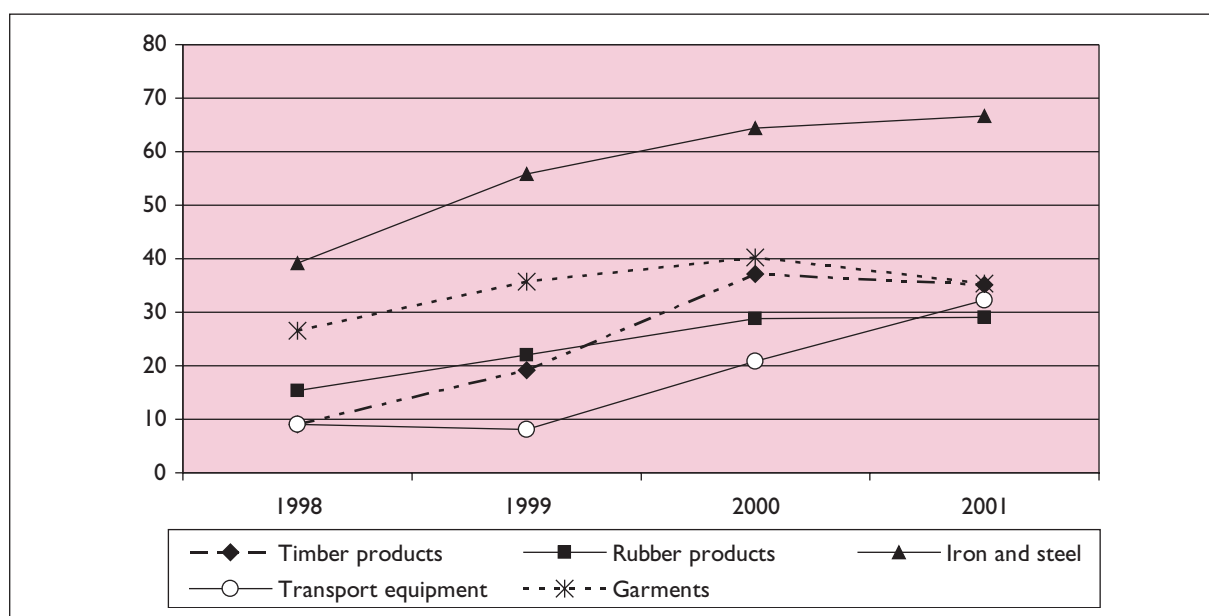
I. Trade

The government has attempted to attract export-oriented FDI by providing a mixture of incentives. The first attempt was Plan Vallejo, which allowed temporary, total or partial duty-free imports on raw materials and machinery, and intermediate goods for the production of goods and services destined for export production. The second was to support the construction of free zones with modern telecommunications and infrastructure. The third was the CERT scheme, which offered tax breaks against exports. In addition, *Apertura* has led to substantial opportunities for foreign investors wishing to access the domestic market.⁹ Government efforts have been backed by partnerships with the private sector to support export promotion within the framework of the *Colombia Competes* (Colombia Competes) programme which was launched in 1998.¹⁰ From 1992 to 2002 FDI inflows have helped to bring the following significant changes to Colombia's trade patterns:

a) Export orientation and technological intensity

Between 1998 and 2001, 40 per cent of foreign-invested companies in the manufacturing industry were involved in exporting.¹¹ Their exports contributed close to 21 per cent of total national exports and accounted for 53 per cent of manufacturing exports. The four manufacturing industries in which foreign-invested companies have undergone the greatest increase in export orientation are: the iron and steel industry, transport equipment, rubber products, and timber products (see Figure I.5).

Figure I.5. Export orientation of manufacturing FDI in Colombia, 1998-2001
(Percentage)



Source: Pedraza, 2002.

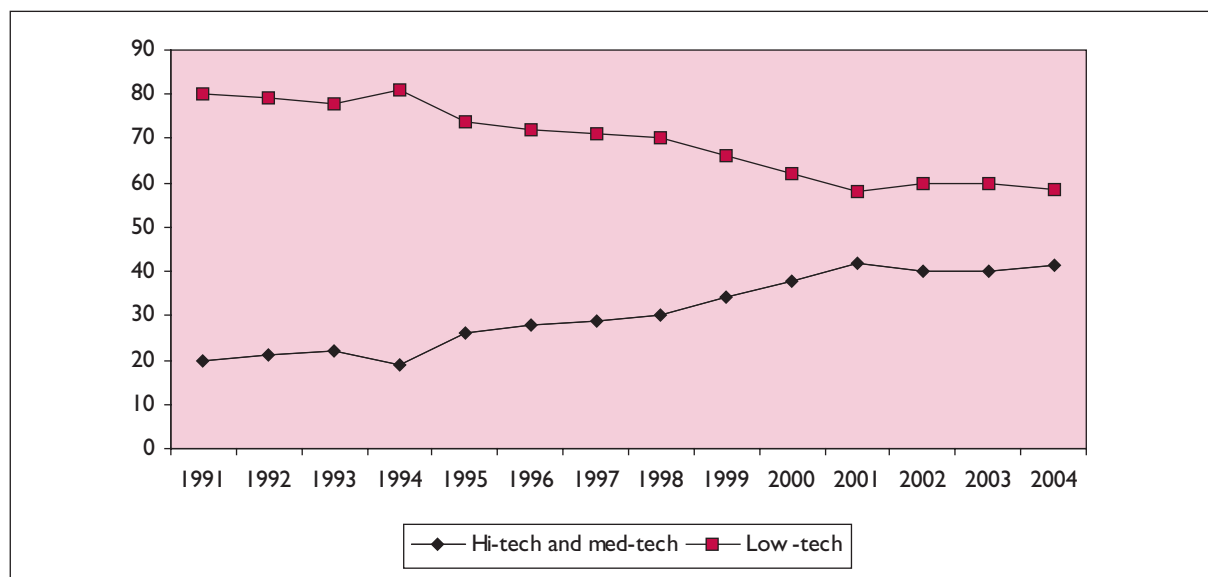
⁹ On the basis of Colombia's notifications to the WTO, the WTO Committee on Subsidies has identified the Plan Vallejo and the CERT programme as export subsidies. The CERT scheme was abolished in 2003. Plan Vallejo will be phased out by 2006. See Chapter II.

¹⁰ Juan Gaviria (1998). *Port privatization and competition in Colombia*. World Bank, note 167.

¹¹ Pedraza (2002) based on DANE's Annual Manufacturing Survey.

Whilst there are no statistics to confirm a direct linkage, it seems plausible that the increasing export orientation of FDI has been associated with the rising share of high technology products in total exports. Figure I.6 shows that the share of high technology exports as a percentage of all exports doubled from 1991 to 2004 from 20 to 40 per cent.

Figure I.6. Share of Colombian exports according to technological intensity, 1991-2004
(Percentage)



Note: Technological classification is based on UNIDO methodology.
Source: DANE, calculations ANDI.

b) Local supply

Despite TNC affiliates having a significant share of total national imports (36 per cent in 1998-2001), they did not as a rule tend to depend heavily on imports, in preference to generating linkages with local suppliers.¹² Depending on the sub-sector, their imports to sales ratios ranged between 4 and 50 per cent (Pedraza 2002), with the vast majority of sub-sectors clustered between 15 and 25 per cent. Although no figures could be found for the import dependency of domestic firms, a proxy is the ratio of total imports to GDP of 21.4 per cent.

Big differences do exist between sub-sectors. Those with a high technological component are more dependent on imports. TNCs in industrial chemicals, iron and steel, professional and scientific material manufacturing and transport equipment have significant imports to sales ratios. On another measure, the share of imports by TNCs in the industrial chemicals and the iron and steel sectors between 1998 and 2001 was 48 and 42 per cent, respectively (Pedraza, 2002).

c) Little FDI in free trade zones (FTZs)

FTZs have existed in Colombia since 1958. As of January 2004, there were 10 zones hosting 537 firms both local and foreign,¹³ with exports in 2003 amounting to \$219 million, well below their sales to the domestic market. At the same time only 11.2 per cent of FTZ land is occupied.

¹² Import dependency is measured as the import/sale ratio of FDI recipient firms. Higher indicator values reveal an increased dependency on external supply by these companies.

¹³ These firms held total fixed assets of \$387 million and employed 25,030 people directly and 70,703 indirectly.

There are several reasons for the disappointing export and occupancy outcomes. The services FTZs offer are too expensive for small firms and inadequate for large firms who can negotiate better security, logistics and warehousing packages for themselves.

At the same time, the benefits offered by FTZs were in the past crowded out by the Plan Vallejo and CERT tax advantages available to all exporting firms, regardless of where they were located. However, decree 1989 of 2002 modified the application of CERT, eliminating their access to exporters. FTZs have also been the subject of frequent regulatory changes, poor tax administration and service shortcomings.

In December 2005, the Government approved a new FTZ regulation, which may create an improved framework for attracting investment and generating employment in the country's FTZs. The new regulation would provide fiscal incentives for those enterprises that establish their operations in the area, encouraging the creation of industrial clusters. This new tool will allow operating and industrial users to access, as of 1 January 2007, a preferential income tax rate of 15 per cent, while commercial users will pay the full rate. In addition, FTZ users who transfer funds abroad will, as of 2007, be exempt from the remittance tax. Finally, in addition to this new law, the Ministry of Trade, Industry and Tourism is currently drafting the Free Trade Zone Regulatory Decree.

Box 1.3. Unilever establishes its Andean regional headquarters in Colombia

Unilever's decision to establish its Andean regional headquarters in Colombia is a good example of how foreign firms perceive Colombia's locational advantages, particularly for regional exports. Unilever is one of the world's leading TNCs in the production and distribution of consumer goods, in food, house and personal care. Established in the Andean region for several decades, Unilever started a thorough restructuring of its regional operations in the early 1990s, at the same time the Andean Community was establishing a free trade area. Unilever expanded and consolidated its presence in the region by acquiring some local firms and entering into selected strategic alliances. As a first step towards integrating regional production during 1980s, Unilever assigned the coordination of activities in Venezuela to its Colombian affiliate. However, by the end of the 1990s, while Unilever's presence in the Andean region was important, it was not dominant, as competition was strong in these markets.

In order to improve its market share, Unilever's management decided to re-organize the regional operations within the framework of a new global strategy. This strategy reduced the number of brands and established a world supply chain. This new strategy led to significant changes in Andean operations and a rethinking of the regional administration. The concentration strategy eliminated 40 per cent of the brands that the company had produced and distributed earlier in the region. The supply chain rationalization closed down factories located in Peru and Venezuela and reduced activities in Ecuador. Most of Unilever's production moved to Colombia where the regional headquarters – Unilever Andina S.A. – was established in 2000. The selection of Colombia as the regional hub came after a detailed location competitiveness analysis. Unilever considered that it was important to establish the regional headquarters in the market offering the best growth potential. With a market of 43 million people and a growing economy, Colombia accounted for 30 per cent of total Unilever sales in the region. Another important factor was human resources. For Unilever's management, Colombia had the best supply of qualified human resources thanks to its education system and availability of competent middle managers. In addition, Colombia offered good connectivity and easy transportation links within the region.

Security was an issue of concern before the final decision to establish its regional headquarters in Colombia was taken. However, in the past two years security conditions have improved in Colombia. Expatriates often hesitated before accepting Colombia as a duty station; however, once settled most of them enjoyed a good quality of life and provided positive references to their colleagues. Unilever's strategy in the Andean region has achieved good results. In 2003, Unilever sales in the Andean market were \$600 million, 80 per cent of which were goods manufactured in the region and 20 per cent imported. 2,600 employees are now directly employed in the region.

Source: UNCTAD.

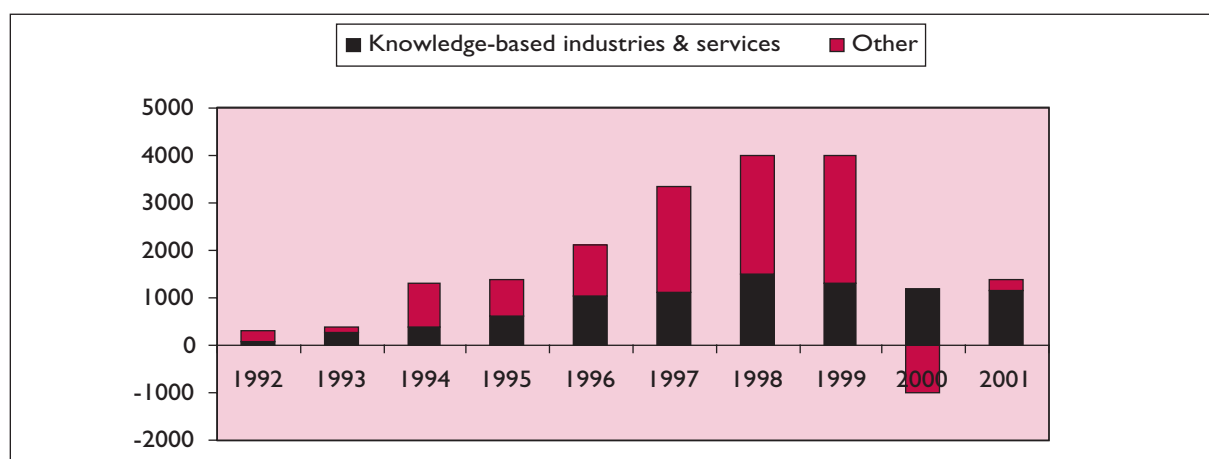
2. FDI, technology, productivity and skills upgrading

Many developing countries are keen to attract FDI in order to stimulate technology and innovation spillovers in management and production and upgrade skills.

These benefits are felt most when they spill over into the domestic economy through linkages between domestic firms and TNCs. To maximize these benefits, local firms need sufficient absorptive capacity. One of the aims of a government's programme – *Colombia Compite* – is to support innovation, learning and investment in local firms, which facilitate technology transfer, R&D capabilities and local skills development. This programme is reviewed more extensively in Chapter III.

There is some evidence that this is working to help Colombia obtain higher technology FDI. For example, the share of FDI taken by knowledge-based industries, though small, has been growing.¹⁴ It has also been better sustained during the economic downturn of 1999-2000 (Figure I.7).

Figure I.7. Share of FDI into knowledge-based industries and other industries¹⁵



Source: National Planning Department (DNP).

While further data of this type is difficult to collect, the evidence above does show that Colombia has had some success in technology transfer but is nonetheless held back by the lack of a stronger skills and technological base.

At the same time, an UNCTAD survey brought out interesting examples of how TNCs have contributed to bringing new hard and soft technology to Colombia:

- **R&D.** TNCs in Colombia generally possess small support laboratories for technical assistance and innovation of an incremental nature. Only a few large domestic and foreign firms have organized R&D centres and links to industrial technology development centres.¹⁶ Unfortunately, since 1999 there has been a deterioration in both private and public funding to R&D (see Chapter III).

¹⁴ The OECD uses the International Standard Industrial Classification, second revision with four digits, but only three-digit classification is available in Colombia. Nevertheless, since only three digits are used to classify low- and medium-low technology industries and the fourth digit just helps to distinguish between high and medium-high-technology industries, the last two categories were regrouped into knowledge-based for the case of Colombia. See «Classification of industries based on technology» (OECD, 1999, p.106).

¹⁵ Excluding the oil sector.

¹⁶ UNCTAD (1999). *The Science, Technology and Innovation Policy Review*. United Nations publication sales no. E.99.II.D.13.

- **Skills upgrading.** Support for training and skills development has been a feature of most TNCs operating in Colombia, in particular for managers. A number of TNCs have elected Bogotá as the regional headquarters for their manufacturing operations (such as Unilever, Siemens) and provide training to their companies from there.
- **A shift to a more capital-intensive production and higher wages.**¹⁷ TNC affiliates have a higher capital-labour ratio than local firms, and as a result, greater labour productivity and wage rates. The available figures for 1995 to 1999 show that in all manufacturing sub-sectors, affiliates have higher capital-labour ratios and have therefore used more technology than domestic firms. Outstanding sub-sectors are glass and glass products manufacturing, in which affiliates had ratios which were 4.5 times greater than domestic firms. Even more basic sub-sectors such as the iron and steel industry were remarkable for the high relative value of this indicator. At the same time, wage rates in all industrial sub-sectors are higher in affiliates than local firms; the highest differences being in oil and coal, manufacturing of electrical equipment and glass and glass products manufacturing. The possibility of spillovers is glimpsed from the steadily increasing levels of labour productivity throughout the manufacturing sector in the last four years.¹⁸

D. Overall assessment

Colombia's performance in FDI attraction is promising but remains unfulfilled. Relative to both population size and GDP, it scores lower than the Andean Community. When related solely to population, it trails well behind the major Latin American economies with which it will be competing economically as the continent pursues its gradual integration.

Nevertheless, FDI has had a positive impact on the economy. Investment is not solely concentrated in privatization and natural resource extraction. In fact, a growing proportion of investments have been earmarked to manufacturing and services. Investments have also contributed to the growth of high technology exports and increased the capital-intensity of production, with some evidence of technology transfer. Furthermore, TNC affiliates have increasingly established linkages with local suppliers.

Many of the above indicators show a marked improvement following liberalization in the early 1990s. Similarly, regional integration has given Colombia the opportunity to act as a regional platform, as reflected in both by increased exports within the Andean Community and outward investment towards it. There is also evidence that market- and efficiency-seeking FDI, aimed at the region is being consolidated in Colombia.

Colombia is experiencing a period of renewed growth. While some of this can be attributed to the effects of FDI, credit should be given to the Government's recent reforms and the Democratic Security Policy, which has brought about a significant improvement in the security situation and a consequent boost in confidence.

¹⁷ The indicators analyzed in this section are drawn from the evaluation of TNC affiliates productivity during the 1995-1999 period. More information is available in: Pedraza (2002). Efectos indirectos de la inversión extranjera directa: evidencia para la economía colombiana.

¹⁸ DANE-Observatorio de competitividad.

II. THE INVESTMENT FRAMEWORK

A. Specific FDI measures

Colombia's Constitution, adopted in 1991, liberalized its approach in important areas related to the rights and protections of foreign investors. This cleared the way for reforms enacted in the statutory regime for FDI, which has been steadily modernized. Impediments to the legal adoption of investment treaties have been removed and an important step will be to implement a network of treaties with appropriate standards of treatment and protection. Several institutions deal with FDI policy and promotion in Colombia (see Box II.1).

I. Entry and establishment

a) The Statutory Regime

Law 9 of 1991 establishes the general legal basis for foreign investment, following the constitution. Law 9 is mainly administered and interpreted through two decrees. Decree 2080 of 2000, is considered the effective regime for FDI except where superseded by international treaties. Decree 4210 of 2004, which partially modified Decree 2080 of 2000, was recently repealed.¹⁹ This was strengthened and clarified in July 2003 by Decree 1844. An initial exclusion of inter-corporate loans from the FDI regime was rectified. In 2005, Law 963 established the basis for legal stability agreements (see section 2 (b)). The principal principles governing the FDI regime are:

- **Equality**
Foreign investment has the same treatment as national investment. Therefore, foreign investors may not be subjected to discriminatory conditions or treatment, nor may they be given preferential treatment over national investment.
- **Universality**
Foreign investment is welcome in all the sectors of the economy, with the exception of:
 - Defence and national security activities;
 - Processing, selling and disposal of toxic, hazardous or radioactive waste not produced in the country;
 - Network television concessions, which cannot have foreign investment exceeding 40 per cent of the total of the concessionaire's equity²⁰.
- **Automatic approval for investment**
With the exception of the foreign investment restrictions mentioned above, foreign investors may invest in all other sectors of the Colombian economy without prior authorization. Of course, entry into the regulated sectors such as financial services, hydrocarbons and mining is subject to approval but this applies to all investors, irrespective of nationality of ownership.

b) International Treaties

International treaties become effective when they are ratified by the President, following congressional approval and review of constitutional consistency by the Constitutional Court. Once incorporated into domestic law, treaties are considered a direct source of law to the extent that they are not inconsistent with the constitution.

¹⁹ The legal framework for FDI includes: Constitution (article 13) Law 9 of 1991, Decree 1735 of 1993, Decree 2080 of 2000, Decree 1844 of 2003, Decree 1866 of 2005 and Declaration 8 of 2000, and 4474 de 2005.

²⁰ Law 182 of 1995.

Accordingly, Colombia's current FDI legal framework also incorporates binding norms (Decisions 291 and 292) resulting from its membership since 1991 of the Community of Andean Nations (CAN),²¹ which aims to establish a common market. It also reflects the Treaty on Free Trade between Colombia, Mexico, and Venezuela (more generally known as the Group of 3 or G-3 Treaty), which entered into force in 1995.

Colombia is currently negotiating a free trade agreement (FTA) with the United States that will contain a chapter on investment. Overall, the agreement should improve legal security and the investment environment. The government is keen to conclude this treaty as the United States already has trade agreements with three important competitors – Chile, Mexico and Panama. In addition, the current United States-Andean Preferential Trade Agreement (ATPDEA), tied to drug eradication programmes, expires at the end of 2006 and has little prospect of being renewed. The signing of the FTA with the United States would also stimulate similar agreements with other home countries.²²

c) Foreign investment entry

Most commercial activity is open to FDI. However, the Political Constitution,²³ Decree 2080 of 2000²⁴ and other related regulations expressly prohibit foreign investment in those sectors related to defence and national security; the processing of foreign toxic, hazardous or radioactive waste;²⁵ and the ownership and commercial use of land in earmarked areas (50 km from borders, islands and ecological and other reserved zones).²⁶ Also, in the television sector only 40 per cent foreign ownership is permitted, on a reciprocal basis.²⁷ (Table II.1) In addition, Colombia's National Economic and Social Policy Council (CONPES) can, at its discretion, restrict FDI in other activities. It has not done so and in reality is unlikely to extend current FDI restrictions. However, CONPES retains the legal right to restrict FDI (which if implemented would restrict FDI only to those cases accepted by CONPES). This should be formally clarified by CONPES, confirming the negative list, which is the current practice.

Apart from those related to national security, there are now few FDI entry restrictions. These are largely limited to investments in the field of transport and should be reviewed to confirm whether they are in force and if they are pertinent to the national interest.²⁸ There is a precedent for this. In December 2004, the government abolished foreign ownership restrictions in oil exploration and production.

²¹ CAN Member Status are Bolivia, Colombia, Ecuador, Peru and Venezuela.

²² On the impact of BITs, see UNCTAD (2004). *International Investment Agreements: Key Issues* (UNCTAD/ITE/IIT/2004/10 (Vol. III) and www.unctad.org/ia.

²³ See Articles 81 and 223 of the Political Constitution.

²⁴ According to the Ministry of Trade, Industry and Tourism, as supported by Concept 1.255 of 2000 of the Council of State and interpretation 220-53816 of 1999 of the Superintendency of Enterprises, the restrictions of the Commercial Code have been eliminated by Decree 2080 of 2000.

²⁵ Article 6, Decree 2080 of 2000.

²⁶ Decree 1415 of 1940 and Decree 471 of 1986.

²⁷ Article 34 of Law 182 of 1995 as amended by Article 1 of Law 680 of 2001.

²⁸ See previous footnote. The Ministry of Foreign Trade also informed that during the FTA negotiations with the United States, the Government of Colombia confirmed that the Civil Code FDI restrictions are not enforced.

Box II.1. Institutions involved with FDI

The National Economic and Social Policy Council (CONPES) is Colombia's highest national authority for economic and social planning. It has the authority to regulate foreign investment and can reserve activities to nationals and define the degree of foreign investment allowed in a particular sector. The Ministry of Foreign Trade formulates foreign investment policy and coordinates governmental strategies to increase the country's competitiveness and receive foreign investment. It also negotiates international investment agreements.

Within the Ministry of Trade, Industry and Tourism, the Directorate of Foreign Investment: (a) undertakes diagnostic studies on topics related to foreign investment in Colombia and Colombian investment abroad; (b) promotes the adoption of norms relating to foreign investments and modifications and adjustments thereof; (c) coordinates and participates in the negotiation of foreign investment agreements; and (d) seeks to simplify procedures, legal stability, openness among different government entities, and enhance the business climate for foreign investors in the country. For legal stability agreements, the Directorate of Productivity and Competitiveness acts as the technical secretariat for negotiating with investors.

COINVERTIR (Invest in Colombia Corporation) is a mixed public/private sector, non-profit company created in 1992 to promote and facilitate the development and consolidation of foreign investment. It promoted Colombia as an investment location, assisted potential investors, provided some investors with after-care services and conducted investment climate monitoring with recommendations for improvement. In January 2005, the government merged COINVERTIR and PROEXPORT – the export promotion agency. Together with COINVERTIR, the government designed the REI network (*Red Especializada de Inversión*) (see Chapter III) to improve coordination between the organizations involved in investment policy and promotion. However, the start-up and implementation of REI have been delayed.

Source: UNCTAD.

Table II.1. FDI restrictions in Colombia, 2005

Sector/activity	Type of restrictions to FDI	Legal source
Importing or production of munitions, weapons or explosives	Prohibition	Constitution, Article 223 Decree 2080 of 2000
Processing, handling, disposal of toxic, dangerous or radioactive waste	Prohibition	Constitution, Article 81 Decree 2080 of 2000
Maritime agents	Max. 40 per cent foreign ownership	Commercial Code, 1971, Article 1490*
Colombian Commercial Airline	Max. 40 per cent foreign ownership	Commercial Code, 1971, Article 1426*
Commercial ships licensed in Colombia	Foreign ownership prohibited	Commercial Code, 1971, Article 1458*
Commercial shipping companies	Max. 40 per cent foreign ownership	Commercial Code, 1971, Article 1426*
Television	40 per cent foreign ownership on reciprocal basis	Article 34 of Law 182 of 1995 as amended by article 1 of Law 680 of 2001
Land in designated areas (50 km from borders, islands and ecological and other reserved zones)	Prohibition of ownership or restrictions on commercial use.	Decree 1415 of 1940 Decree 471 of 1986
Financial and Banking	Prior authorization	Decree 663 of 1993

Source: UNCTAD and COINVERTIR (2005). *Surprising Colombia: Foreign Investment Guide, 2005*.

*Note. According to the Ministry of Trade, Industry and Tourism, following Concept 1.255 of 2000 of the Council of State and Interpretation 220-53816 of 1999 of the Superintendency of Enterprises, the restrictions of the Commercial Code have been eliminated by the Political Constitution of 1991, Law 9 of 1991 and Decree 2080 of 2000.

d) Entry and establishment regulations

Entry and establishment regulations are reasonably straightforward compared to other countries in Latin America. Where foreign investment is allowed, there is no prior screening and the foreign investor only needs to register²⁹ the capital inflow required for the investment with the central bank in order to maintain its foreign exchange rights. Of course, screening is required for regulatory purposes in a variety of financial services and in public utilities' investments. But this applies to both foreign and national investors.

2. Treatment and protection of FDI

Colombia's policies for foreign investment reflect four basic principles: (a) equality of treatment; (b) universality; (c) automatic authorization; and (d) stability of investment reimbursement and profit transfer. However, Article 100 of the constitution originally allowed the Government to suspend certain rights for reasons of security. It also allowed the Government to pass laws and presumably decrees with the force of law, that could undermine national treatment guarantees. Although the Government has never used this provision, it was qualified the same year so as to guarantee national treatment on all matters except, of course, for capital repatriation.³⁰ This was in response to foreign investors' concerns.

In addition, the Andean Community Treaty provides for national treatment of foreign investors in member countries, with the caveat that in cases of conflict between the two, national legislation assumes precedence over community legislation. The G-3 treaty provides for most favoured nation (MFN) status among member states.

a) Bilateral investment treaties

Colombia has concluded five bilateral investment treaties (BITs), namely with Cuba and the United Kingdom and Peru in 1994, Spain in 1995 and Chile in 2000. The first three have not entered into force because they clashed with Article 58 of the Constitution, which allowed for expropriation without compensation, although the article has never been applied. The constitution was subsequently amended by Act 1 of 1999 and some of the above-mentioned agreements are currently being renegotiated and updated. Once concluded, they will again be subject to approval, review and ratification. The BIT with the United Kingdom is being renegotiated (and will also be subject to approval, review and ratification), while the BIT with Chile has been reviewed and cleared. However, because of a new policy of Chile to initiate broader agreements, the ratification process has been halted and a new treaty will be negotiated with Chile. The BITs with Peru (the only one currently in force), the United Kingdom and Spain all specify national treatment and MFN treatment for foreign investors.

In 2003, the Government published a "Model Bilateral Accord for the Promotion and Protection of Investments" or model BIT, based on an analysis of its history of investment negotiations. The model BIT was designed as a template and will be reviewed regularly to take into account of any treaties which are being concluded and subsequent negotiations. Offering investors greater legal protection, it was used as the basis for a new BIT signed with Spain in March 2005. Given the considerable effort taken in its design, the Government should ensure that it is used as a launch pad for a new round of BIT negotiations as a mechanism to improve investment protection and investment promotion. In 2006 the government revised the BIT model to integrate recent trends in international investment standards and the outcome of the latest agreements negotiated by Colombia, including the BITs with Spain and Switzerland, as well as the Free Trade Agreement (FTA) with the United States.

b) Legal stability agreements

By Law 963 of July 2005, investments exceeding about \$1.2 million can obtain contractual protection from adverse changes in national legislation through a legal stability contract (LSC). The eligible sectors are: industry;

²⁹ Chapter III of Decree 2080 of 2000

³⁰ Article 15, Paragraph 4 of Law 9 of 1991.

agriculture; mining; free trade zones; petroleum; telecommunications; construction; railway and harbour developments; electric power generation; irrigation and water supply; and any activity which is approved by a special committee convened for this purpose. Portfolio investments are not permitted.

The concept is based on similar schemes in Chile and Peru but Colombia's approach is markedly different. Colombia adopts a negative list approach. The government may agree to stabilize any regulation, unless expressly excluded by law.³¹ LSCs in Chile and Peru are confined to a predetermined list (with some variation by sector – see Box II.2) of favourable matters and there is no negotiation either of the scope of the provisions, their drafting or the duration of the contract. Colombia's LSCs may also explicitly include regulations and administrative rulings issued pursuant to the law. Local authority matters are excluded. Investors are required to pay each year a premium of 1 per cent of the amounts invested in that year (reduced to 0.5 per cent in an "unproductive" year).

The LSC can have a term of 3 to 20 years, subject to negotiation. The LSCs are a positive initiative and their approach breaks new ground. But they present a number of issues of principle and practice that may affect the vital interests of both the Government and investors:

- **Large-scale investment.** Major investors in regulated industries (including oil and gas, mining, power generation and infrastructure concessions) will seek to negotiate development or concession agreements with the government in any event. Their investment (and debt financing) may require it. Such agreements contain a balance of rights and obligations on *both* parties. Investors will not expect to pay to obtain government undertakings on project terms. If the LSCs become the only channel available, the fee requirement may be seen as a disincentive rather than as an optional payment for additional protection.

Box II.2. Legal stability agreements in Chile and Peru

Chile's stability contracts provide guarantees on the terms and conditions of the legal, regulatory and policy regime applicable to the investment. They also include non-discriminatory treatment, allowance for any form of FDI, indefinite holding and control of assets, transfer rights (remission of profits, repatriation of capital), acquisition of foreign currency at prevailing inter-bank rates of exchange, and a *guaranteed* corporate tax rate for up to 20 years, which include the right to take advantage of more favourable tax rates enacted subsequently. Chile does not require investors to specify in advance modifications of the regime that could impact on their investments.

Peru's stability legislation currently allows investors to enter into stability contracts with the state at both the level of the individual investor and the enterprise. The agreements provide contractual assurances for up to 10 years (or longer in the case of concessions) to protect against any change in certain key policies. Variations regarding eligibility depend on the sectors involved. Mining, power, hydrocarbons and infrastructure have the most favourable arrangements. The 10-year guarantee of stability covers sector legislation (with certain variations for regulated industries), national treatment, corporate income tax, free remittance abroad of profits, access to the most favourable exchange rate for currency conversions for inward and outward remittances and income tax payable on dividends or other forms of profit-sharing. The contracts also provide for stability with regard to labour regulations and export promotion schemes (drawback). In the case of stability for corporate income tax, the investment must be a new investment, or a 50 per cent expansion of the capital and reserves of an existing enterprise. It is possible on a once-only basis for the investor to move to the prevailing general legal regime when that would be more advantageous. Rights under the contract are automatically transferable.

Source: UNCTAD.

³¹ Exclusions from the scope of LSCs are: (i) indirect taxes; (ii) any tax decreed for an emergency; (iii) social security regulations; (v) financial sector regulations; and (iv) tariffs for public services.

- **Dispute settlement.** International arbitration is not allowed for the settlement of investor-state disputes arising from the LSCs, even for foreign investors.
- **Cherry-picking.** An important benefit of LSCs is that investors can lock in incentives. However, investors will also be able to adopt any more favourable provisions as regulations change in the future. Colombia's tax incentives are a *package* of measures and become problematical in this regard. A change in a single tax measure could lead to over-generous treatment for investors with LSCs and defeat otherwise sensible reform (Figure II.2 in Section B shows the effect of eliminating the minimum tax, for example). Two possible options include a general reform of corporate taxation (which can then be locked in), or the LSCs themselves should contain exclusions on the right to cherry-pick.
- **Litigation.** The LSCs could themselves become a source of litigation and thus sour the very climate that they are designed to foster. First, the requirement for payment and the positive list approach will stimulate investors and their legal advisers to maximize the government's activities that should be covered by the LSCs. The scope for future litigation could be immense. Second, the Government is not obliged to honour its stability undertakings if investors breach various "good behaviour" provisions (these, apparently, include offences committed abroad). Again, the scope for disagreement and litigation is huge.
- **Bureaucracy.** The positive list approach will entail much work for both parties in negotiating the agreements. Furthermore, the government will also have additional bureaucracy in recording future changes in law when adopted by investors and checking premium payments. The process should be simplified by developing model language and scope for the general protections that investors will seek.
- **Cost.** The premium rate should be reviewed. It should vary with the duration of the contract.

These observations all suggest that the Government should take a more calibrated approach in its offer to investors of the measures to be stabilized and their rights to adopt more favourable future provisions. In turn, foreign investors should have the right to international arbitration, at least on matters that are central to the viability of their investments (see Section 4 on dispute resolution).

3. Investment protection, expropriation and compensation

The Constitution guarantees the rights of property that has been legally acquired, although it does allow for these rights to be ceded in the public or social interest. A provision in the Constitution allowing for expropriation without compensation was removed in 1999. There is now a right of appeal both on the basis of the decision itself and on the level of compensation. However, the constitution does not specify the detailed elements of compensation. UNCTAD's survey and interviews with foreign investors indicated that these matters are of some concern to investors. Now that the constitutional impediment to payment of compensation has been removed, these matters can be taken up by treaty, as was the case with the Spanish BIT. Foreign investors perceive the current government's effort to negotiate BITs as an improvement, particularly with regard to compensation issues.

Colombia is a signatory to international agreements for protection against political risks through the World Bank Multilateral Investment Guaranty Agreement (MIGA) and the United States Overseas Private Investment Corporation (OPIC).

Colombia's model BIT states that expropriation measure will be subject to review by the judiciary,³² reflecting the BITs Colombia negotiated with the United Kingdom, Spain and Chile in which expropriation is subject to review by either the judiciary or an independent authority. The model BIT adds that no expropriation should take place outside of cases provided for by law and should be without discrimination and for public utility or in the public interest.

³² Article VI-3.

With regards to regional commitments, Andean Community rules do not cover expropriation or compensation. But the G-3 treaty does. It requires compensation to be equivalent to the fair market value of the investment at the time of expropriation, with no reduction in value owing to the fact that the intent to expropriate became known before the actual date of the action. In contrast to Colombian legislation, it adds that compensation should be paid promptly, be freely transferable outside the country, be convertible at normal market rates and include interest at the current market rate for the currency used. The G-3 treaty goes further, stating that governments may not expropriate or nationalize investments in a direct or indirect way. Nor can governments adopt equivalent measures, unless it is for a public purpose and on a non-discriminatory basis, in which case it should follow the G-3 rules on compensation. These provisions are similar to those of NAFTA and in line with international standards of investment protection.

This Review recommends that any future BITs should follow the G-3 rules on compensation (see above).

4. Dispute resolution

International arbitration. Colombia is party to the Washington Convention that established the International Centre for the Settlement of Investment Disputes (ICSID), as well as the New York Panama and Montevideo Conventions. Where covered by an ICSID clause on arbitration in a BIT, or specified in a contract between the investor and the government, an investor may resort to international arbitration for an investor-State dispute as an alternative to arbitral or judicial resolution under local law. However, given that only one BIT is in effect, though several others are being negotiated, approved, reviewed, and/or ratified, investors may, for the time being, only resort to international arbitration where it is provided for in a contract.

The G-3 treaty also contains provisions for dispute settlements, including ICSID, UNCITRAL, and/or other forum agreed by both parties. In the regional treaty with CAN, dispute settlement procedures are left to national law.³³ With regards to the execution of international arbitration, only ICSID arbitral awards are automatically binding on members (see Articles 53, 54 and 55) without national judicial review. For other international arbitration outside the ICSID, investors must obtain an *exequatur* (leave) from of the Supreme Court of Justice before going to arbitration to authorize the enforcement of any obligation arising from international arbitral awards in Colombia.

This process is costly and time consuming for investors. It is also technically difficult because of its demands, conditions and limitations and is not frequently seen in comparator countries. In practice, the government has respected and paid compensation related to international arbitration outside ICSID. However, investors consulted have overall felt that the access to, and conditions of enforcement, of international arbitration is a potential risk.³⁴

National arbitration. The norms regulating domestic arbitration have been simplified over time; however it is still a complex, time-consuming and unclear process. Thus, even though Colombia has a legal framework for arbitration and resolution of disputes, companies that rely on domestic arbitration face a lengthy dispute resolution process.³⁵

A recent initiative had been presented in Congress to unify laws and judicial procedures for arbitration at the international and national levels. Investors are concerned that its enactment would allow both judicial review of international awards and judicial *revision* as well. This would permit re-examination of the substantive and the procedural findings and logic of the decision, making it even more difficult and less certain that awards against the State will be enforced. However, this proposal has now been withdrawn.

³³ Artículo 10 de la Decisión Andina 291.

³⁴ See results of the UNCTAD survey in Annex I and Doing Business in Colombia, www.doingbusiness.org.

³⁵ For example, the Investor Protection Index i calculated by the World Bank is 5.7 for Colombia, for Peru it is 6.3. Source: <http://www.doingbusiness.org>. Also, see the annex for details on UNCTAD's survey.

As of now, the majority of conflicts between the state and investors have been solved by national arbitration. Considering the difficulties in executing resolutions of international arbitration outside the ICSID, national arbitration is still the best option, despite its drawbacks. The ideal situation for an investor would be the possibility to opt for international arbitration (easily enforceable in Colombia) or national arbitration (with a simple, safe and inexpensive process).

5. Foreign exchange regime/transfer of capital and profits

Foreign exchange transfer rights are a special concern for foreign investors and, since 1991, Colombia has been gradually liberalizing its foreign exchange policies. Foreign exchange used for direct investment no longer requires prior registration at the central bank. Full remittance of profits and proceeds from partial or total disinvestment is permitted, subject to the payment of applicable taxes. The government may, however, restrict such remittances, in the event of international reserves falling below three months worth of imports. This exclusion pertains in the regimes of many other countries.

With regards to regional commitments, CAN allows foreign investors to remit net profits and the proceeds of divestment in freely convertible currency subject to payment of applicable taxes. The G-3 treaty reiterates the provisions of Colombian law in that all transfers related to an investment are allowed. It adds that these can be made freely and without delay, except in cases of serious balance of payment problems – a caveat also contained in Colombian law.

Colombia's BITs mirror the provisions of the G-3 treaty and add that any restrictions arising from balance of payments problems should only be enforced for a limited period, in a non-discriminatory manner and in line with current laws.

In interviews with UNCTAD, investors expressed their concerns on the fact that the commercial code³⁶ only allows capital reduction, and in case of foreigners' capital repatriation, as long as a company's remaining assets are double its liabilities. Furthermore, companies cannot distribute profits if they have losses affecting the company's equity. However, these provisions are meant as social protection measures and apply both to foreign and national investors.

6. Performance requirements

According to the government, there are no performance requirements explicitly applicable to FDI entry and establishment. And, as a member of the World Trade Organization (WTO), Colombia has to abide by the Trade-Related Investment Measures (TRIMs), which prohibit local content requirements as a condition for investment.³⁷ TRIMs only regulate performance requirements imposed on investors who wish to benefit from *investment* incentives related to the entry and establishment of FDI. But the wider GATT/WTO framework also imposes obligations relating to export promotion and export-related performance requirements, some of which may also qualify as TRIMs if they affect the right of *foreign* investors to benefit from export incentives.

The Agreement on Subsidies and Countervailing Measures (SCM) prohibits export subsidies, and similarly to TRIMs rules, the GATT/WTO framework prohibits subsidies that depend on export performance, or on the use of domestic products. On this basis, the *Plan Vallejo* and the CERT programme have been identified by the WTO as export subsidies.

However, TRIMs are not contravened by Colombian laws and regulations.³⁸

³⁶ Articles 145, 151 and 241.

³⁷ Agreement on the implementation of Article VI [i.e 6] of the General Agreement on Tariffs and Trade 1994.

³⁸ http://www.wto.org/english/news_e/news04_e/sub_committee_04nov04_e.htm. G/TRIMS/N/1/COL/1 and G/TRIMS/N/1/COL/2

The government has until 31 December 2006 to phase out these export-related incentives and has announced that they will be replaced by incentives for employment generation and investment in new technologies. Following discussions between the Ministry of Foreign Trade and various free zones, a draft law is currently being discussed between the Ministries of Foreign Trade and Finance and Public Credit.³⁹

With regards to regional commitments, the Andean Community allows performance requirements not prohibited by GATT/WTO for licensing technology, technical assistance, technical services and other technological contracts in accordance with the law of member countries. Under the agreement, such contracts must be registered before the competent national entity in conformity with applicable national law. The registering entity will evaluate proposals on a case-by-case basis and determine certain quantitative criteria to demonstrate the effects of the imported technology. In contrast, the G-3 treaty prohibits performance requirements as conditions for the establishment, acquisition, expansion, management, conduct, or operation of a covered investment, subject to certain specific general exceptions or exclusions. Performance requirements specifically prohibited include those specifying a location for production facilities, minimum levels of employment generation, or requirements for worker training.

7. Overall assessment of specific measures

Colombia's overall regime governing FDI in the country – despite some weaknesses – is similar to those in fellow member states of the Andean Community and most of Latin American countries. It is a regime that normally would attract increased FDI. However, Colombia has to deal with a severe internal conflict and the rising influence of the drug trade, aspects which may outweigh the attractions of Colombia for many investors. At international level, Colombia also faces competition from other Latin American and Asian countries for attracting FDI. The country has also steadily improved its openness to FDI and standards of treatment of foreign investors. But Colombia needs to take further steps to fully implement its policy objectives. Recommended actions are as follows:

Legal framework: Foreign investors are confronted with a panoply of constitutional provisions, laws, decrees, resolutions, ministerial decrees and other official statements that define investor rights and obligations (see UNCTAD survey, Annex I). The norms which, according to those investors consulted, are frequently changed, amended or interpreted, affect legal stability. A single and comprehensive code, which would set explicitly forth the rights and obligations of foreign investors could contribute to the openness of the regime and be very valuable to foreign investors.

Sectors amenable to FDI restrictions: Decree 2080 of 2000 (paragraph of article 6), authorizes CONPES to identify sectors of the economy in which the Government of Colombia will admit FDI. This approach has never been used by CONPES. Therefore, this regulation should be replaced by a provision that reflects current practice to add or initiate deletions from a negative list.

Expropriation, compensation: The legal standard of protection in relation to expropriation has improved steadily although the Constitution itself does not provide many details on compensation. Absent a constitutional amendment, this can be covered by appropriate provisions in treaties, following the language used in the G-3 treaty or in the BIT agreed with Spain in March 2005. According to the government, a provision in this regard is included in the investment chapter of the FTA with the United States, a feature which strengthens existing regulations on expropriation.

Investor/state dispute resolution: In the event of investor-state disputes, an investor may, by virtue of a contract or applicable treaty, have recourse to international arbitration. However, the current law does not help the enforcement of international awards and proposed legislation relating to such enforcement would

³⁹ After the deadline for the completion of the Review, Law 1004 of 2005 on free zones was passed. However, it is not possible to review it here.

allow Colombian courts to “review” as well as “enforce” such awards. If Colombian courts are required to review the substance of international arbitral awards and, at the same time enforce them, this could undermine the purpose and benefits of international arbitration for foreign investors. Currently, only disputes arbitrated under ICSID must be enforced without judicial review. The government should also improve national arbitration.

Legal stability contracts: LSCs are a useful tool and Colombia’s approach is innovative. To be useful to foreign investors it should enable recourse to international arbitration for major disputes. The Government must also take care in granting investors the right to benefit from more favourable future regulation in cases related to tax incentive packages. More generally, the scope for bureaucracy and litigation against the government should be limited by developing standard language and scope for the general provisions to be negotiated with investors.

Investment treaties relating to FDI: Colombia has only one BIT currently in effect, although it has concluded six such treaties since 1994. The constitutional norm on expropriation without compensation has been removed and ratification of existing treaties should now proceed. It is clear that such treaties would fill important gaps in the existing national regime for treatment and protection of foreign investors. Colombia should expand its treaty network and constantly update the model BIT with modern provisions. The 2006 update of the Model BIT is an important step in this regard.

B. General investment measures and conditions

The 1991 constitutional reforms, which enabled reform of investment measures of specific interest to foreign investors, also facilitated progressive changes in general measures and conditions in the investment framework.

I. Taxation

a) Principal taxes

The principal taxes affecting business are:

- Income tax (including a minimum tax based on net assets);
- Dividend withholding tax imposed on resident and non-resident shareholders;
- Remittance tax on dividends paid to non-residents;
- Withholding taxes on payments abroad of service fees, interest and royalties;
- Capital gains tax;
- Value-added tax (VAT), municipal sales tax on services and financial transactions tax; and
- Import duties.

The current corporate tax rate of 35 per cent is supplemented until 2006 by a 10 per cent surcharge to give a combined rate of 38.5 per cent. At first sight, this is a high rate. Tax depreciation rates of 5-20 per cent are low, but in 2004 a 30 per cent investment tax credit was introduced for investment in productive fixed assets in all sectors until 2007. This credit must be utilised within 5 years of acquiring the asset. In general, losses can be carried forward for 8 years but only 25 per cent of such accumulated losses can be deducted in any one year. Tax rates on overseas remittances are 10 per cent on technical services, 39.5 per cent on interest and 39.5 per cent on royalties.

An interesting feature of Colombia's corporate taxation regime is that dividends paid from business income that has not been fully taxed are subject to a (domestic) withholding tax at the corporate tax rate of 35 per cent. This can affect the benefit of fiscal incentives to lower the corporate tax burden, although the withholding tax can be avoided by deferring dividend payments for 5 years. A foreign investor is subject to a domestic withholding tax, as applicable, and to a remittance tax of 7 per cent on the gross dividends paid. Colombia has no double tax treaties in force (DTTs), although it has limited sector-specific agreements with some countries. It has a policy of not including direct tax matters in multilateral agreements. (Whilst Decision 40 of the CAN contains provisions on the avoidance of double taxation, its members have never followed these). Colombia regards direct taxation matters as being matters for bilateral negotiation.⁴⁰ Recently, the Government of Colombia negotiated a DTT with Spain and started negotiations with Chile, the Czech Republic and Switzerland.

The law *presumes* a minimum taxable income 6 per cent of the net assets of the firm. In many countries a minimum tax is an *alternative* tax system, and the tax is not applicable to correctly filed returns. In Colombia, minimum tax must be paid even if genuine losses are made. Decree 633 was introduced in December 2000 to improve tax collection and curb the worsening fiscal deficit. The reform consisted mainly of a tax on financial transactions, which has recently been raised to 0.4 per cent. This tax applies to all withdrawals, including cashiers' checks and ATM transactions.

The corporate tax burden on an investor is thus a complex combination of favourable and unfavourable elements depending in part on the scope of incentives and the investor's ability to avoid some tax features. The scope of fiscal incentives is discussed below and the interplay of these elements is modelled in some illustrative cases in order to assess the net impact of the fiscal regime on the foreign investor in Colombia. The basic VAT rate is 16 per cent, with certain transactions subject to rates ranging between 7 to 25 per cent according to the types of goods or services. Exports are zero-rated. In principle, import duties are set by the CAN common regime, although national exceptions are quite widespread. Colombia's weighted average applied tariff is 11.28 per cent.

b) Incentives

Colombia operates a number of fiscal incentive schemes designed to promote either desirable outcomes, such as exports or job creation, or to promote investment in priority industries and services. All incentives are available to both national and foreign investors. Schemes to promote investment in **export activities** are summarized in Table II.2.

Many of the incentives are, quite properly, designed to relieve the burden from exporters of import duties and VAT on operating inputs and, increasingly, on capital inputs as well. These measures help exporters compete on a level playing field with competitors in export markets. The free zone and special economic zone programmes provide, in addition, income tax holidays.

⁴⁰ In March 2005, Colombia and Spain agreed a BIT and a DTT, which are currently being ratified.

Table II.2. Trade incentives in Colombia (export-related), 2005

Law	Incentive	Coverage	Expiry
Quimbaya Law	Exemption from income and municipal taxes for a period of 10 years for new companies incorporated in this area, with a gradual reduction during the period depending on the location. - Reimbursement of VAT paid on import or purchase of capital goods. - Duty exemption on capital goods imported during the first year of operation.	Coffee- growing zone	31 December 2005
Plan Vallejo	Exemption of duty and VAT for imports of raw materials and inputs used exclusively to produce goods or services total or partially for export. The fiscal reform of 2002 excluded capital goods used to produce exports from enjoying these incentives as of 2007. The other incentives are maintained.	Nationwide	2006
Free zones, Law 7 of 1991 and Decree 1277 of 2002	Fiscal incentives include: exemption from income and complementary taxes for receipts derived from exports; customs duties; VAT on capital goods, equipment, supplies, and imported spare parts; and all taxes imposed on the remission of profits.	10 free zones	2006
Special Economic Export Zones, Decree 1227 of 2002	Same as free zones.	Five cities	
Exemption programme	5-10 year exemption of raw materials from import duties.	Special export programmes.	

Source: UNCTAD.

Colombia also has numerous incentives that are **not export-related**. Decree 2755 of 2003 provides tax holidays for approved projects or for desired outcomes in many industries. These are summarized in Table II.3.

Table II.3. Colombia's basic regime of fiscal incentives (non-export related)

Sector	Activity	Term
A. Total exemption from income taxes on revenues		
Computers/ software	Software development (elaboration, commercialization or licensing of certified software)	10 years
Electric	Energy sales generated from wind resources, biomass, or agricultural waste (requirement: transacting, obtaining, and selling carbon dioxide emission certificates with investment of at least 50 per cent of the value of such certificates in works of social benefit in regions where the generator operates)	15 years
Forestry	Use of new plantations; investment in sawmills related to such plantations and planting of wood-use trees	Indefinite
Hydrocarbons	Seismic services	5 years
Infrastructure	Sale of properties dedicated to the public interest	10 years
Pharmaceuticals	Exploitation of new medicinal products	10 years
Public utilities	Water, electricity, local telecommunications, natural gas	Not defined
Tourism	Services of new hotels built between 2003 and 2018	30 years
	Services of remodelled or enlarged hotels between 2003 and 2018	30 years
	Ecotourism services	15 years
Transportation	Shallow draft river transportation	15 years
B. Immediate and full capital expenditure deduction		
Agriculture	New investments in cultivation/production of fruits, olives, rubber, cocoa	
Environment	New investment in environmental improvements or controls (annual deduction limited to no more than 20 per cent of taxpayer's income) [Art. 78 of Law 788 of 2002]	
C. Credits against taxes payable		
Employment generation	Wage costs related to creation of new jobs (conditional) upon no less than 5 per cent increase in new jobs over prior year; limited to 15 per cent of income taxes payable. [Law 633 of 2000].	

Source: UNCTAD.

c) Assessment of the fiscal regime for investment

Colombia's approach to direct taxation is characterized by relatively high general rates of corporate taxes, but numerous incentives schemes for priority activities. Indirect taxation in the form of import duties is more conventional. Investors for the domestic market pay import duties at CAN rates. Exporters can benefit from schemes that provide import duty relief on their key operating inputs (such as through Plan Vallejo) and in some cases (such as in EPZs), on their capital inputs, as well.

On the surface, **corporate tax** incentives appear to be very attractive. Ten to fifteen-year tax holidays are offered in several key industries and 30 per cent investment tax credits are granted on investment in productive fixed assets in all industries. However, this appearance is deceptive. Tax holidays and investment tax credit are nullified by a withholding tax on profits paid out of untaxed income, unless dividends are deferred for 5 years. If investors are willing to defer dividends, these incentives become quite attractive. The minimum tax of 6 per cent on net equity becomes the key applicable tax in the intervening period. The minimum tax is itself problematic. It is an instrument for combating tax evasion. It can result in a significant tax liability for an investor with genuine losses. Such losses are often incurred in the start-up phase when debt repayments are high or full-capacity has not been reached. It is a disincentive for genuine investors. Corporate tax incentives can aptly be described as a "merengue" regime for the investor as it consists of several forward and backwards steps with potentially favourable or unfavourable results. UNCTAD's comparative tax tool⁴¹ has been used to compare Colombia's taxation of investment in some representative industries with the taxation regimes of three other groups of comparators:

- other CAN countries plus Chile ("CAN + Chile");
- the two FDI regional powerhouses, Brazil and Mexico; and
- selected other leading international attractors of FDI in the relevant sector.

The results of the comparisons are depicted in Figure II.1 and reviewed in Box II.3. In Figure II.1, three Colombian tax cases have been compared in each sector. The principal features and variations in corporate tax as between the three cases are as shown below (table II.4). CAN rates of import duty are applied in calculating the indirect tax burden, except in the export manufacturing case where duty relief is available.

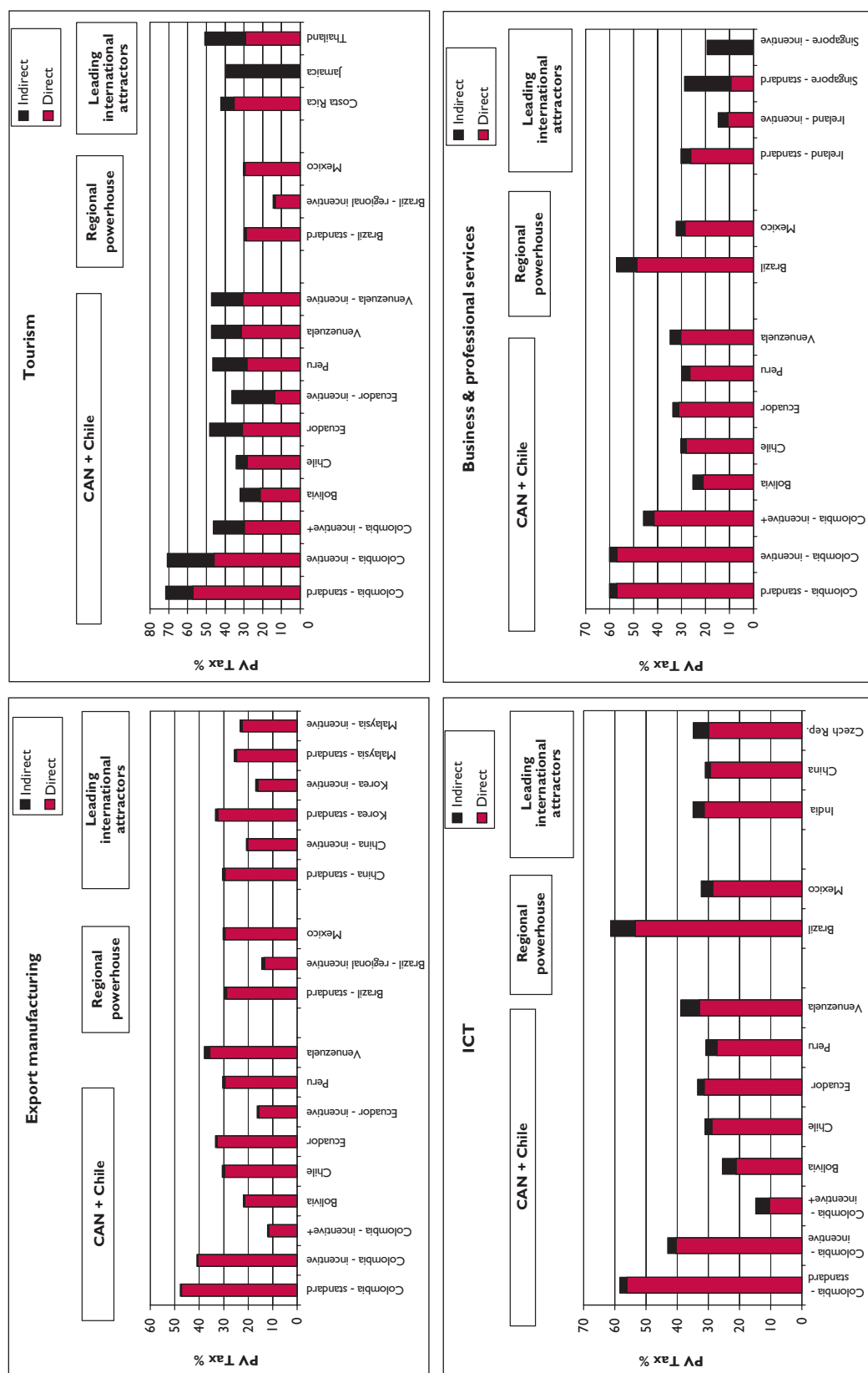
Table II.4. Variation in corporate tax

<i>Tax case</i>	<i>Tax rate</i>	<i>Min. tax</i>	<i>Investment tax credit</i>	<i>Withholding & remittance taxes on dividends</i>
Colombia standard	Full	➡	➡	➡
Colombia incentive	Holiday	➡	➡	➡
Colombia incentive +	Holiday	➡	➡	No – dividends deferred 5 years

➡ = applicable

⁴¹ The methodology of UNCTAD's tax tool is explained in the Annex to this chapter.

Figure II.1. Taxation of investment in Colombia and comparator countries



Source: UNCTAD Investment Compass.

Box II.3. Is Colombian corporate taxation competitive?

In **export manufacturing**, Colombia's standard and incentive tax regimes are likely to be deeply uncompetitive when compared to those of CAN + Chile, the regional powerhouses and leading international attractors. If, and only if, dividends are deferred, the incentive scheme becomes very attractive compared to most Latin American competitors and on a par with the most attractive regimes of leading international attractors. The comparisons assume that import duty remission continues to be available on operating inputs.

In **tourism** (hotel development), Colombia's standard and incentive regimes are quite uncompetitive in contrast to those in vigour in CAN + Chile (and especially with the incentives offered by Ecuador) unless, again, the investor obtains incentives and defers dividend payments.

In **IT and business & professional services** the pattern is the same. Colombia's regime is not competitive with either CAN + Chile or the regional powerhouses (with the exception of Brazil), but becomes very attractive against the regional and worldwide sample if the investor can obtain tax holidays and delay dividend payments.

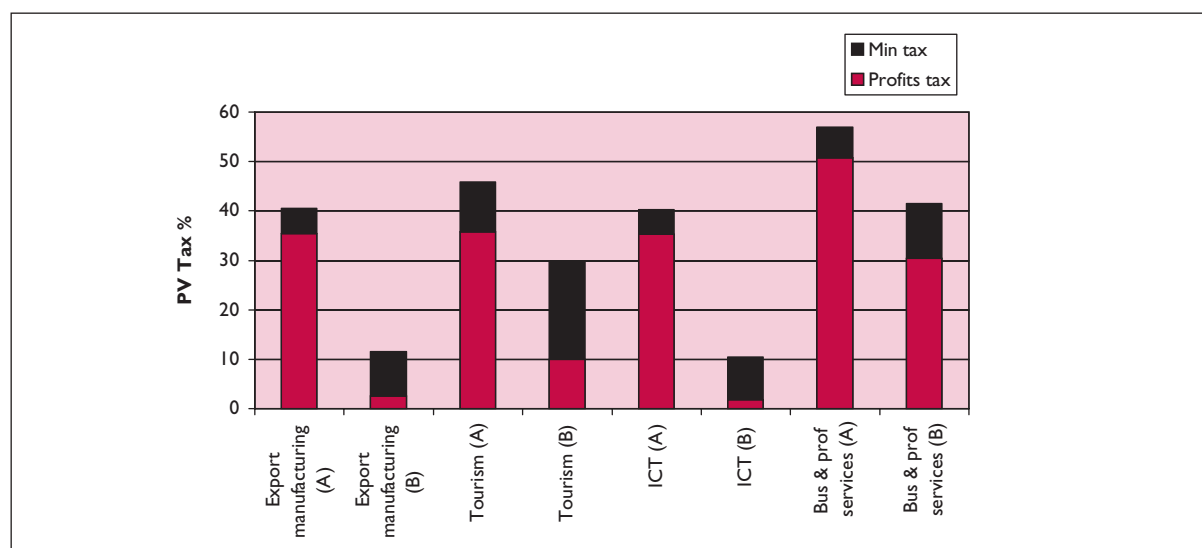
Source: UNCTAD Investment Compass.

The Government of Colombia is considering a comprehensive reform to reduce taxation, limit exemptions and widen the tax base. Comprehensive reform is strongly supported. The results in Figure II.1, as discussed in Box II.3, show that:

- **the standard tax system is uncompetitive, especially** for investors who do not obtain tax incentives in the form of tax holidays. Favourable features, such as the investment tax credit, are negated by other features such as the withholding tax on untaxed income.
- **tax holidays can be more attractive than in other developing countries.** However, this is the case only if the investor can avoid withholding tax by deferring dividends. In such cases, corporate tax is principally collected in the form of the minimum tax as shown in Figure II.2.
- **the minimum tax is highly problematical.** It is neither an effective instrument for collecting taxes where incentives impact strongly nor, as discussed above, is it a well-targeted instrument because it applies even when genuine losses are made.

The *objective* of the current incentive regime is to promote new investment in general, and reinvestment in particular; but the *design* of the investment tax regime has led to the problems described above. The objectives could be better achieved by a much simplified regime, which includes the following elements *as a package*:

- Substantial lowering of the standard corporate tax rate to a more competitive level;
- Resort less frequently to long-term tax holidays;
- Fewer restrictions on the utilization of losses carried forward to enable quicker recovery of investment;
- Abolition of the withholding tax on dividends paid from untaxed income and the remittance tax in favour of a low flat rate on dividends paid to both residents and non-residents. The current withholding tax device is, in particular, less necessary if tax holidays are abolished.
- Abolition of the minimum tax or, if this step results in major revenue leakage, the Government should enable any investment tax credit to be creditable against the minimum tax. This would assist early-stage investors with weak cash flow and preserve the overall positive bias of the tax system towards supporting reinvestment.

Figure II.2. Effect of the minimum tax in incentive cases

Note: Each case shows the relative burden of profits tax and the minimum tax when tax holidays apply. In case (A), dividends are not deferred. In case (B), dividends are deferred for 5 years.

2. Foreign exchange arrangements

Colombia maintains conventional foreign exchange controls. Companies must convert proceeds from their sales in foreign exchange into Colombian pesos. However, the peso is convertible and investors report no untoward restrictions on access to hard currency. The peso is reasonably stable against major currencies. Colombia has acceded to Article VIII of the IMF.

There are special provisions for companies in the oil, coal and natural gas sectors, including exploration, production and technical services. Where sales are in foreign currency, operators are not required to convert foreign currency except to pay obligations in local currency. This is a welcome provision for investors in the natural resources sector who undertake very large investments and depend on hard currency loans for a substantial part of project financing.

3. Company establishment

Table II.4 shows the procedures that need to be followed when starting up a company in Colombia. The Chamber of Commerce of Bogotá, the city of Cali and the Inter-American Development Bank (IADB) have started a programme to establish a one-stop centre that aims to halve the processing time of the formalities associated with starting a company. This project is currently working well. The Chamber of Commerce of Bogotá reports that a company has been able to complete all formalities in one day. This initiative should be extended to all main cities.

Table II.5. Steps to establish a company in Colombia, 2005

Steps	Duration	Cost
1. Verify commercial name, brand name and economic activity at the Chamber of Commerce	2 hours	No cost if done online. \$1 if done at the Chamber of Commerce
2. Register the company statutes and obtain notarized copies.	5 days	Based on capital
3. Register the company at the Fiscal Registry and get the fiscal identification number - NIT	7 hours	No cost
4. Register the company - commercial registration - at the Chamber of Commerce	3 days	Based on capital
5. Open a bank account and deposit the capital	2 hours	No cost
6. Register official books at the Chamber of Commerce.	8 days	\$40 (\$10 for each book)
7. Get permission for intended land use from either the district planning authorities (Planeación Distrital) or city authorities (Curaduría Urbana), depending on location.	5 days	No cost with district authorities. \$75 with city authorities.
8. Register the company with social security (Administradora de Riesgos Profesionales).	2 days	No cost
9. Register employees with social security (Administradora de Riesgos Profesionales).	2 days	No cost
10. Register employees with the national health insurance scheme (Empresa promotora de Salud)	15 days	No cost
11. Register employees with a pension scheme	30 days	Based on employees' expected income
12. Register the company with the family benefits fund (Caja de Compensación Familiar)	3 days	No cost
13. Register employees with the family benefits fund	2 days	No cost
14. Get fire safety certificate	18 days	\$11
Total: 14 steps		

Source: UNCTAD, Investment Gateway, <http://Colombia.investway.info/>.

Legend:

Creation		Operation	
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4. Labour market legislation

The Colombian Labour regime is regulated by the substantive Labour Code and Law 50 of 1990. Law 100 of 1993 governs social security and pensions. The Constitution provides for the right to organize unions, to engage in collective bargaining and to strike. The Constitution also provides for incorporation of ratified international labour conventions into the basic Labour Code. The regime ordains rules governing pay, other employment costs, bonuses, pensions, work hours, vacations, severance pay, transportation and family subsidies and safety requirements.

Improvements in labour flexibility have recently been made. Law 789 of 2002 introduced flexible working contracts, cut overtime costs, streamlined severance payments (Article 6), and provided tax exemptions for employers hiring individuals aged over 50 or between 16 and 25 and provided subsidies to those employing jobless heads of households. The UNCTAD survey found that foreign investors commended these new measures. The

World Bank, which identified all reforms affecting the business environment in 145 countries, ranked Colombia second among the top 10 reformers, with marked progress in labour regulations.⁴² In fact, the more flexible regime combined with competitive local wages and a favourable cost of living are among the main attractions for foreign investors.⁴³

Despite these reforms, the investors surveyed by UNCTAD (see annex) state that some problems persist. These include high contributions to social funds and high mandatory severance payments compared to requirements in other countries in the region. Concern was also expressed with regard to the minimum wage level and the difficulty of linking wages to productivity instead of seniority. Overtime pay requirements and rules were considered excessive because, even when compensated by time off, it is still necessary to pay triple time for Sunday work.

As a consequence of high unemployment and difficulties in law enforcement, labour regulations are largely ignored in many areas of the country. In parallel with its efforts to modernize labour law and improve flexibility for employers the government is entitled to expect greater compliance by employers.

5. Employment of non-citizens

Colombian and foreign-owned companies may hire foreign employees, who enjoy the same rights in the workforce as Colombians. There are limits on the number of foreign employees who may be hired. Companies with more than ten employees are subject to the following restrictions: no more than ten per cent of their regular staff may be foreign; and up to 20 per cent of specialized, technical or management personnel may be foreign. In the event an enterprise wishes to exceed these limits, it must obtain special permission from the Ministry of Social Protection.

Foreign investors consider that the issuance of temporary entry permits for technical personnel should be eased. Such permits cover the very short-term needs for technical support and do not entail residence in Colombia. According to recent information provided by the Ministry of Foreign Affairs, the system has been reviewed and eased. It can facilitate investors in requirement for technical and specialized skills, especially given Colombia's wish to attract the latest technology to the country.

6. Land and property law

Colombia's body of civil and commercial law includes significant legal coverage of the law of property, both personal ("Movable") and real ("Immovable"). Real property is covered for the most part in the Civil Code, but not in any single, organized framework. Rather, the Civil Code regulates aspects of land and property law in different titles and chapters. Book 4 of the Civil Code addresses contractual obligations relating to real property, whilst other sections deal with mortgaging of real property and transfers and registration thereof.

Land titles are freely and promptly transferable and the registration of titles is administered well. According to the World Bank, in Colombia, it takes 23 days to register land transactions, compared with the regional average of 56.0 and OECD average of 34.⁴⁴

⁴² World Bank (2004). *Doing Business 2005* and <http://rru.worldbank.org/DoingBusiness/>

⁴³ Source: The Economist Intelligence Unit. June 2005.

⁴⁴ More information is available at: <http://rru.worldbank.org/DoingBusiness/>

7. Colombian commercial law

Colombia has a large and complex body of commercial law, based on its Civil Code (which dates back to 1887 and subsequently amended) and the new Commercial Code of 1971, as amended or even sometimes replaced by statutes with specific application to specific areas of commercial law. The codes and the new commercial code of 1971 are buttressed by superseding statutes or decrees, on example of this is the new law on e-commerce. Together with related provisions of the civil code, they constitute the commercial law regime.

a) *The Commercial Code*

The commercial code and freestanding laws incorporated by reference into it, cover such broad areas as agency, banking and credit, bankruptcy/reorganization, business establishment/conduct, commercial contracts, credit, corporate organization, fiduciary obligations, insurance, industrial property and real property law. The civil code, in addition to covering civil status, inheritance and other matters, also contains provisions relating to contracts, mortgages, liens, notary functions and registries.

As with many countries with a civil code legacy, the tendency has been to address new areas of legal and regulatory reach (like e-commerce) through separate statutory enactments that can extend integrated regulation to all of these new areas, rather than amending the various codes which often result in a complex body of law.

b) *Corporate governance*

Corporate governance standards are poor and are characterized by a lack of openness and information dissemination by companies (particularly those listed in the stock market). This has obliged the government to take steps to impose higher standards. Law 964 of 2005 was introduced to improve corporate governance by listed companies, including improved disclosure rules. There has not been sufficient time since the law came into force to evaluate improvements. However, the government could also take steps to promote better corporate governance standards in all enterprises, including SMEs.

c) *Bankruptcy legislation*

Law 550 of 1999 amended the country's existing bankruptcy regulations. It provides a framework to facilitate the re-organization of businesses experiencing economic difficulties so as to avoid the single response of liquidation, while ensuring provision for the concerns of shareholders, customers and other stakeholders.

d) *Electronic commerce*

Colombia was the first Latin American country to adopt the United Nations Model Law on Electronic Commerce, sometimes referred to as the UNCITRAL Model Code. Law 527 of 1999 defines and establishes the rules for access to and use of electronic data, electronic commerce and digital signatures. The law recognises contracts concluded over the Internet and gives examples of the types of transactions that would be valid as a part of an electronic contract.

The government has been active in the promotion of e-commerce in Colombia. In 2000, it inaugurated a pilot programme called the *Agenda de Conectividad*, which facilitates government-to-government and government-to-citizen transactions online. Its objectives are: (1) to expand access to information infrastructure; (2) to promote the use of ICT in education and training, as well as in business; (3) to promote development of a national ICT industry; (4) to generate national content; and (5) to facilitate the government's online activity.

In May 2000, Colombia and the United States signed a declaration in which both countries recognized the importance of e-commerce and agreed to cooperate in removing barriers and implement a transparent and non-discriminatory legal framework for such activity. The declaration outlines general principles that should guide governmental policy on e-commerce. These principles acknowledge that the private sector should lead e-commerce development and that governments should avoid unnecessary regulations or restrictions and ensure that their actions with regard to e-commerce are fully transparent. A specific chapter promoting e-commerce is included in the current FTA negotiations with the United States.

8. The rule of law in Colombia

Colombia has a comprehensive legal framework for business as would be expected by investors. Colombia's judicial system defines the legal rights of commercial entities, reviews regulatory enforcement procedures and adjudicates contract disputes in the business community. The judicial framework includes the Council of State, the Constitutional Court, the Supreme Court of Justice and the various departmental and district courts, which are also overseen for administrative matters by the Superior Judicial Council.

The 1991 constitution provided the judiciary with greater administrative and financial independence from the executive branch; since this time the courts have acted more independently. But the judicial system remains relatively weak with non-substantive procedural requirements, time-consuming practices and frequent instances of corruption. Contract enforcement in Colombia is only marginally less onerous than in the region. The World Bank estimates enforcing contracts costs an average of 18.6 per cent of the debt incurred in comparison with the regional average of 23.3 per cent and the OECD average of 10.8 per cent.⁴⁵

According to the UNCTAD survey,⁴⁶ a major difficulty for foreign investors in Colombia is the high level of legal instability arising from the frequent issuing of regulations and administrative rulings affecting day-to-day business. This introduces uncertainty and adds a feeling of legal insecurity to the other security issues facing business in Colombia.⁴⁷ To improve legal stability and reduce administrative procedures and requirements that are not backed up by law, congress passed Laws 962 and 963 in 2005. Law 962 simplified current administrative procedures and provided for the continual review of any new procedure in line with the spirit of simplicity of this norm. Law 963 concerns the legal stability agreement discussed earlier. This is expected to increase the openness of the regulatory framework and to improve law enforcement.

9. Intellectual property rights

The legal regime for intellectual property rights (IPR) starts with Article 61 of the Constitution of 1991, which provides that "the state will protect intellectual property for the time, and according to the formalities, established by law." Colombia provides for both copyright and industrial property protection based on a combination of Colombian law (Law 23 of 1982 and Law 44 of 1993) and the regulatory regimes for IPR of the Andean Community and the G-3 treaty. As a member of WTO, Colombia is bound by the provisions of the Uruguay Round Agreement on Trade-Related Intellectual Property (TRIPs). It is also a member of the World Intellectual Property Organization (WIPO) and a signatory to the Paris Convention for the Protection of Industrial Property, the 1978 Union for the Protection of New Plant Varieties, and the Patent Cooperation Treaty. Colombia is also a member of, or signatory to, the Berne and Universal Copyright Conventions, the Buenos Aires and Washington Conventions, the Rome Convention for the Protection of Performers, Producers of Phonograms and Broadcasting Organisations, the Geneva Convention for Phonograms, the WIPO Copyright Treaty and the Performances and Phonograms Treaty.

⁴⁵ World Bank, *Doing Business in 2005: Removing Obstacles to Growth*. Washington D.C.

⁴⁶ See annex – UNCTAD Survey of Foreign Investors Established in Colombia.

⁴⁷ Paul Holden, Director of Enterprise Research Institute in Washington (www.eri-la.org).

Colombia's modern copyright law – Law 44 of 1993 – extends protection for computer software to 50 years. Law 44 and Colombia's new criminal code, which entered into force in 2001, designates copyright infringement as a crime. Andean Community Decision 351 of 1993 also regulates, in part, copyright enforcement for Andean member countries with provisions covering literary and artistic works, computer programmes, databases and so-called “neighbouring rights” (live performances, phonograms, and broadcasting). Chapter XVIII of the G-3 treaty contains broadly similar provisions.

Investors note that, whilst the legal/regulatory regime governing intellectual and industrial property rights reflects modern best practices, enforcement is still posing problems, particularly in sectors such as pharmaceuticals, information technology, agrochemicals and the music industry (see UNCTAD survey, Annex 1).

Within the FTA negotiation with the United States, the issue of intellectual property rights has been reviewed.⁴⁸ If the FTA proceeds, a more stringent approach to legal protection and enforcement could result.

10. Competition law

As is the case with many developing countries, Colombia suffers from a relatively high level of industrial concentration in a few large conglomerates and a lack of effective enforcement of antitrust laws. Nevertheless, it does have a modern legal/regulatory framework governing restrictive commercial practices and unfair competition. Article 333 of the Constitution provides that it is a function of the state to prevent any obstruction or restriction to the free market and to avoid or control any abuse of dominant position in the Colombian market. The substantive area is governed principally by the Colombian commercial code. The Superintendency of Industry and Commerce, a technical agency of the Ministry of Trade, Industry and Tourism, has powers to deal with anti-competitive practices, including merger control. Within the Superintendency, the office of the Division for the Promotion of Competition effectively regulates competition. This regime is supplemented by Decision 285 of the Andean Community's Rules for the Prevention or Correction of Distortion of Competition Generated by Practices that Restrict Free Competition, although the latter does not govern mergers.

It is illegal to enter into any agreement that directly or indirectly tends to limit production, supply, distribution, or consumption of national or foreign raw materials, products, merchandise or services; it is likewise illegal to engage in any practices, procedures, or systems that tend to limit free competition or to maintain or fix unfair prices. The law spells out activities that are considered an abuse of dominant position.

Any proposed mergers resulting in aggregate sales which exceeding 20 per cent of market share or involving businesses' individual or combined assets which exceed approximately \$8.2 million must be notified to the authorities. The Superintendency may initiate official action to determine whether the merger would lead to undue restraint of free competition. It may not contest cases of mergers, consolidation, integration or acquisition of control of firms if the parties involved prove there may be significant efficiency improvements, and that the action will result in cost savings that may not otherwise be obtained and they guarantee such acts will not result in a reduction of supply to the market. Parties may appeal an order of the superintendency to an administrative tribunal.

Foreign firms in Colombia have reported that, notwithstanding the positive regime for competition, there are problems with law enforcement. To address this situation, Law 962 of 2005 ordered that procedures be ruled by the civil procedures code. The effectiveness of this measure should be closely monitored.

⁴⁸ The Economist Intelligence Unit. Country Report. June 2005.

Finally, many foreign investors allege that discriminatory treatment exists when dealing with private enterprises or state entities when it comes to subsidies, especially in the telecommunications sector. In the latter case, the double role of the state as *regulator* on the one hand, and as *commercial operator* on the other, has generated a problem that needs to be addressed and resolved by establishing a clear differentiation of roles and fair application of the rules of the game.

II. Sectoral regimes in backbone services

The approval of the new constitution of 1991 cleared the way for new legislation to liberalize the investment regimes in key sectors, especially in services. For example, Laws 80 (administrative contracts, 1993), 142 (public utilities, 1994) and 143 (electricity, 1994), governing infrastructure, all stemmed from the 1991 constitutional reform. Liberalization was greatest in financial services, telecommunications, accounting/auditing, energy services and tourism. The establishment of a commercial presence in Colombia is still required in order to provide advertising, audiovisual, franchising, data processing and professional services.⁴⁹

In the short term, privatization will present FDI opportunities in financial services (Granahorrar and Bancafe), the electric power sector and gas distribution. A feature of Colombia is that many public utilities and infrastructure services are run by municipal enterprises. The latter have sought to engage private sector investment through concessions. There are successful cases in roads (the urban transportation integrated system for the Pereira - Dosquebradas - La Virginia metropolitan area), water, sanitation, ports (port of Cartagena) and airport services (El Dorado airport, Bogotá). These kinds of partnerships have helped to develop a gradual and selective approach to reforms and have been generally successful as a way of creating an attractive environment for private national and foreign investment.

Outcomes have been mixed in other areas, such as the liberalization of telecommunications and electricity, in terms of increased efficiency, coverage and consumer welfare. The main elements of these sectoral regimes are as follows:

- **Telecommunications:** Sector reforms during the 1990s accelerated the modernization of the telecommunications networks, and facilitated the introduction of new services, such as mobile telephony and the Internet. The reform process focused on liberalization rather than privatization. Colombia ended its state monopoly on long distance and international telephone services in November 1998 and opened the sector to foreign investment, although under the WTO Agreement on Basic Telecommunications Services, it continues to reserve the possibility to limit foreign ownership of telecommunications companies to 70 per cent of the capital of the enterprise licensed to operate.⁵⁰ Colombia also imposes a review of market development and economic needs to determine market access and licensing for cellular, local, long-distance and international services. In its other commitments under the WTO Agreement, Colombia made fairly liberal commitments on most basic telecom services, but it specifically prohibited “call back” services and fixed and mobile satellite systems.

Considering the sector as a whole, public enterprises at both the national and municipal level dominate the sector. In each of the four major services (local, national, international and mobile), in 2005 the two largest players accounted for between 70 to 100 per cent of the market.⁵¹ In addition, the high price attached to licences for new entrants has further prevented the establishment of a level playing field

⁴⁹ Foreign suppliers are required to have a commercial presence to establish and operate in a member's territory, or establish a branch, agency, or wholly-owned subsidiary.

⁵⁰ See Table II.1.

⁵¹ World Bank (2004). *Colombia: Recent Economic Developments in Infrastructure and (REDI) 2004. Balancing Social and Productive Needs for Infrastructure.*

between public and private operators. There are also concerns for fair treatment of private operators because of the double role of the state as both regulator and commercial service provider. For example, a dispute that arose in cellular telephony included key issues left undefined in the contract, such as the licence extension price, coverage level, assets transfer to the government and entry of services that are close substitutes, quality of services, customers' price discrimination and uneven tax regime across competing firms. Most of the conflicts that emerged after concessions were granted were resolved in favour of the investors. Apart from these issues, the current legal framework needs to be updated to take account of matters such as technological convergence among alternative services.

In April 2003 the government prepared draft legislation for the telecom sector based on feedback from stakeholders, users, and groups of professionals in the sector. Among the recommendations being considered are: (a) separation of the government's role as a service provider from its role as a regulator; (b) ensuring the independence of the sector regulator in relation to the affiliated communications ministry with regard to its compliance responsibilities; (c) clarifying the role of other government agencies including consumer protection, price control, or other oversight ministries in setting national regulatory policy; and (d) providing a clear definition of responsibilities of local governments (departmental and municipal) in the matter.

Broadly speaking, Colombia has so far been successful in managing the liberalization of the telecommunications sector. It should continue this work by separating its provider and regulatory roles. The announcement of the partial privatization of Telecom Colombia is a welcome step.

- **Electricity:** Law 143 of 1994 encouraged greater private sector involvement in the power sector and separated the electricity industry into generation, transmission and distribution components. Policy is set by the Ministry of Mines and Energy, whilst the Energy and Gas Regulatory Commission (CREG) regulates the generation, transportation and distribution of electric power and gas. A study carried out in 2002 by the World Bank⁵² reported high levels of investor dissatisfaction with the electricity sector in Colombia (83 per cent of respondents), second only to dissatisfaction levels in Argentina. In their view, CREG has not developed a sound regulatory framework but has introduced new regulatory measures that have modified the rules of the game and put at risk infrastructure expansion related to electricity services. The situation has resulted in companies launching lawsuits against the regulatory body. In addition, operators have serious security problems in those parts of the country where pylons have been knocked down following guerrilla warfare. Tariff regulation presents issues. The government intends to modify a controversial 2001 measure affecting the wholesale power market. Resolution 34 caps the wholesale market price paid to thermal power generators, which are forced to supply additional electricity to cover shortages on the national grid. CREG imposed the regulation in an effort to stop alleged price gouging by power companies after a wave of terrorist attacks on power infrastructure limited the capacity of lower-cost generators to supply power to the national grid. Fossil-power generators have protested the measure since its inception, saying it does not adequately cover costs, leading to losses.

Lastly, the production and distribution network (*Capital Energía* and *Luz de Bogotá*) in Bogotá are owned by the same TNC, Endesa (Spain). Endesa has acquired the Colombian operations through its Chilean affiliates, Enresis and Betania. The law does not compel Endesa to divest one of the privatized companies. This vertical integration cannot, therefore, be legally challenged. It would be advisable to review the legal framework regulating vertical integration in the sector.

⁵² Lamech, Ranjit and Kazim, Saeed. *Private Investors in Developing Countries, Survey 2002, Preliminary Findings*. Energy Forum 2002, The World Bank, 5 June 2002. Washington D.C.

12. Overall assessment of general measures

Since the constitutional reform of 1991, Colombia has revised and modernized many of the major regulatory areas that impact business. The progress over the last 15 years can be described as steady though not spectacular. The reforms have moved at a similar pace to those undertaken in many parts of the world to broaden the opportunities for private investment and improve the investment climate whilst maintaining appropriate oversight to protect the public interest. Noteworthy improvements have been made in company establishment procedures, land registration, labour law, services liberalization, updating of commercial law to facilitate e-commerce and in intellectual property protection.

Reforms are continuing. The *priority for future reform* should be **corporate taxation**. The current standard tax system is uncompetitive, tax holidays are only attractive provided the investor can afford to defer dividends, and the minimum tax is neither effective nor well targeted. A fundamentally changed approach is needed. Suggestions are contained in sub-section I above.

By contrast, only *carefully considered extensions* are needed in other general measures. An appropriate direction of change has already been established. Indeed, the World Bank has ranked Colombia among the two most successful investment climate reformers in 2004.⁵³ Consideration should be given to introducing further flexibility in **labour law**, (e.g. concerning overtime rules and severance payment), to achieving greater independence in **utilities' regulation** and mandating higher standards of **corporate governance** (continuing the work done to improve the governance of listed companies).

The *next priority* for future reform appears to lie in the need to review, simplify and exercise restraint in the laws and regulations that apply to business. For example, the **commercial code** should be reviewed. The new **Law 962** to simplify regulations and restrain the issuing of administrative rulings that are not founded in law, should be carried through. Otherwise, legal uncertainty will only add to investors' other concerns about the stability and security of their rights and property.

The UNCTAD survey found that investors welcome the legal reforms that have been undertaken but have raised questions about the quality of administration of regulations and the commercial justice system. Institutions need to be strengthened in order to improve service delivery and compliance. The streamlined company establishment system in Bogotá and the prompt administration of land transfers indicate that better performance is achievable. The priority is to strengthen the **commercial justice system**, including arbitration.

⁵³ World Bank (2005). *Doing Business in 2005: Removing Obstacles to Growth*. Washington D.C.

Appendix. Methodology of international tax comparisons

The Comparative Taxation Survey conducted by UNCTAD (see www.unctad.org/compass) compares a country's taxation on investment in several sectors with taxation in selected other countries – neighbours and countries elsewhere that have succeeded in attracting FDI to the sectors concerned. These comparisons enable the country to assess the competitiveness of its taxation schemes. Taxation affects the cost of investment and its profitability and thus the return on investment. This impact is not just a question of looking at the headline rate of tax on profits.

The tax burden on the investor depends on a number of factors and how they interact, including any expenses that are allowed, rates of capital allowances (tax depreciation), the availability of tax credits, investment allowances and tax holidays, the loss-carry-forward provisions and the taxation of dividends, among other things. Moreover, customs and excise duties affect the cost of investment and operating margins. Taken together these make up the overall fiscal regime that affects the cost of and return on investment. Comparative tax modelling is a method of taking into account the most important of these variables in the fiscal regime in a manner that facilitates comparison between countries. The tax variables included in the analysis are:

- Corporate income tax;
- Rate of tax including tax holidays, if any;
- Loss-carry-forward provisions;
- Capital allowances, investment allowances and investment credits;
- Tax on dividends; and
- Customs import duties and excise duties on business inputs.

Financial models of project investment and financing, revenues and expenses are used for a hypothetical business in each sector. They are based on typical costs and revenues experienced in such businesses in a developing economy. The business models cover a selected business within each sector.

The fiscal regime in a country and the chosen comparator countries for each sector is applied to the standard business model for each sector over 10 years beginning with the initial investment. The financial models calculate net cash flow to the investor assuming that the company pays out all residual profits after tax (100 per cent dividend pay out) and that the investor gains the residual value of the company which is sold after 10 years for an amount equal to its balance sheet value. The impact of the fiscal regime is presented as the *Present value of Tax (PV Tax %)*. PV Tax % is the total of taxes and duties collected by government over the 10 years as a percentage of the project cash flow pre-tax and post-finance where both cash flows are discounted to the present value at a rate of 10 per cent per annum. PV Tax % thus measures how much of an investor's potential project return is taken by the government in taxes and duties. The higher the PV Tax % the more the fiscal regime burdens investors and reduces the incentive to invest.

Source: UNCTAD Investment Compass (www.unctad.org/compass).

III. STRATEGIC DIRECTIONS FOR FDI

Improving the country's international competitiveness has been a core objective of successive Colombian governments and remains a cornerstone of the present government's national economic strategy. Since 1999, Colombia has been implementing a comprehensive programme on competitiveness. Despite changes in government, the programme has been a cornerstone of the country's efforts to build a more dynamic and competitive economy (see Box III.1).

In 2005, the government has designed the Internal Agenda to promote productivity and competitiveness and build consensus and actions among national, local institutions, private sector and civil society on the strategic directions and actions in the short, medium and long-term to improve the productivity and competitiveness of the production system (National Planning Department, 2006).

Box III.1. Colombia *Compite*

The purpose of *Compite* is to promote interaction among enterprises, local and national government, trade unions and the civil society in order to build a competitiveness culture. It has developed vertical and horizontal structures comprising:

Redes Especializadas consist of 11 national committees which focus on factors that the World Economic Forum has identified as crucial to competitiveness. These factors are globalization, transport, energy and gas, ICTs, science and technology, human capital, labour, government and institutions, management and finance. Following cutbacks, only the first five are still in operation today.

Convenios de Competividad Exportadora (regional agreements) are export competitiveness agreements based in each region. They examine how sectors can better integrate themselves vertically and how to tackle bottlenecks in the supply chain. They are also tasked with promoting the creation of industrial clusters. Between 2000 and 2002, 40 agreements have been subscribed, 14 of which have been directly coordinated by the Ministry of Trade, Industry and Tourism. Others are under the leadership of the Ministry of Agriculture and/or of relevant local institutions.

CARCES are provincial councils, one in each province, tasked with tackling problems at the local level. There are seven councils with a paid director working full time on implementation programmes. The other councils function as discussion and coordinating forums among the private sector, local governments and academia.

Productivity network is a system to exchange information and experiences on productivity. It comprises nine centres: one is the national productivity centre (CNP) and the others are regional centres operating in Cauca, Tolima, Antioquia, Caribe, Bocayá, Oriente, Eje Cafetero, and Bogotá. Other activities include: specialized workshop, productivity weeks, virtual networks for capacity-building. There are also special agreements named "Andrés Bello" (special agreements on education, science and technology).

The Nodo Facilitador (facilitating node) was initially composed of the Presidency, the National Planning Department, and the Ministry of Trade, Industry and Tourism. It coordinated different parts of the programme, making changes where necessary and acting as a facilitator between different members. At present, the coordination role is entrusted to the National Planning Department.

Source: Ministry of Trade, Industry and Tourism.

The government's policy on competitiveness represents an ideal platform for the development of a strategy that seeks to attract FDI that is consistent with developmental goals. Such an FDI strategy has not been fully developed. The competitiveness policy's focus is, quite properly, on endogenous change. Its objective at the firm

level is to strengthen the capacity of local enterprises to produce higher value products and participate more effectively in the international production system. The FDI – or exogenous – dimension as an *agent* of change has not been fully introduced. FDI can help in local technological upgrading and competitiveness building. This requires introducing concepts and institutions designed to attract and benefit from “quality” FDI into the competitiveness agenda. Such FDI can contribute in three ways:

- First, new foreign entrants can increase the intensity of competition in the domestic market, reinforcing the pressure on existing enterprises to upgrade.
- Second, FDI transfers not only capital but also a package of hard and soft technologies, as well as access to and knowledge of export markets and specialized management skills. These factors can bring direct and spillover benefits to national competitiveness.
- Third, FDI in the export value chain requires local suppliers to attain international standards and can materially assist them to achieve these standards.

The development of an FDI strategy that is fully integrated with the competitiveness policy requires:

- A realistic assessment of the efficiencies and external market access that Colombia can offer foreign investors compared with alternative investment locations;
- The strengthening of a dedicated investment promotion agency to undertake the specialized work of FDI attraction, and the development and dissemination of a strategy and a policy statement to organize actions related to FDI.

An UNCTAD survey was conducted among TNCs affiliates based in the country (Table III.1) to identify their current motivations for investing in Colombia.

The predominant factor is the local market size and suggests that most FDI entering the country is attracted by the domestic market rather than by the comparative efficiencies or external market access that Colombia can offer. This includes the quality of the labour force and of its science and technology capacity. Colombia’s position as an export platform for the *region* is more highly rated but the ultimate goals of the competitiveness policy are to position Colombia as a base for exporting to the most demanding markets of the global production system.

Table III.1. Importance of selected FDI determinants in investment decisions

FDI determinants	Percentage of companies responding “very important” or “crucial”
Local market size	55.0
Macroeconomic stability	31.0
Geographic location	31.0
Export platform to regional markets	28.1
Quality of labour force	25.4
Availability of skilled labour	24.1
Benefit from a local company’s know how	22.8
Labour costs	22.4
Access to inputs/supplies	12.1
Access to natural resources	6.9

Source: UNCTAD survey (2003).

The following sections provide recommendations to address the concerns mentioned above. Part A highlights points of policy that need to be addressed. Part B provides concrete recommendations on institutional matters.

A. Orientation of policy

I. Building the skills base

A middle-income developing country like Colombia cannot expect to attract efficiency-seeking FDI on the basis of low labour costs. Workforce skills become of primary importance. In this respect, the profile presented by Colombia needs to be augmented. At the management level, Table III.2 shows that Colombia is highly rated for the low cost and high quality of its managers. However, there are issues related to Colombia's ability to produce high quality graduates in science, engineering and technology.

Table III.2. Wages and quality of managers in selected countries in Latin America, 2003

	Managerial wages (\$)*		Quality of managers (index)	
	IT	Production	Competence**	Credibility***
Argentina	3 376	5 758	6.19	4.32
Brazil	5 589	6 607	6.79	6.38
Chile	4 947	5 545	7.94	7.30
Colombia	3 643	4 110	7.43	7.09
Ecuador	2 792	4 060	n.a	n.a
Peru	4 577	4 894	n.a	n.a
Venezuela	5 089	4 736	6.33	5.25
Panama	3 684	3 761	n.a	n.a
Mexico	8 365	11 877	5.70	5.25

* Net monthly wages of companies with annual sales of \$50–199 million.

** Competent senior managers are: I=not available, I0=available.

*** Credibility of managers is: I=is not widely acknowledged, I0=is widely acknowledged in the economy.

Source: America Economía (2004).

Table III.3 provides comparative information on Colombia's skills' development in science, engineering and technology. Colombia has clearly made great strides as judged by the rapid increase in the numbers of graduates. Its ratios are now on a par with those of Chile.

Table III.3. Qualified graduates across periods and countries

	Colombia			Chile			Mexico		
	1996 (per million)	2002 (per million)	Change (per cent)	1996 (per million)	2002 (per million)	Change (per cent)	1996 (per million)	2002 (per million)	Change (per cent)
Graduating in science, engineering and technology	519.7	777.6	49.6	376.6	511.6	35.9	601.0	741.2	23.3
First degree	5.0	12.0	138.4	13.9	13.9	-0.3	28.7	41.7	45.4
Masters									

Source: 2004 Indicators, Red de indicadores de ciencia y tecnología, 2004, www.riicyt.org.

However, while the increase in science and technology graduates is welcome, it appears to have been at the expense of quality.⁵⁴ This was confirmed in interviews with investors conducted by UNCTAD. The rapid expansion of higher education has been sustained by a proliferation of private educational institutions. This came about because the state higher education system was unable to catch up with the huge increase in demand resulting from a previous expansion of secondary education. In 1992, 55 per cent of school leavers continued to tertiary level. By 1999 demand was such that only 37 per cent of school leavers could continue in education.⁵⁵

However, while the private sector has reduced the gap between demand and supply, it has not made the necessary investment in its teaching and research staff. Standards vary and quality assurance is lacking.⁵⁶

In addressing the quality issue, Colombia can look to other countries for guidance. Chile is a good example. It has a similar proportion (about two-thirds) of undergraduates enrolled in private universities, yet it is well-known for the quality of its teaching and research. This was achieved by two sets of reforms. The first reform, conducted in the early 1980s saw the introduction of tuition fees at public universities balanced by aid for poorer students, public funding tied to stronger evaluation systems and measures to increase private funding of public institutions. This was then reinforced by a second reform that introduced a system for accrediting on an institutional basis rather than on a course basis, and a better coordination of the sector by the government through streamlining ministerial structures.⁵⁷

Colombia needs to consider reforms along these lines, especially if it sees greater private provision of higher education as its long term goal. Its current framework for quality assurance is spread among a number of overlapping government institutions. Accreditation is awarded on a course basis rather than an institution basis, leaving little incentive for the institution as a whole, including staffing and funding, to be well managed. At the same time, accreditation has only been available for the best courses in each subject, leaving much of the sector outside the spotlight of scrutiny. Accreditation should therefore be made compulsory for all educational institutions. Furthermore, a lack of support for poorer students affects their participation in higher education.

2. Building local science and technology capacity

In addition to a robust skills base, a strong local science and technology capacity is necessary both to attract efficiency-seeking FDI and to broaden the number of companies able to benefit from FDI by absorbing the know-how that comes with it. Although Colombia has a number of science and technology institutions (see Box III.2), as Table III.4 shows, Colombia's expenditure on R&D as a proportion of GDP has, unfortunately, fallen markedly between 1996 and 2001, the latest year for which all figures are available. By comparison, in the same period, Chile's expenditure on R&D has increased, especially since 2000, and with increased private sector participation. Chile also has a larger number of science and technology (S&T) workers as a percentage of the workforce than Colombia.

It is interesting that Colombia's S&T personnel has grown rapidly at a time when its R&D expenditure has fallen. However, as mentioned in the previous section, the number of qualified teaching and research staff has not kept pace with the growth in students; the quantity of science and technology graduates has been at the expense of quality. This will affect Colombia's attractiveness as a destination for quality FDI, the ability of its firms to absorb spillovers of know-how and their ability to develop new technologies and export higher technology products.

⁵⁴ World Bank (2003). Tertiary Education in Colombia: Paving the way for Reform.

⁵⁵ World Bank (2002). Project Appraisal Document on a Proposed Loan to the Republic of Colombia for a Higher Education Improving Access Project.

⁵⁶ Ibid.

⁵⁷ World Bank (2003). Tertiary Education in Colombia: Paving the Way for Reform.

Box III.2. Colombian science and technology institutions

In the last 20 years, COLCIENCIAS, the national science and technology agency, has been leading a national innovation system called *Sistema Nacional de Innovación*. Since 1995, this system comprised the following:

- Network of technology development centres (*Red de Centros de Desarrollo Tecnológico*)
- Business Incubator Network (*Red de Incubadoras de Empresas*)
- Directory of Business Innovators (*Directorio de Empresas Innovadoras*)
- Innovation and technological development projects (*Proyectos de Innovación y Desarrollo Tecnológico*)
- Universities and groups of technological research (*Universidades y Grupos de Investigación Tecnológica*)
- Funding (*Fuentes de Financiación*)
- Regional Productivity Centers (*Centros Regionales de Productividad*)
- Andrés Bello Agreement (*Convenio Andrés Bello*)

An UNCTAD review on science, technology and innovation policy in 2000 recognized that Colombia's the national innovation system was well-designed. However, it also pointed to weak links between national R&D institutions and industry. It foresaw some progress from the creation of 11 National science and technology programmes by COLCIENCIAS. In addition, sectoral technology development centres have been established to create a link between public and private sector initiatives. However, according to investors recently interviewed by UNCTAD, only some of the centres meet their needs.

Source: www.colciencias.gov.co. UNCTAD (1999). *Science, Technology and Innovation Policy Review*. Sales No. E.99.II.D.13.

Table III.4. Selected indicators of technology and innovation development in Colombia, 1996-2002

Indicators		Colombia		Chile	
		1996	2002	1996	2002
Expenditure on R&D as percentage of GDP	Private	0.34	0.20*	0.15	0.32
	Public	0.60	0.33*	0.34	0.38
S&T personnel per million of population	Total	168.3	299.0	828.9	894.4*
	of which researchers	97.7	169.1	424.0	434.1*
	of which technicians	49.0	129.9	356.1	407.5*

Source: 2004 Indicators, Red de indicadores de ciencia y tecnología, 2004. Available at: <http://www.ricyt.org>. *2001, as these are the latest complete figures available.

The reduction in R&D expenditure can be explained. On the one hand, the decline in government spending on R&D is partly a result of spending re-allocated to implement the Democratic Security Policy. At the same time, the private sector's share of R&D expenditure, while traditionally higher than the government's, has declined by the same proportion.⁵⁸ This is due to several factors, which include the 1999 to 2001 recession, reduced opportunities for joint R&D as a result of the government pull-out and a restructuring of R&D in TNCs, with R&D being centralized outside Colombia. Changes in the pharmaceutical industry illustrate the last point well. In 1995 there were 487 foreign laboratories operating in the country. By 2001, following a period of international consolidation, this had declined to 127.⁵⁹

⁵⁸ 2004 Indicators, Red de indicadores de ciencia y tecnología, 2004. Available at: <http://www.ricyt.org>.

⁵⁹ Department of Planning of Colombia, 2005. In addition, UNCTAD confirmed that among the developing countries, Asia is the magnet for FDI in R&D. See UNCTAD (2005). *World Investment Report: Transnational Corporations and Internationalization of R&D*. Sales No. E.05.II.D.10.

This is a cause for concern. With lower expenditure in R&D, the quality of Colombia's higher education and research sector will decline relative to its competitors. In the long term this will affect the quality of its outputs.

As Table III.4 shows, Chile increased R&D expenditure thanks to the contribution by the private sector. Measures taken by the government include implementing a tougher intellectual property rights regime, stronger investment protection, government R&D grants, and tax incentives for companies contracting research to universities.⁶⁰ In 2005 the government undertook a further set of reforms, which included setting up a national R&D fund supported by mining taxes.

Colombia has applied selective fiscal incentives for R&D. For example, there are incentives for software and pharmaceutical development. The scope for fiscal incentives on private expenditure in R&D should be reviewed. Incentives should not only target research in high technology products. Colombia exports a good deal of medium technology goods as well as petroleum-related commodities. It is in these sectors where it has a competitive strength.

At the same time, the government should make sure that there are no further reductions in public expenditure on R&D. Where there is public funding, it should be well-targeted. New Zealand provides a good example with allocations focused on applied research and dependent on the importance of knowledge spillovers from each R&D project.

An appropriate balance between public funding and fiscal incentives is necessary, partly because the government does not have the wherewithal to provide the funds and partly because funds are prone to capture by interest groups⁶¹, are often inaccessible to small firms, form a bureaucratic barrier between firms and their innovation strategies and are not always relevant to industry's needs.

3. Focusing on Colombia's trade stance

Colombia needs a complementary trade strategy, which confers the best prospects for export growth and a shift to higher technology goods.

As an exporter, Colombia is a relative minnow. Its total exports (manufacturing, commodities and services) represented 19 per cent of GDP in 2004, ranking it 132nd in the world.⁶² Furthermore, Colombia has not kept pace with the recent expansion in world trade.⁶³

Figure III.1 shows exports of different categories of technology-based products (which exclude food, petroleum and other natural products) relative to world trade in each technology category. This is an important indicator.⁶⁴

While the bulk of Colombia's exports are in commodities, the magnitude of technology-based products demonstrates to efficiency-seeking investors the presence of technically competent firms able to access the main markets. Overall technology-based exports have been increasing. Figure III.1 shows that the proportion of technology-based exports to all exports increased from 20.2 per cent in 1994 to 26.2 per cent in 2004. This growth has been driven by medium technology products.

⁶⁰ World Bank (2002). *Chile - Science, Technology and Innovation*.

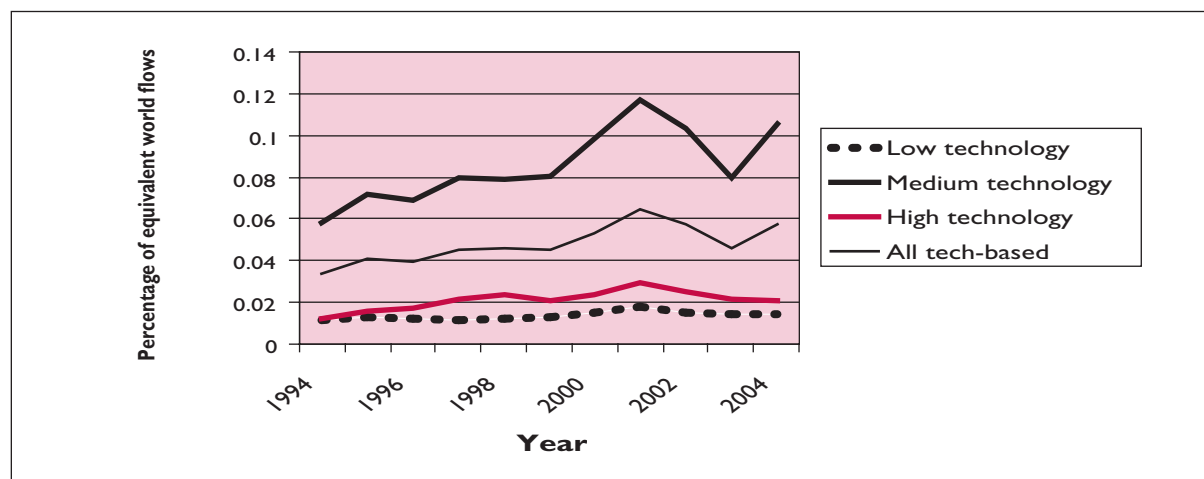
⁶¹ Fiscal incentives usually favour medium and large-sized enterprises.

⁶² Nationmaster, www.nationmaster.com

⁶³ Between 1994 and 2004, world exports increased by 107 per cent and Colombia's exports increased by 85 per cent. UNCTAD statistics.

⁶⁴ The complete list of product categories is available at: <http://www.unctad.org>. For example, high technology comprises pharmaceuticals and electrical products; medium-technology includes cosmetics and washing machines; and low technology includes leather and garments.

Figure III.1. Colombia's exports of technology-based manufactures by technology category as a percentage of total equivalent world flows, 1994-2004



Source: UNCTAD, based on Comtrade database.

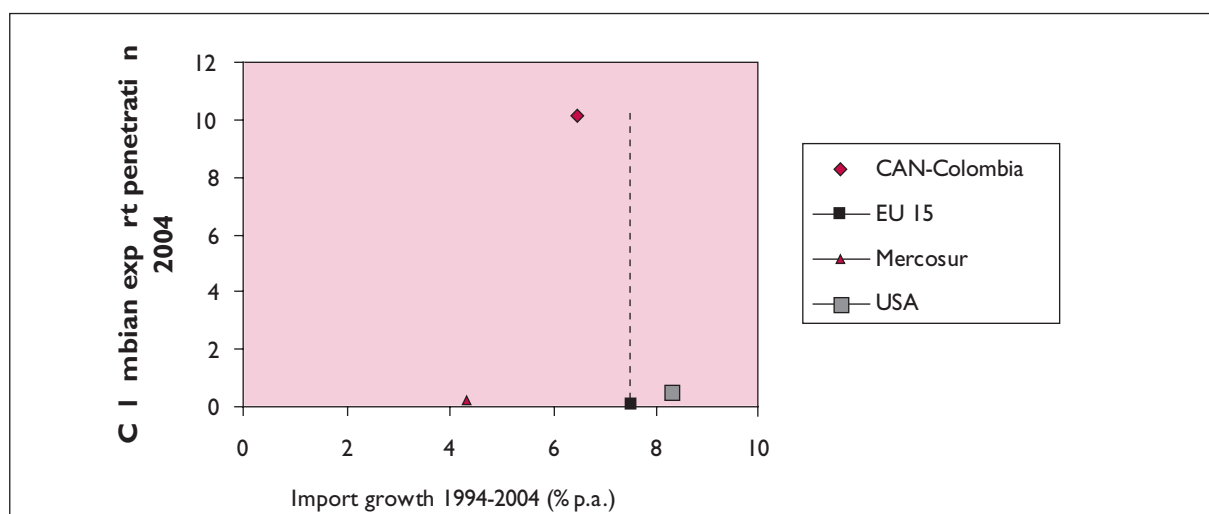
	1994	2004
Total exports (\$bn)	8.5	16.
% of which tech-based	20.2	26.2

Table III.5. Export penetration of technology-based goods in main markets by Colombia and Chile (in per cent)

Partner	Tech group	Export penetration of Colombia as per cent of total imports of each technology group to each market		Export penetration of Chile as per cent of total imports of each technology group to each market	
		2001	2002	2001	2002
United States	High-technology	1.301	1.793	0.473	0.239
	Medium-technology	3.122	8.366	0.950	1.710
	Low-technology	9.850	14.397	2.865	2.834
Japan	High-technology	0.003	0.001	0.003	0.002
	Medium-technology	0.023	0.042	0.026	0.022
	Low-technology	0.044	0.027	0.008	0.029
Mexico	High-technology	0.025	0.011	0.237	0.148
	Medium-technology	0.113	0.097	2.071	0.809
	Low-technology	0.476	0.171	2.533	1.537
EU	High-technology	0.006	0.045	0.673	0.135
	Medium-technology	0.353	0.354	0.372	0.114
	Low-technology	0.619	0.449	0.070	0.024

Source: Comtrade database.

Note: Export penetration of a technological category measures the percentage of a market's total imports of that technological category, which have been captured by a particular exporter.

Figure III.2. Export growth and export penetration of Colombia's main export markets

Source: Comtrade database.

Table III.5 shows the export penetration of Colombian and Chilean technology-based products by technology category. Figure III.2 plots the growth in imports of goods in different markets against the level of penetration by Colombian goods. The most promising markets are those which have high growth and low penetration, the least promising are those with low growth and high penetration.

Colombia's penetration of CAN has been high with increasing penetration in all categories and a penetration of all goods of over ten per cent. However, import growth in CAN is below the world average. It will be difficult for Colombia to increase its import penetration much further. The logical strategy is, therefore, to defend its dominant position and consolidate its exports. This could include attracting investment in ways that entrench its brands in CAN countries (see section on brands).

Both the original 15 members of the European Union (EU-15) and the United States are high growth markets. Exports to both these highly-demanding markets have decreased in low technology products and increased in medium technology products, suggesting an upward technology shift.⁶⁵ Of these markets, the US is closer and faster growing. Colombia's priority should be to negotiate favourable access terms to both these markets. In particular, it should seek access arrangements to the United States on par with those achieved by Mexico and Chile, especially in those exports in which it has already had some success.⁶⁶

Colombia appears to be giving very high priority to the trade negotiations with the United States. This is an appropriate strategic choice given *Colombia Compite's* agenda and the role FDI can play.

Note on services exports

The unavailability of relevant data means that a similar analysis cannot be performed with services. What is evident is that between 2001 and 2004, world trade in services increased by 12.4 per cent a year. Over the same period, Colombia's services exports increased only 0.6 per cent a year.⁶⁷ On this issue, it is important to note that a system on trade in services is being developed by a committee on statistics on services which

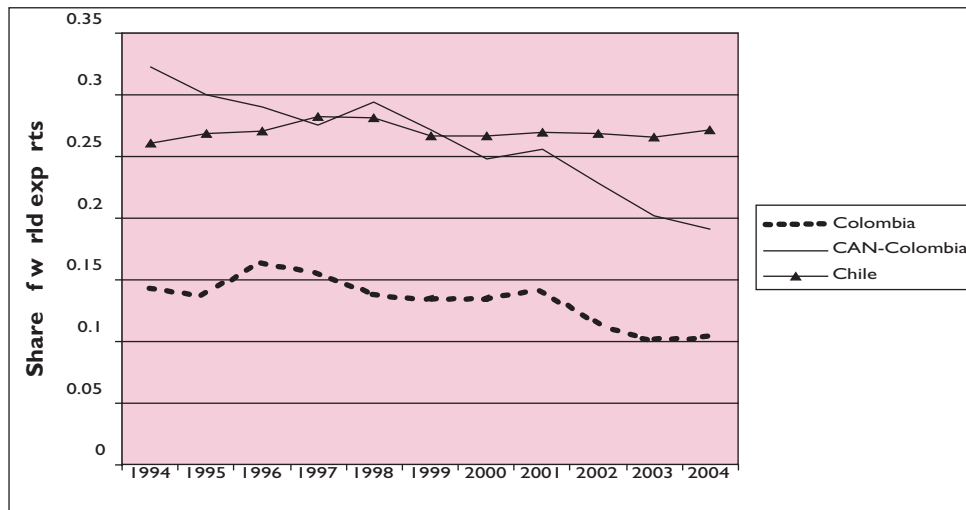
⁶⁵ Medium technology exports to the US have been dominated by polymers, iron products and chemicals, while exports to the EU-15 they have been dominated by pig iron. Nevertheless, despite the growth in high and medium technology products to the most demanding markets, exports to these countries continue to be dominated overwhelmingly by commodities: e.g. oil, agricultural products and coffee (in descending order) to the United States and coffee to the EU.

⁶⁶ Valued at \$58.3 million in 2004, these exports are dominated by aircraft parts, telecommunications and medical equipment.

⁶⁷ UNCTAD statistics on trade in services.

brings together the National Planning Department, the Central Bank, National Statistics and the Ministry of Trade, Industry and Tourism. This programme aims to dramatically improve the information Colombia has with regard to services exports and the data collection methodology.

Figure III.3. Exports of services relative to world trade in services, 1994 to 2003
(Percentages)



Source: UNCTAD Handbook of Statistics

Although services offer potential, it is not possible here to make any recommendations on services-related investment. However, Box III.2, which is based on interviews carried out by UNCTAD, shows two areas that could develop services exports through FDI.

Box III.3. Colombia's potential for services-related exports through FDI

Health services in Colombia have comparative advantages over neighbouring countries due to the availability of state-of-the-art medical training, high technology equipment and facilities and lower costs. A rehabilitation treatment in a Colombian clinic costs around \$6,500 per month all inclusive. The same service in Cuba would cost around \$9,000, \$17,000 in the United States and \$23,000 in the Netherlands. Moreover, modern hospital administrative systems and quality control programmes are being developed to make these services more attractive to regional markets. Furthermore, a large percentage of Colombian physicians attended education programmes in the United States and are familiar with United States health services and products. The Valle del Cauca region has already developed a health cluster exporting to the United States.

Colombia has well-developed **facilities for ICT**. Seventy companies are located in six Parquesofts. Although there have been a number of strategic alliances with foreign investors, no large FDI has been attracted despite the positive experience of some local projects launched in collaboration with foreign investors. For example, Mecosoft, a start-up Colombian software company, had a strategic alliance with the Spanish Group ESP (Software Español de Finanzas). In 2005, the Softland Group (Spain) acquired Mecosoft and this acquisition made it possible to further develop the company. There has been significant progress in training professionals in the IT area within the framework of the Connectivity Agenda launched in 2002. There is a subsidy for training/retraining professionals in technology issues (via COLCIENCIAS); the goal they have established is train 13,000 professionals within a two-year period. However, there are no secure job prospects for these professionals. Therefore, FDI in call centres, business services and software development could be targeted.

Source: UNCTAD.

4. Improving infrastructure

Colombia's export potential and attractiveness to investors is linked to the efficiency and security of transportation as well as reliability and affordability of the energy supply. In the export manufacturing industries, infrastructure services, including energy, transport, telecommunications and others comprise 16 per cent of the total costs of production.⁶⁸

This does not include the opportunity costs of disruption caused by poor infrastructure. In a World Bank survey⁶⁹ of 61 firms in three major export-oriented productive chains (textiles, paper and sugar), 50 per cent of surveyed companies had encountered delays of more than four days in international deliveries and 27 per cent had experienced delays at ports and airports. Seventy per cent of the firms complained of Colombia's road conditions. Given the need to focus on manufacturing exports, this point needs urgently to be addressed.

The state of Colombia's paved roads remains below the regional average and needs to be improved.⁷⁰ Plans are afoot to pave 2,500 km of roads through a bond issue. Furthermore, ten per cent of all privatization proceeds will be spent on municipal and regional infrastructure. It is important that the government finances roads and other projects in insecure areas, as these are unlikely to attract private investment. However, it does plan to attract \$6.5 billion in private investment in the next few years to invest in specific infrastructure and utility projects, especially those that will earn hard currency such as ports and airports. Long-term plans have also been developed by the Internal Agenda. Nevertheless, the government should bear in mind an increasing reticence by foreign investors to invest in infrastructure and utility projects.⁷¹

The improvement in the security situation has eased the movement of goods around the country, but insurance costs remain high. The power supply has increased in reliability owing to greater investment in this sector from the public and private sectors,⁷² but is below the regional average (IMD, 2004; REDI, 2004), as does the quality of telecommunications. However, Colombia is the regional leader in social infrastructure and has the highest levels of access to water and sanitation.

B. Institutional strengthening

I. Investment promotion

Colombia needs an investment promotion strategy to achieve the objective of attracting quality FDI in order to upgrade the economy and improve the competitive environment. In order to implement this, an appropriate institutional structure is necessary.

History

Colombia used to have its own investment promotion agency called Coinvertir. It was established in 1992 and was funded by government and private contributions, with the private sector occupying half the seats on its executive board. Dwindling contributions from both sides meant that after five years its position became untenable. In 2005, it was merged with Proexport, the export promotion agency. This decision was taken after a thorough review of a panel comprising several ministries, with the assistance of a consulting firm.

Whilst small compared to many other investment promotion agencies (IPAs) in the region,⁷³ largely reactive and financially weak. Coinvertir did respond well to investor queries, disseminating excellent information

⁶⁸ World Bank (2004). *Infrastructure contribution to economic growth, Recent Economic Developments in Infrastructure*.

⁶⁹ Ibid.

⁷⁰ Ibid.

⁷¹ See UNCTAD (2004). *World Investment Report 2004. The shift towards services*. United Nations Publication Sales no. E.03.II.D8. Geneva.

⁷² Ibid.

⁷³ The average IPA in developing countries has 29 staff. An UNCTAD survey in 1999 showed that, on average, resources of IPAs are 73 per cent from government, 10 per cent from fee-based services, 9 per cent from international aid, 2 per cent from the private sector, and 6 per cent from other sources. UNCTAD (2002). *The World of Investment Promotion at a Glance. A Survey of Investment Promotion Agencies*. United Nations Sales no. UNCTAD/ITE/IPC/3. Geneva.

material and playing a positive advocacy role for improvements in the investment policy framework – all this with a staff of only fifteen.

Merging the two agencies poses some risks. A number of countries have taken the same path, citing reasons of synergy and cost savings (the latter being especially important for small countries). A recent poll by UNCTAD⁷⁴ showed this to be the case 45 per cent of the time. However, the experience of UNCTAD is that these two types of activities are not similar and should not be carried out by one and the same agency. Wells and Wint (2000) explain this well, noting that the skills and approach required are fundamentally different. Helping local firms to sell products and services abroad is a different proposition than convincing foreign executives to commit and risk capital in a new country. There are synergies perhaps in image building and branding, but less so in direct marketing. Furthermore, FDI promotion targets high-level corporate investment planning at the CEO level, while export promoters address companies' sales departments, who are often not aware of corporate investment strategies. Export promotion tends to have short-term targets, while investment promotion requires a medium- and long-term approach. Thus, an independent investment promotion agency is more suited to the role.⁷⁵

Box III.4. Promoting Bogotá and Cundinamarca

The Chamber of Commerce and the mayor's office in Bogotá have taken the lead in initiating investment promotion for Bogotá and the Cundinamarca region. This forms part of the regional efforts to develop and implement a competitiveness plan, making the city and the region a centre for investment and technology. The reasons to invest in Bogotá- Cundinamarca were analysed and grouped into five main factors:

Market size. It is the largest economic centre in the country and the Andean region, accounting for 27 per cent of national GDP and enjoys the highest income per capita. It is also the region's financial centre.

Dynamic exports and FDI. Export growth has averaged nine per cent in the past four years and the region has been Colombia's largest destination of FDI.

Qualified human resources. It has 70 universities and 50 bilingual schools. Seventeen technological centres offer services to entrepreneurs and 70 per cent of the population is less than 40 years old, representing a qualified and young labour force.

Quality of life. The region has higher scores in human development indices compared to other regions in the country, the scores are also higher than the average for Latin America. It has excellent facilities and services.

Good administration. In the past three years, the region has invested \$1.2 billion to improve infrastructure and economic activities.

This accounts for the high concentration of inward FDI in recent years, locating to this region. This is likely to be reinforced by a regional investment promotion strategy known as Bogotá Dynamic Region. Run by the chamber of commerce and the mayor's office, it will be fully in charge of implementing this strategy in concordance with Proexport guidelines.

Source: Bogotá Chamber of Commerce.

More information is available at: <http://www.ccb.org.co/guiadelinversionista>

However, the merging of Coinvertir into Proexport was taken with the full determination to strengthen investment promotion. These changes are recent. Full evaluation of concrete results can only take place after three to five years. According to recent information provided by Proexport, initial results are very encouraging. The institutional memory of Coinvertir has been preserved with ten former staff members joining Proexport. Coinvertir is established as a division within Proexport headed by a vice-president. Five junior staff have been recruited and a further five members of staff have been posted abroad in priority countries, including the United

⁷⁴ UNCTAD, 2002. *The World of Investment Promotion at a Glance. A survey of investment promotion agencies*, UNCTAD/ITE/IPC/3.

⁷⁵ Wells, L. Jr. and Alvin G. Wint (2000). *Marketing a Country. Promotion as a Tool for Attracting Foreign Investment*. Revised Edition, FIAS.

vestment promotion unit at headquarters. The remaining staff handles policy advocacy and legal issues, with only one person dealing with aftercare. In addition, the Coinvertir website (www.coinvertir.org) has been upgraded and fully merged with the main page of Proexport, but with a separate sub-heading "Invest in Colombia". (www.proexport.com.co).

During the first year of operations, there was a three-fold increase in the number of projects handled by the agency. Proexport generated \$128 million of FDI in 2005 and an estimated \$80 million in 2006. There is a close collaboration with provinces and regions, which have initiated investment promotion, such as Bogotá – Cundinamarca (see Box III.3) and Cali. However, no protocol exists to define such cooperation and no systematic approach to attracting FDI to provinces and regions or for assisting investors locally likewise exists.

A proposal to re-organize the functions of the investment division of Proexport

Although investment promotion is represented as a division within Proexport, its independence has been assured. Therefore, for the purpose of this discussion, the investment division will be referred to in the text as an investment promotion agency (IPA). The question now is whether this IPA is engaging in the right activities.

Colombia needs to strengthen its investment promotion functions. The existence of a government competitiveness policy, which handles policy advocacy, after-care and linkages, means that the IPA can be small, high-powered and focused. It could work in partnership with the programme on competitiveness and should concentrate on a few specific roles for which it can be measured and judged. The bulk of its work should be in FDI generation, with some work on image-building.

The primary task of the IPA should be the generation of new FDI that will support the competitiveness agenda. Distinctive tasks would include:

- The attraction of TNCs that can become value chain leaders to provide a cutting edge for local supplier upgrading; and
- Targeting of market-seeking foreign investors to increase competitiveness in highly concentrated domestic markets;
- Supporting investment attraction to expand Colombia's brand presence overseas, in the medium and long term.

Attracting value chain leaders will support the efforts of consolidating clusters around which Colombia can provide high and medium technology exports to the US and EU. This will require analysing and prioritizing the list of potential clusters prepared by the competitiveness programme and attracting investment from chain leaders to consolidate these clusters. The list includes: cotton/fibres/textiles and garments; domestic and commercial appliances; auto-parts and automobile production; coffee; electronics; metal/mechanics; petrochemicals; cosmetics; forestry/paper and pulp; flowers; furniture; engineering and construction; graphic design; software and services; health professional services, and logistics and transportation (see section 2 below on strengthening linkages).

Attracting investors for Colombia's brands means generating investment for Colombian companies seeking to expand into new markets within the region and further afield. This fits in with the proposed strategy of consolidating Colombia's presence in the CAN market. The section on brands describes this in further detail.

Attracting competitors in concentrated domestic markets will provide competition where it is needed; this will stimulate domestic incumbents to improve their product offering, either through competitive pressure or through technology transfer. Table III.6 shows that Colombia's competition environment ranks favourably against its CAN neighbours, but nevertheless trails Brazil, Mexico and Chile.

Table III.6. Ratings of local competition in selected countries in Latin America, 2002

	Local competition		Entry of new competitors
	Extent*	Intensity**	
World average	4.4	5.1	5.2
Bolivia	3.0	4.0	4.3
Colombia	4.9	4.7	4.9
Ecuador	4.2	3.9	4.2
Peru	3.3	5.2	5.0
Venezuela	3.1	4.3	4.8
Panama	4.4	5.0	5.2
Brazil	5.2	5.2	5.6
Mexico	4.7	5.0	5.0
Chile	5.4	5.9	5.7
China	5.2	5.5	5.6

Ratings from 1 to 7.

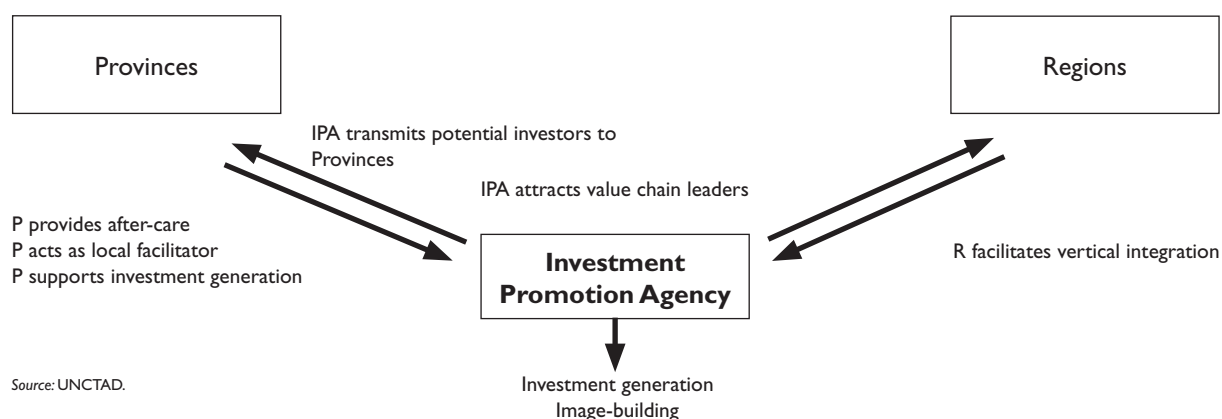
*Competition comes primarily from: (1= imports, 7=local firms or local subsidiaries of multinationals).

**Competition in the local market is: (1= limited and price-cutting is rare, 7= intense and market leadership changes over time).

Apart from targeted FDI generation the IPA should strengthen image- building. Image-building is needed to offset the negative security image and emphasize the country's science and technology capabilities as a destination for FDI, among other functions. Proexport has already initiated such activities in 2005.

Structurally, the investment promotion should maintain its independence within Proexport, but should have formal partnership arrangements with different institutions. At the provincial level, chambers of commerce or where feasible provincial councils (CARCES, if properly funded) should have the capacity to generate information on investment opportunities, promote FDI attraction at the level of site inspections, facilitate new investor start-up and provide after-care. These institutions should act as local partners for the IPA, which takes the lead in overseas promotion. At the regional level regional, competitiveness institutions should work with the IPA in value chain development by facilitating the vertical integration of each cluster. Figure III.4 illustrates these partnerships.

Figure III.4. Proposed partnerships between the investment promotion agency and central and local institutions



This promotion partnership will vary in strength depending on the capabilities of the provincial and regional counterparts. To formalize the different levels of cooperation, service-level agreements should be created. It is recommended that these agreements be divided into three tiers, as practiced by the Invest in Sweden Agency, reflecting the level of commitment (including financial) to the projects, cooperation between the agency and the provincial and regional counterparts, and the competence level of the staff in those counterparts.

The following are indicative of the different levels which could apply:

1. Tier 1 could require that minimum standards are achieved by the counterparts in terms of promotional material for investors, service delivery to new and existing investors and database maintenance for after-care purposes.
2. Tier 2 could require harmonization and closer alignment of investment promotion strategies and active involvement in the after-care programme.
3. Tier 3 could enable the counterparts to participate directly in the work of the IPA as co-funders and share staff. Regional counterparts would take a proactive role in vertical integration and cluster development.

Regular briefings and capacity-building programmes will be organized for all tiers; the aim is to have all counterparts operating at the Tier 3 level as soon as possible, although it should be accepted that some counterparts will wish to participate in the process more actively than others. Investment promotion is a public good (reducing information barriers to investment decisions) and the funding of an investment promotion agency should reflect this. Experience both within and outside Colombia shows that it is not realistic to rely on private sector contributions. Moreover, a recent UNCTAD survey showed that 73 per cent of IPAs are State-financed and only 2 per cent are privately financed.⁷⁶ The Government of Colombia should therefore provide the funding to maintain the IPA, although it may consider measures to offset part of the cost by, among others, charging fees for specific services to businesses and cost-sharing with provincial and regional counterparts in Tier 3 partnerships.

Whilst the IPA should be publicly funded, there are specific roles for the private sector and for donors. Donors can be approached to finance a unit to specifically attract investment from their countries, such as the German Desk in Ghana. TNCs can be asked to second staff to the IPA to develop industry-specific strategies (as Scotland does). And private sector representatives can make a valuable contribution as board members of the IPA. However, none of these instruments should be used for core funding.

At the same time, the government should bear in mind that the IPA is but one element of a national FDI strategy. Much of the IPA's work focuses on attracting quality investment, but this in turn needs a strong skills base, investment in R&D and a good infrastructure. The functioning of the IPA should accompany policy measures to address the issues raised in Part A above.

2. Strengthening linkages

The impact of FDI on knowledge transfer and technological upgrading can be improved through linkages between TNCs and their customers and suppliers. This is recognized in the competitiveness programme as it seeks to promote deepen value-added activities within Colombia by improving local supplier quality.

The IPA should have a specific role to play in supporting the work of dedicated ministries and institutions in achieving these objectives. The IPA should assume a role in strengthening local suppliers and deepening the value chain by attracting TNCs that can lead an integrated value chain. Table III.7 is an IMD survey. It shows that

⁷⁶ UNCTAD (2001). *The World of Investment Promotion at a Glance: A Survey of Investment Promotion Practices*. United Nations Publications no. UNCTAD/ITE/IPC/3. Geneva.

local supplier quality in Colombia is rated as the best in the CAN region, but below the world average and below the ratings of some alternative locations for FDI elsewhere in the region.

Table III.7. Ratings* of supply capacity in selected countries in Latin America, 2002

	Availability of components/parts	Local supplier quality	Cluster development	Value chain presence
World average	3.8	4.7	3.5	4.1
Bolivia	2.5	3.2	2.3	2.8
Colombia	3.8	4.4	2.9	3.5
Ecuador	2.5	3.3	2.3	3.0
Peru	3.6	3.9	3.3	3.0
Venezuela	2.9	3.5	2.7	2.7
Panama	3.8	4.6	3.5	4.4
Brazil	5.1	4.9	3.6	3.7
Mexico	3.5	4.2	3.6	2.8
Chile	3.5	5.2	3.2	3.4
China	5.4	3.9	3.3	3.9

*Ratings range from 1 to 7. Source: World Economic Forum (2002) Competitiveness Report: Latin America.

The presence of foreign chain leaders would also enhance the competitiveness of Colombian suppliers and their ability to integrate into regional and global supply production chains through guidance and market incentives on quality, sustaining technical support, on-time delivery, product technology, production times and procurement. The IPA should have a partnership role with local institutions, which are responsible for promoting vertical integration. Whilst the IPA should target chain leaders much needs to be done at the local level to ensure that effective supplier relationships are nurtured. Programmes should be developed and should be supported by incentives for customers and suppliers (see Box III.5).

3. Using Colombia's brand portfolio

Colombia has many well-developed local brands, as can be expected in a middle-income developing country. These include Bavaria (beverages, see Box III.6), la Nacional de Chocolates (food, see Box I.2), Organización Corona (ceramics) and the Nacional Federation of Coffee Growers. The first firm, Bavaria, was acquired by SABMiller, a South African brewer in 2005.

Several Colombian companies are reported to be ready for regional expansion, including: Harinera del Valle (foods); Casa Luker (coffee); Levapán (bakeries); Postobón (soft drinks); Hoteles Dann; Condimentos el Rey (condiments); Colanta (dairy and meat products); Incauca (sugar); Carpack (packaging); and Protela (lingerie) y Fabricato (textiles and home linen).⁷⁷

There is a case for government support to regional and international expansion plans of these brands. Their expansion will strengthen Colombia's exports of goods and business support services. This will consolidate Colombia's regional presence and help to create opportunities in new markets. The IPA could assist these brands with investment-related aspects of expansion. However, there is no consensus on the fact that IPAs

⁷⁷ Revista Dinero (2004). Comprar para competir. 28 May, No. 206.

should carry out these activities. For example, some successful IPAs such as Ireland, have decided not to deal with outward FDI. In other cases, such as Singapore, these activities have been integrated as part of their strategies. In fact, these activities could include supporting inward investment in the core business by providing assistance in finding franchise and distribution partners in overseas markets. However, many IPAs have decided to focus on the promotion of inward investment because of limited resources and there is no clear indication of the effectiveness of outward investment promotion. The Government of Colombia is aware of the importance of expanding its support activities to outward investment and it is planning to provide such support. However, at this stage, it prefers to focus its promotion efforts on attracting inward FDI.

Box III.5. Incentives to intensify supplier relations and technology transfer in South-East Asia

Incentives for customers

The Centre-Satellite Factory System in Taiwan Province of China is designed to make supplier relations with SMEs more attractive to large firms. It comprises a package of tax depreciation incentives, subsidies and advisory services by public institutions.

Two factors explain its success. SMEs in the Taiwan Province of China, are more competitive and the system combines incentives for customers with advisory services that strengthen the suppliers. The Umbrella subcontracting scheme in Malaysia links up small suppliers with large marketing firms (umbrella companies).

The latter have the expertise and funds necessary to support SME suppliers in designing, manufacturing, quality control and marketing. In return, the umbrella companies are awarded public contracts without having to participate in bidding, as well as receiving a 5 per cent commission for their services. Not all schemes have been successful. Large industrial firms in Malaysia receive 5 per cent tax relief if they buy primary products from national SMEs. However, take-up has been feeble as the reduction in tax does not make up for the higher costs of local suppliers.

Incentives for suppliers

Suppliers in the Republic of Korea receive soft credit lines for process and product improvement as well as credit guarantees. In addition, they are granted rapid tax depreciation for investment in laboratories and control equipment and are exempt from stamp duty.

Source: UNCTAD (2000). *TNC-SME Linkages for Development*. United Nations Publication Sales No. UNCTAD/ITE/TEB/1. Geneva.

Box III.6. Bavaria's expansion strategy attracted FDI

Grupo Empresarial Bavaria (GEB) is the largest Colombian company operating in the beverages sector (beer, mineral water, sweet drinks and milk) and the second largest South American brewer. GEB decided to change its marketing strategy in 2000 by reducing its brands and focusing on specific market segments. Since 2000, the company had invested \$135 million in acquisitions in Colombia alongside acquisitions in Ecuador (\$165 million), Panama (\$260 million) and Peru (\$1.2 billion). It had also invested in Chile, Bolivia and Costa Rica and started penetrating the United States market by exporting \$1.8 million of drinks in 2003. Following this expansion, GEB was now an important regional player and aimed to rank among the ten largest beer companies in the world by 2006.

With a well-established production base and a healthy portfolio of local brands, GEB was always in a competitive position. However, its healthy margins were based on scale economies and a low marketing budget. Spotting this, SABMiller, a South African brewer, acquired GEB in 2005. Soon after, SABMiller unveiled an ambitious plan to sustain sales growth, diversify GEB's brands, overhaul its marketing operations and improve efficiency.

Source: Revista Dinero and SABMiller website, www.sabmiller.com.

Inward investment in the core business within Colombia can bring direct benefits in the form of capital and know-how (see Box III.5). Franchising and distribution partnerships in foreign markets bring investors who know their own markets and have a better understanding of the risks involved. For Colombian companies, these partnerships fund overseas expansion and bring the local knowledge required to access these markets effectively. A promising example of overseas expansion funded by franchisees is *Juan Valdez, Café de Colombia* (Box III.7).

Box III.7. Juan Valdez, Café de Colombia

The National Federation of Coffee Growers of Colombia, founded in 1926, is an independent marketing entity for local coffee growers. Within Colombia, the federation provides a network of agricultural expertise and quality control to ensure the highest standards for Colombian coffee. Around the world, the Federation's offices work with appropriate trade and media channels in host countries to promote the consumption of Colombian coffee. One of the competitive advantages of Colombia's coffee growers is product quality. To reinforce this, the federation developed the brand *100% Café de Colombia*, which it operates with roasters around the world. The brand is identified by a trademark, featuring Juan Valdez, an advertising symbol, and the Colombian mountains. With this trademark, customers are assured of drinking pure Colombian coffee approved by the Federation's rigorous quality control standards. The brand now represents 560 000 growers and the Federation plans to pitch it upmarket. Between December 2003 and June 2004, the Federation opened 11 Juan Valdez outlets in Colombia. International expansion started in September 2004, with the opening of a shop in Washington and New York. More Juan Valdez coffee shops are planned for Los Angeles, Chicago and Miami and the goal of opening 200 to 300 shops worldwide by 2007.

Sources: <http://www.cafedecolombia.com> and USA Today, 8 September 2004.

An overview of Colombia's biggest brand portfolios is provided below. It is taken from a review conducted by *Dinero* magazine and *Compass* (Table III.8).⁷⁸ The brands are valued on their intangible contribution to the company.

C. Conclusions

Colombia needs a more developed FDI strategy to complement the competitiveness and internationalization goals.

This strategy needs to systematically address the requirements of foreign investors in the areas of skills, science and technology, exports and infrastructure and requires the strengthening of the investment promotion agency. It must inculcate stronger linkages with local supplier firms and a greater exposure for Colombia's brands.

This FDI strategy should emphasize the attraction of "quality" FDI. This means attracting efficiency-seeking investors with the capability to place higher technology Colombian products on world markets, whilst sourcing supplies from local firms and upgrading their capacities in the process. To attract and more fully benefit from such FDI, Colombia needs to offer skills, R&D and infrastructure that are internationally competitive if it wishes to attract quality investment. UNCTAD's survey of TNC affiliates suggests that these areas of Colombia's profile for efficiency-seeking foreign investors need attention. On the other hand, the priority in trade negotiations given to a preferential trade agreement with the United States is appropriate.

A quality FDI strategy does not mean that market-seeking FDI should be neglected. Rather, it means focusing scarce promotion resources on attracting investments that increase the intensity of competition in a particular sector, forcing incumbents to upgrade their offer without dominating the market.

⁷⁸ "Las marcas mas valiosas". <http://dinero.terra.com.co/dinero/ArticuloView.jsp?id=19229>

The centrepiece of the FDI strategy is to turn the current IPA (as the investment division of Proexport) into a world-class investment promotion agency with a budget and qualified staff to match. Investment promotion should be publicly-funded. Given the well-established nature of Colombia's competitiveness programme, the IPA should focus on investment generation and image-building. Policy advocacy, after-care and the promotion of linkages, which are traditional functions of investment promotion agencies, can be handled by institutions at the provincial and regional level as partners of the investment promotion agency.

Table III.8. Ranking of brand portfolios in Colombia, 2004

More than \$440 million	1	Bavaria (Aguila, Aguila light, Club Colombia, Pilsen, etc.)
Between 44 million and \$154 million	2	Nacional de Chocolates (Jet, Sello Tojo, Tesalia, etc.)
	3	
	4	Carvajal (Bico, Norma, Productos el Cid, Carpark, etc.)
	5	
	6	Noel (Saltín, Wafers, Recreo)
	7	Postobón (Colombiana, Manzana, jugos Hit, agua Cristal) Almacenes Éxito (Ley, Pomona) El Tiempo (Multirevistas, City TV, Metrocuadrado.com, etc.)
	Between 22 million and \$44 million	8	Tencoquímicas (MK, Sal de Frutas Lua, Yodora, etc.)
9		
10		Colombina (Bon Bon Burn, Coffee Delight, Nucita, etc.)
11		
12		Coltabaco (Green, Boston, Imperial, Pielroja, Derby)
13		Familia (Nosotros, Pequeñín, Tena)
14		Quala (Doña Gallina, Bonke, Frutiño, Instacrem, etc.)
15		Protabaco (Mustang, Fly, Premier, Starlite, President, etc.) Meals (Crem Helado, Country Hill) Team (Gourmet, Campi, Oliosoya)
Between 4.4 million and \$22 million	16	Dersa (As, Top)
	17	Levapan
	18	Pat Primo (Manufacturas Elliot)
	19	Casa Luker (Luker, Sol, Quesada, Lukafé, Frutasa)
	20	Harinera del Valle (La Muñeca, Haz de Oros, Conzazon)

Source: Revista Dinero (2004), 28 May, no. 206. Original calculations were in Colombian pesos.

IV. CONCLUSIONS AND RECOMMENDATIONS

Since the early 1990s Colombia has engaged with FDI much more comprehensively than in the past. As a result, inflows have increased, probably on a sustainable basis. FDI has entered many new areas of business, especially through the privatization of service industries. Privatization and oil extraction will continue to provide key opportunities for FDI but there is continued potential in manufacturing and services generally. There is some evidence that – in line with Colombia’s goals – FDI has been attracted to high technology sectors of the economy.

Landmark changes have been introduced and, equally importantly, *sustained and developed* by successive administrations. These include the constitutional reforms of 1991 that cleared the way for a modernization of FDI entry and protection rules, the contemporary *Apertura* or *Opening* process of liberalization and the formation of the Andean Community (CAN). The 1994 *Colombia Compite* programme was an early and innovative effort of Colombia to systematically address its own issues of competitiveness.

Thus, Colombia now has a largely open FDI regime, similar to that in other Andean countries and most countries in Latin America. Recent reforms have improved guarantees to investors, eased business establishment and land registration procedures, established competition legislation and modernized labour laws. Legal stability contracts (LSCs) have also recently been introduced.

Despite these developments, Colombia still trails behind others in attracting FDI. For example, FDI stock is currently less than one-half that of Chile and Argentina. Without question the difficult internal security situation discourages FDI (although the Democratic Security Policy appears to be improving security and business confidence). Nevertheless, there are further developments that could be considered by Colombia to attract FDI and benefit from it, especially in view of the goals and programmes of *Colombia Compite*.

Colombia Compite is a valuable national framework to upgrade competitiveness at the firm level. FDI can become a more active agent of change given *Compite*’s ambitious goals of competitiveness and internationalization. The accent should be on attracting quality FDI that supports these goals. To do so, Colombia needs to systematically address foreign investors’ requirements in the areas of skills, science and technology, exports and infrastructure and requires the strengthening of the investment promotion agency. It must inculcate stronger linkages with local supplier firms and achieve greater exposure for Colombia’s brands.

Recommendations on FDI-specific measures

Colombia has steadily improved its openness to FDI and its standards of treatment and protection of foreign investors. In a practical sense, standards are high. Yet, the internal security situation may lead uninitiated investors (and headquarters of existing Colombian affiliates) to perceive high levels of risk in committing to Colombia. Thus, Colombia could make greater efforts to reduce controllable investment risk perceptions. **In order of priority** such measures could be to:

(i). Widen access to enforceable international arbitration to resolve foreign investor-state disputes. In the absence of relevant laws and treaties, this recourse is now only available for investments governed by project contracts (e.g. in regulated industries). It is expressly excluded from the new legal stability contracts (LSCs). An adequate treaty network and a revised approach to the LSCs would enable many more foreign investors to access international arbitration and would oblige the domestic courts to enforce foreign arbitral awards.

(ii). Improve compensation for expropriation rules in relation to adequacy, form and timeliness. Appropriately worded provisions already appear in the G-3 Treaty.

(iii) Roll out an investment treaty network and revise the Legal Stability Contract law so as to give clear cut undertakings in respect of (i) and (ii) above.

(iv) Strengthen the investment law by consolidating the existing decrees and formalizing the *de facto* negative list approach to FDI entry.

Recommendations of general measures

Many improvements have been made in the last 15 years to modernize major regulatory areas. A small number of important changes remain. The corporate tax regime is uncompetitive and its reform should be a priority. There should also be more flexibility in the labour laws, greater independence in utilities' regulation and in mandatory standards of corporate governance. The commercial code should be consolidated and better enforced. **In order of priority** it is recommended that Colombia:

(i) Thoroughly review corporate taxation. Lower the standard rate to a more competitive level and rely less on long-term tax holidays. Abolish the minimum tax rate or, if this step would result in major revenue leakage, enable investment tax credits to also be creditable against the minimum tax. (This would assist early stage investors with weak cash flow and preserve the overall positive bias of the tax system towards supporting reinvestment.)

Abolish the withholding tax on dividends paid from untaxed income and the remittance tax, in favour of a low flat-rate tax on dividends paid to both residents and non-residents.

Accompany the above changes with less restriction on the utilization of losses carried forward to enable quicker recovery of investment.

(ii) Extend reforms in labour, regulation of utilities and corporate governance. Reduce social contributions, severance payments and overtime supplements. Abolish the link between minimum wages and seniority.

Separate the role of the government as a regulator of utilities from that of a commercial operator and competitor. Prevent vertical integration in the provision of public utilities, such as electricity production and distribution.

Mandate higher standards of corporate governance and continue the work to improve disclosure to shareholders in listed companies.

(iii) Review the commercial code. Simplify and exercise restraint in the laws and regulations that apply to business. The new Law 962 to simplify regulations and to restrain the issuing of administrative rulings that are not founded in law should be carried through.

Findings on strategic elements to attract quality FDI

(i) Build the skills base. This is of primary importance for a middle-income developing country like Colombia as it cannot attract efficiency seeking investment through low labour costs. Colombia managers are competent and there are sufficient numbers of graduates that come onto the job market every year; however, the rapid private sector expansion and request for higher education adversely affected the quality of graduates. Accreditation is weak and needs to be reformed.

(ii) Build local science and technology capacity. Public and private expenditure on R&D has declined. In government, this is a result of shifting priorities. In the private sector, it is a result of the recent recession, limited opportunities for joint activities with government and TNCs centralizing R&D outside Colombia. In addition, fiscal incentives in R&D are too narrow.

(iii) The focus of preferential trade negotiations is appropriate. Colombia has saturated CAN. If Colombia wishes to expand and upgrade its exports, it must secure preferential trade access to the US and EU,

which it is trying to do. These markets are highly-demanding and fast-growing and Colombia has already shown some success in penetrating them with medium and high technology products. Colombia must consolidate its position in CAN, possibly through the expansion of its brands.

(iv) Improve the infrastructure. Infrastructure is poor and is cited as a hindrance by export-oriented investors. The government will fund infrastructure development in insecure areas but also hopes to attract \$6.5 billion of private investment. There is increasing reticence globally by foreign investors in some types of infrastructure but foreign investors should respond to opportunities in Colombia where they can earn hard currency in secure areas, such as in ports and airports.

Recommendations on investment promotion

This Review reiterates that the investment promotion agency should have a distinctive mandate and complement the government's competitiveness policies. Agencies working on competitiveness already perform some of the classic functions of an investment agency. Thus, investment promotion should focus only on FDI generation and image-building.

(i) A distinctive mandate. The IPA should be tasked with soliciting TNCs that can become leaders of an integrated value chain to give a cutting edge to local supplier development, to supporting overseas expansion of investment in Colombia's brands and raising competition in concentrated domestic markets by facilitating foreign entrants.

(ii) Build Colombia's image. This is required to offset the negative security image and emphasize the country's science and technology capabilities as a destination for FDI

(iii) Work with provincial and regional institutions. The IPA should have formal partnership arrangements with these agencies. They should generate information on investment opportunities, promote FDI attraction, facilitate new investor start-up and to provide after-care. Regional competitiveness institutions should work with the IPA in value chain development.

ANNEX – SURVEY OF FOREIGN INVESTORS ESTABLISHED IN COLOMBIA

A survey of 61 foreign investors established in Colombia was undertaken on behalf of UNCTAD by Fedesarrollo between May and October 2003.⁷⁹ Seventy per cent of those companies were more than 75 per cent foreign-owned. Furthermore, 75 per cent were in manufacturing, 17 per cent in services and 8 per cent in hydrocarbons and energy. 49 of those companies were located in Bogotá, five in Cali and three in Medellín. All but one had assets of over \$2 million. The main mode of entry was by establishing subsidiaries, although compared to other surveys carried out by Fedesarrollo in previous years, this method of entry is now on the decline, in favour of joint ventures and acquisitions.

Table A.1. Importance of the local market for foreign companies

What share of your company's total income comes from exports?

Exports share in income	Answers (in per cent)
76-100 per cent	1.7
51-75 per cent	8.3
26-50 per cent	26.7
1-25 per cent	30.0
No exports	33.3

Companies answering the survey considered the potential of local market size as the main determinant of their investment strategy, followed by the possibility of establishing an export platform to other Andean countries.

Table A.2. Determinants of FDI

What was the importance of the following factors in your company's investment decision?

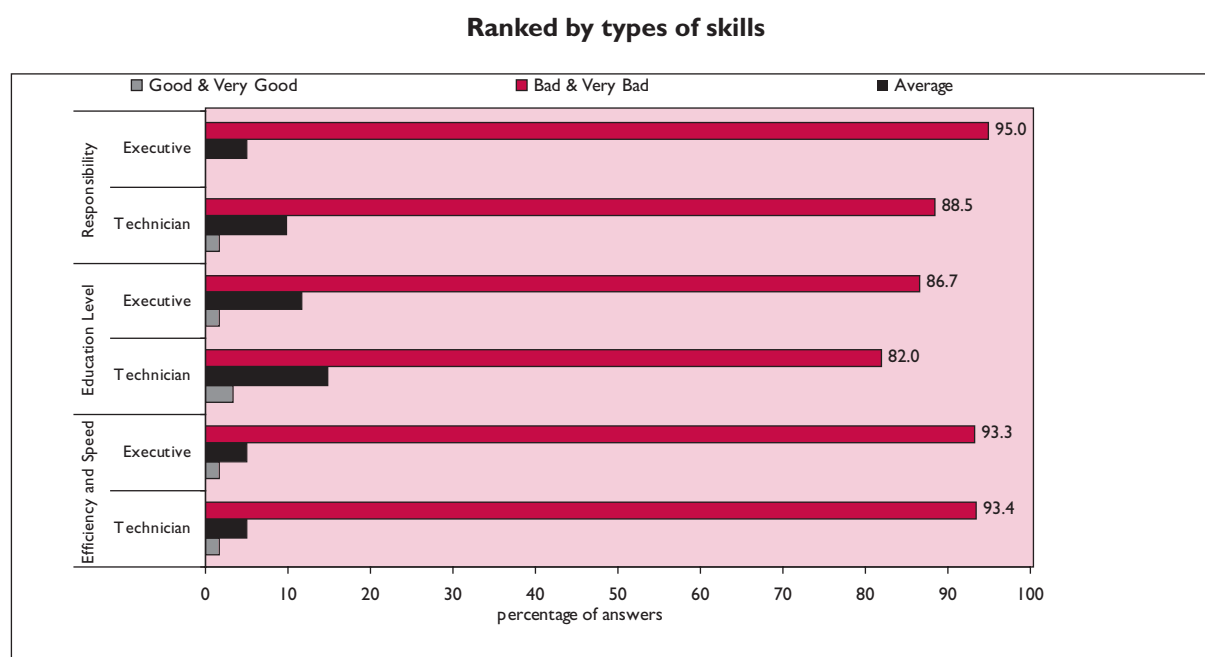
Factors	percentage of companies responding very important or crucial
Potential local market size	55.0
Macroeconomic stability	31.0
Geographic location	31.0
Export platform to regional markets	28.1
Quality of labour force	25.4
Availability of skilled labour	24.1
Benefit from a local company's know-how	22.8
Labour costs	22.4
Access to inputs/supplies	12.1
Access to natural resources	6.9

⁷⁹ The special section of the Survey of Business Opinion by Fedesarrollo to companies with foreign investment, was completed between 9 May and 15 June 2003. A sample of 367 companies was selected among 568 listed by the Invest in Colombia Corporation (COINVERTIR).

I. Quality of labour force

The survey shows that foreign companies have a good opinion of the Colombian labour force, both at the executive and technical levels.

Figure A.1. Qualification of the Colombian labour force



2. Infrastructure

Table A.3. Importance of infrastructure in investment decisions

How did you evaluate the infrastructure?
(Percentage of answers)

Aspects		Negative or very negative	Neutral	Positive or very positive
Land transport	Cost	35.1	33.8	28.1
	Quality	26.7	39.3	33.9
Air transport	Cost	33.3	51.0	15.7
	Quality	11.7	58.8	29.4
Energy	Cost	29.8	43.9	26.3
	Quality	10.7	44.6	44.6
Telecom	Cost	22.8	43.9	33.3
	Quality	15.7	33.3	50.9
Ports	Cost	21.4	46.4	32.1
	Quality	21.4	35.7	42.9

3. Subcontracting

Subcontracting to Colombian suppliers is widespread and responds to foreign companies' requirements. According to the survey, 75 per cent of the companies have subcontracted part of their activities and 93.3 per cent confirmed satisfactory results.

4. Policy aspects

More than 35 per cent of the companies ranked negatively most of the macroeconomic factors included in the survey. Among the factors considered most favourable were economic growth (35 per cent) followed by local consumers' purchasing power (21.3 per cent). The analysis of the impact of labour factors on FDI in different economic sectors shows that foreign investors evaluated positively the labour policy reforms completed in 2002.

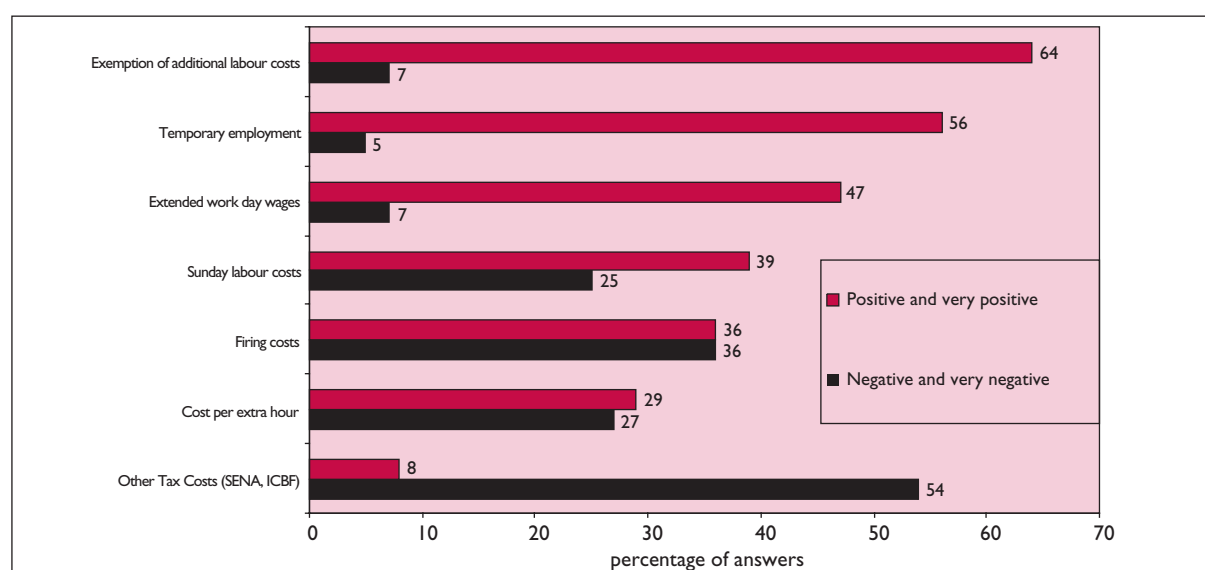
Table A.4. Macroeconomic factors

How does the company evaluate the following factors?
(Percentage of answers)

Factors	Negative – very negative	Neutral	Positive – very positive
Exchange rate volatility	82	18	0
Interest rate volatility	58	42	0
Inflation rate volatility	62	30	8
Public finances imbalances	73	23	3
Fiscal instability	95	3	2
Economic growth	50	15	35
Consumer purchase power	49	30	21
Size and access to domestic capital markets	26	53	21

Figure A.2. Labour factors (including labour reform 2002)

How does the company evaluate the following factors?

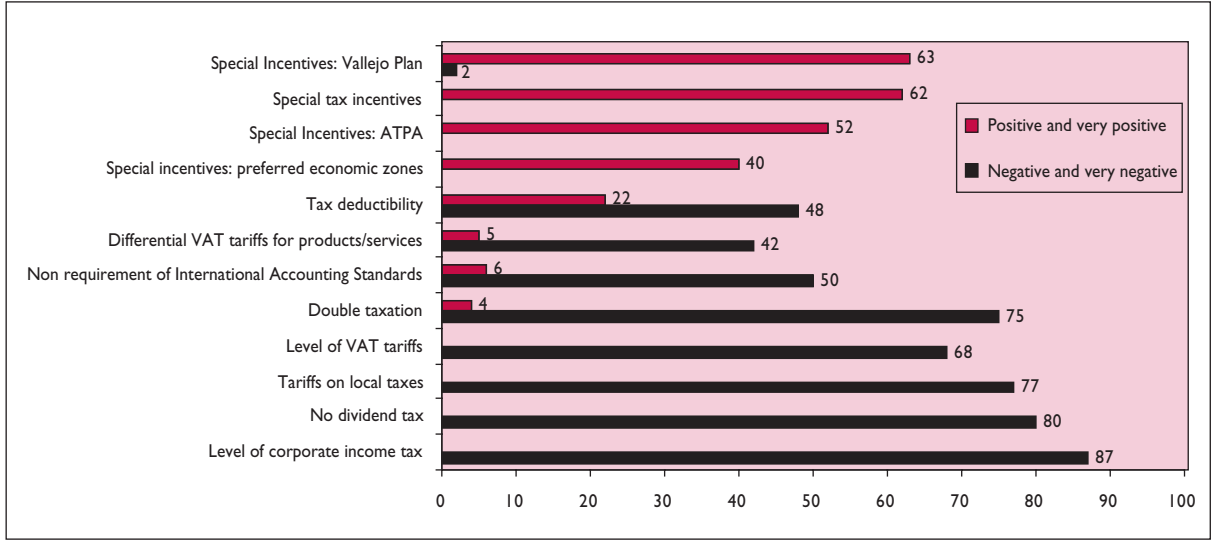


5. Taxation issues

Policymakers have often stated that taxation rates in Colombia are not high in comparison with international rates, the survey, however, shows that several fiscal issues are perceived as very negative by foreign companies.

Figure A.3. Taxation issues

How does the company evaluate the following factors?



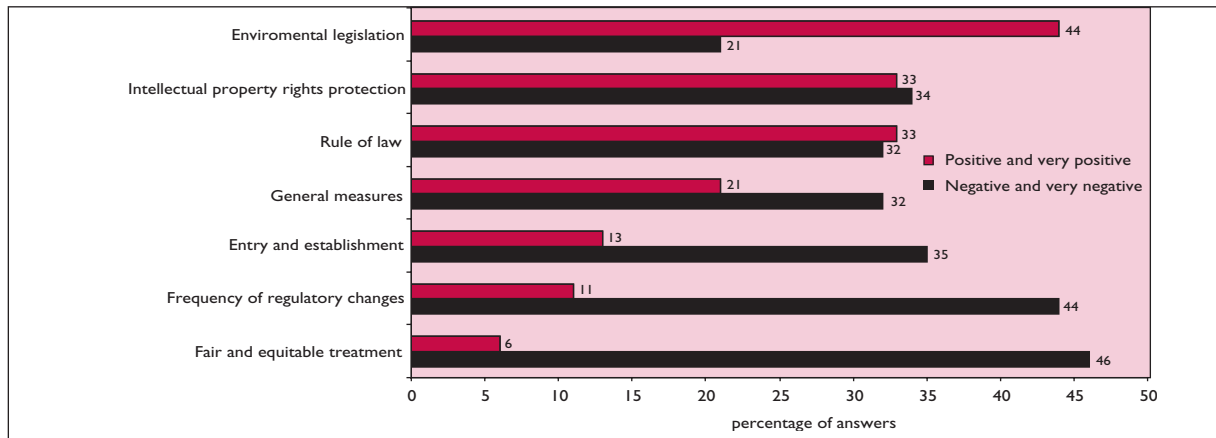
6. Legal issues

At least 50 per cent of the companies considered aspects of the legal framework negatively. Discriminatory treatment of foreign companies is observed by 46 per cent. Forty-four per cent believe that the absence of transition periods is extremely detrimental when regulatory changes occur.

Among positively evaluated legal aspects, environmental regulations stand out (positive or very positive by 44 per cent of companies). The pharmaceutical sector considered that there is lack of protection to intellectual property rights and real estate property rights (67 and 50 per cent of the companies described them like very negative or negative).

Figure A.4. Legal issues

How does the company evaluate the following factors?



7. Establishment procedures

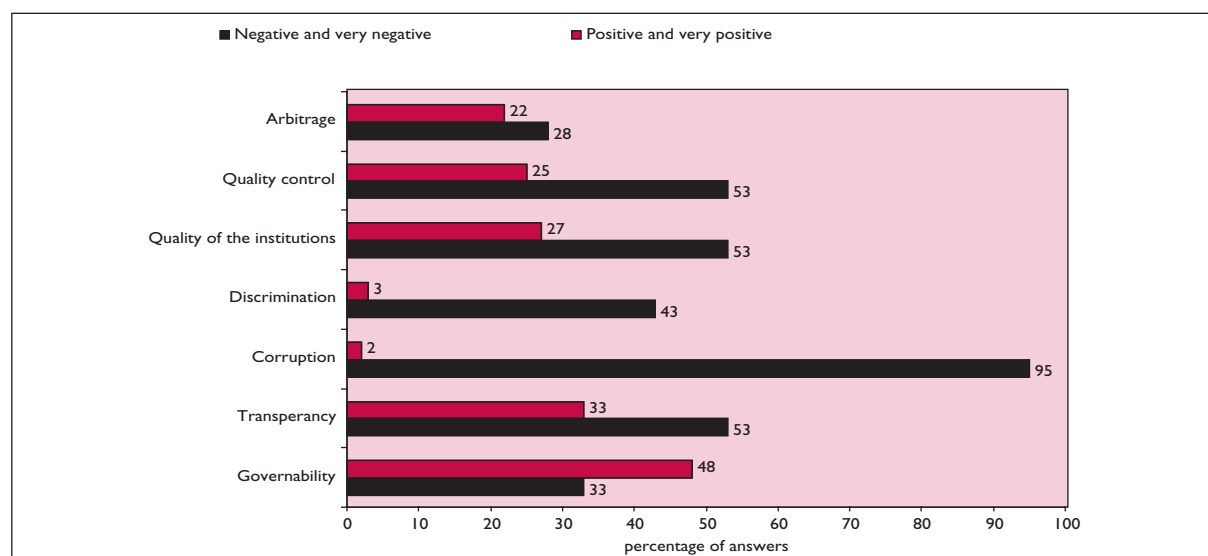
According to survey results, establishment procedures are not perceived as negative. None of the foreign investment procedures included in the survey was described as unfavourable by more than 50 per cent of the companies.

8. Institutional issues

All institutional issues included in the survey were evaluated negatively by more than 50 per cent of the companies.

Figure A.5. Institutional issues

How does the company evaluate the following factors?



9. Future prospects

Using Colombia as an export platform was considered crucial or very important by 25 per cent of the companies surveyed. Survey results confirm that the main regional agreement ranked as important by foreign companies is the Andean Community (49 per cent of the companies have used it), followed by the Group of Three (36 per cent) and the Bilateral Agreement with Chile (31 per cent). It is noteworthy that the preferences granted by the United States under the ATPA/ATPDEA and by the European Union are not frequently used (only 20 per cent of the companies have used it). However, for companies benefiting from these programmes, the preferential treatment is essential.

When the Free Trade for America Agreement would be concluded, 38 per cent of the companies considered that Mexico would be the main competitor for Colombia in attracting FDI, followed by MERCOSUR (38 per cent) and Chile (17 per cent). Eighty-nine per cent of the companies considered positive the prospect of a Bilateral Trade Agreement with the United States. Sectors considered most attractive for FDI were manufacturing (64 per cent of the companies ranked it first or second), management and financial services (37 per cent) and information technology (33 per cent).

Figure A.6. Investment plans

How does your company evaluate the following aspects for future investment in Colombia?

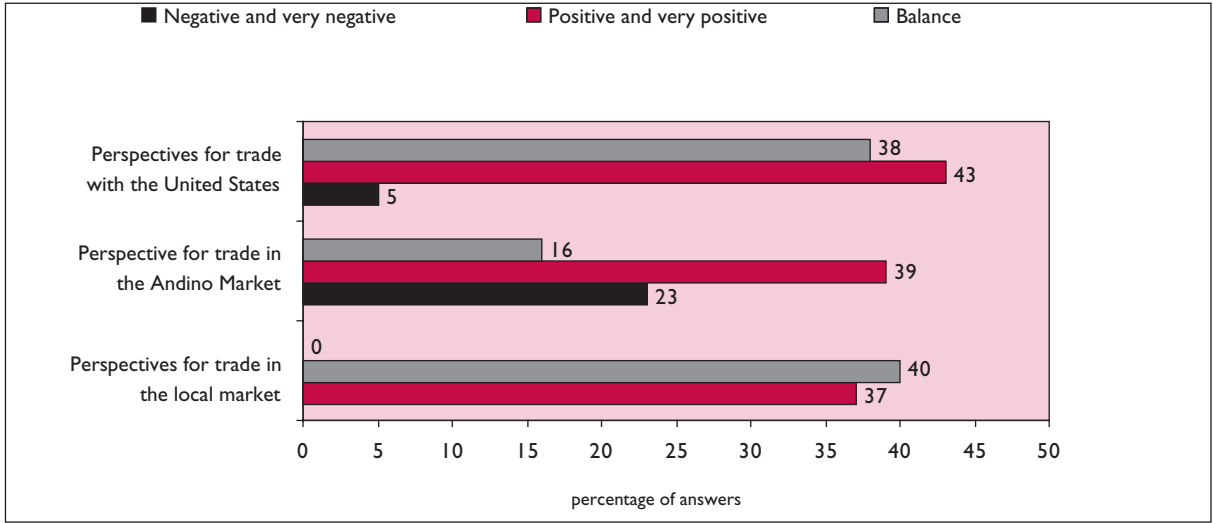
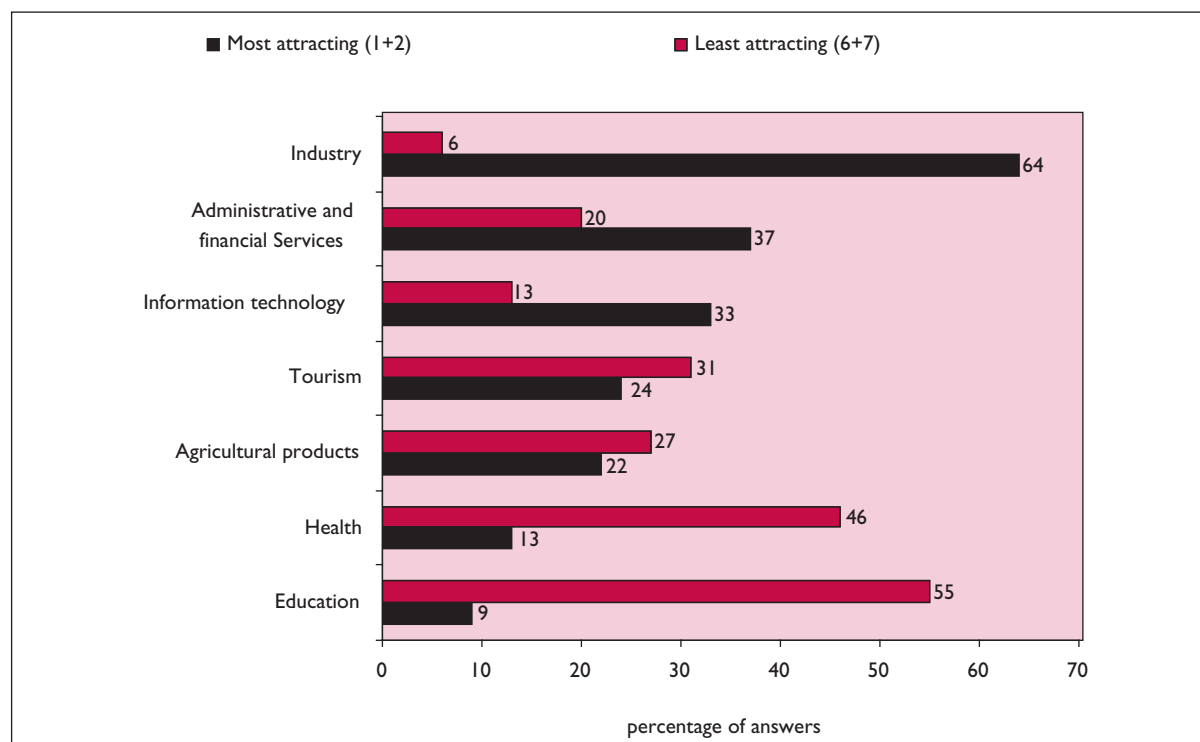


Figure A.7. Colombia's attractiveness in comparison to regional competitors

According to Colombia's potential to attract FDI relative to other competitors in Latin America, please rank the following sectors



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