Chapter 1

The Role of Foreign Direct Investment in Colombia's Economic Development

Colombia's efforts towards political stabilisation and sound macroeconomic policy have enabled the country to boost its economic development and enhance its investment climate. As a result, foreign direct investment (FDI) inflows have increased rapidly, also benefiting from the commodity price boom. After a temporary decline in 2009-10 due to the world economic crisis, Colombia's FDI inflows are expected to reach a record level in 2011. The surge in Colombia's FDI outflows reflects a more general trend shared with other Latin American countries, which have become an important source of FDI abroad, notably within the region.

Privatisation, which is open without any limitations to foreign investors, has led to a significant increase in the weight of the private sector, which today accounts for 85% of GDP. According to the National Development Plan for 2010-14, FDI annual inflows are forecast to exceed USD 13 billion in 2014. However, rather than simply increasing the amount of FDI, the government's objective is to enhance the qualitative role of FDI in the country's development, notably its contribution to job creation and infrastructure improvement.

Recent FDI developments

Colombia's efforts towards political stabilisation, improved domestic security and sound macroeconomic policies have enabled the country to boost economic growth in recent years, with a peak achieved in 2006-07, when real GDP grew on average by more than 7% annually. In relative terms, GDP per capita growth has, however, remained lower than in most Latin American economies (OECD, 2010). The repercussions of the world economic crisis temporarily interrupted the country's growth in 2008-09, but with an increase of 4.3% of GDP in 2010, Colombia came back on the upward track, driven to a large extent by commodity sectors. Based on economic performance in the first half of the year, real GDP is expected to grow by 4.9% in 2011 (IMF, 2011).

The high level of insecurity due, *inter alia*, to armed conflict and terrorism linked to drug traffic, and lack of political stability strongly affected in the past the perception of Colombia by foreign investors, who were reluctant to assume substantial and long-term involvement in the country. Annual foreign direct investment (FDI) inflows therefore remained modest until 2004 (below USD 3 billion annually). They started increasing in 2005 to reach record levels in 2008 (USD 10.6 billion), also benefiting from the commodity price boom. In line with world investment trends, Colombia's annual inflows declined considerably in 2009 (–33%) and slightly in 2010 (–3%). Nevertheless, with almost USD 7 billion of FDI inflows, Colombia was the fourth largest FDI beneficiary in Latin America in 2010 (ECLAC, 2011). Portfolio investment contracted in 2008, but both inflows and outflows have increased since (see Table 1.1 and Figure 1.1).

The expected upturn in international FDI flows in 2011 and, more importantly, the positive investor outlook regarding Colombia's political and economic development and its business climate are expected to attract large amounts of FDI in 2011. According to the preliminary data of the first half of the year, Colombia's inward FDI might exceed in 2011 the 2008 record level.

In mid-2011, Colombia's inward FDI stock amounted to almost USD 85 billion, an increase of 9% compared to the end of the previous year. Recent growth of FDI outflows has resulted in a rapidly increasing outward FDI stock, which reached USD 25 billion in mid-2011.

Table 1.1. **Colombia's international investment**

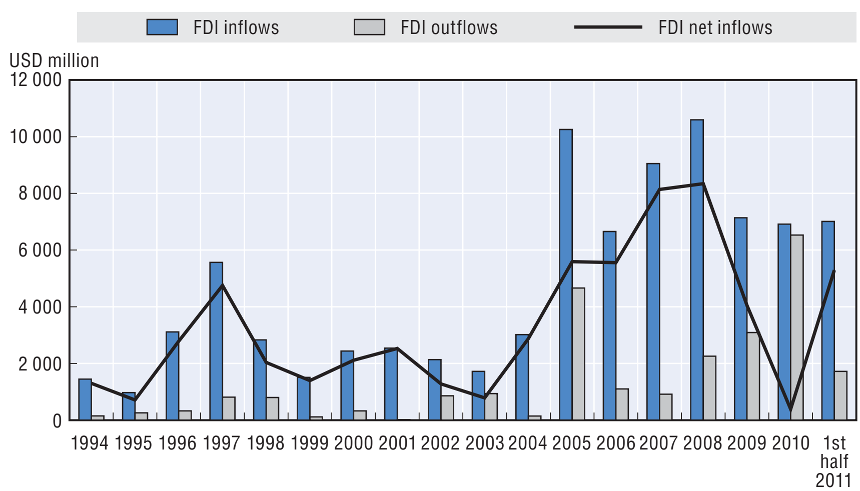
Million USD

	2005	2006	2007	2008	2009	2010	2011 (6 months)
Direct investment inflows	10 252	6 656	9 049	10 596	7 137	6 915	7 008
Portfolio inflows	–53	902	1 884	–1 195	4 668	3 263	2 419*
Direct investment outflows	4 662	1 098	913	2 254	3 088	6 529	1 718
Portfolio outflows	1 689	3 333	993	–188	2 802	1 768	1 529*
FDI stock							
Inward	37 526	44 182	53 230	63 827	70 964	77 879	84 887
Outward	9 394	10 493	11 405	13 659	16 748	23 276	24 994
Memorandum items							
Inward flows as % of gross fixed capital formation	36	19	19	19	13	11	n.a.
Inward stock as % of GDP	26	27	26	26	30	27	n.a.

* 1st quarter 2011.

Source: Central Bank of Colombia, *IMF Balance of Payments Statistics*.

Figure 1.1. **FDI flows in and from Colombia (1994-mid-2011)**

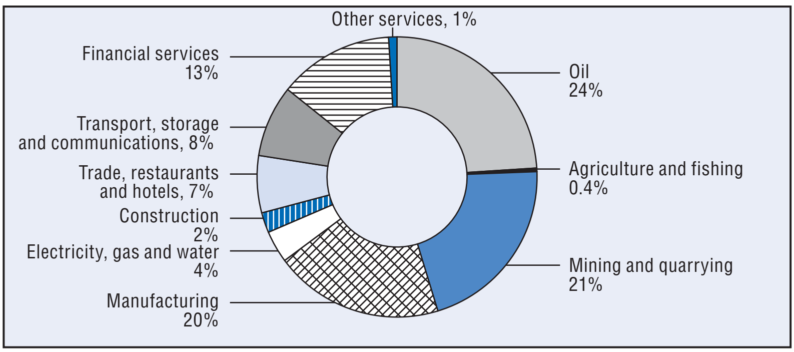


Source: Central Bank of Colombia.

The United States is the most important investor in Colombia, representing 23% of the total FDI stock, followed by Panama (12%) and Spain (11%) (see Annex A). Since 2005, the oil and natural gas and mining and quarrying sectors have attracted most of new investment, increasing their share to respectively 24% and 21% of the FDI inward stock in 2011 (see Figure 1.2), whereas the part of manufacturing and financial services has diminished (from 39% in 2005 to 33% in mid-2011). In general, annual sectoral inflows are subject to wide fluctuations depending on the conclusion of large deals, such as in manufacturing in 2005, transport and communications in 2005-06 and the financial sector in 2007-08.

During recent years, Colombia's FDI stock has corresponded to some 27% of GDP, and annual inflows have represented between 36% (in 2005) and 11% (in 2010) of the country's gross fixed capital formation (see Table 1.1). In terms of its FDI stock, Colombia is the third major destination for FDI in South America behind Brazil and Chile. With USD 1 811 of FDI stock per capita, Colombia also ranks among the major beneficiaries of FDI in this region after Chile (USD 8 160), Mexico (USD 2 878) and Brazil (USD 2 478).

Figure 1.2. **Colombia's inward FDI position by main sectors (mid-2011)**



Source: Central Bank of Colombia.

The rapid growth of Colombia's outward investment flows in recent years reflects a more general trend shared with other Latin American and Caribbean countries, which, as a region, have become an important source of FDI. The part of the region in developing countries' investment flows increased from 6% in 2000 to 17% in 2010. With a share of 2.3% of GDP, Colombia's outward FDI flows are the second highest in the region after Chile's (4.6%) (ECLAC, 2011). These developments correspond to the growing internationalisation of Latin American firms, especially in basic industries (hydrocarbons, mining, iron and steel), mass consumption goods (food and beverages) and some services (energy, telecommunications). The United States is the first destination of Colombia's outward investment.

Although oil, mining and quarrying still dominate the country's FDI outward stock (34%), the share of other sectors such as manufacturing (25%), financial services (14%) and electricity (12%) have also been increasing. Most Colombian outward investment goes to other Latin American countries, participating in the emergence of the so-called "translatinas", *i.e.* Latin American multinational enterprises. Colombian major outward investors include: Interconexion Electrica (ISA) and Empresas Públicas de Medellín (EPM) in the electricity sector, Grupo Bancolombia in financial services, Grupo Nutresa in food production and Avianca in airlines (Poveda Garcés, 2011). The Colombian authorities consider that recent developments attest of growing economic vigour and maturity of large domestic firms with a positive impact on the country's exports and employment.

According to the National Development Plan (see Box 1.1), FDI is expected to continue to play an important role in the country's future economic development with annual inflows forecast to exceed USD 13 billion in 2014. However, the government's objective is not simply to increase FDI levels but to enhance the qualitative role of FDI in the country's development, notably its contribution to job creation, especially in the service sector, and to the improvement of infrastructure.

Box 1.1. **Private investment targets in Colombia's National Development Plan 2010-14**

Colombia's 4-year National Development Plan (NDP) 2010-14 ("Prosperity for All") has been developed by the government in close co-operation with state agencies, local authorities and civil society. Based on the evaluation of the country's priorities and needs, including at the regional level, it identifies the objectives in different relevant areas and sets up the means to achieve them. The NDP estimates total investment needs at USD 317 billion, of which private investment should represent 40%.

Public investment will be channelled above all to the health and education sectors, as well as innovation, for which a specific fund will be created. In contrast, the coal and oil industries' needs should be covered mainly by foreign investment. The NDP also quantifies the investment targets in other sectors, such as mining (USD 49 billion), housing construction (USD 18 billion) and transport infrastructure (USD 8.5 billion).

Source: Colombia, Ministry of Trade, Industry and Tourism; Reuters (2011); *The Economist* (2011).

Foreign investor participation in privatisation programmes

The principle of equal treatment of investors, irrespective of their nationality, applies to privatisation. Under Colombian law, there are no restrictions or limitations to the participation of foreign capital in the sale of shares of State-owned enterprises. The 1999 Privatisation Law regulates the sale of shares and state participation in companies' capital and establishes that any individual or legal person can acquire shares sold by the State, without distinction based on the nationality of investors. The Law also provides that the sale of State-owned shares should be subject to large publicity and effective competition. According to Colombia's Political Constitution of 1991 (hereafter, *the Constitution*), special treatment is granted to workers of State-owned enterprises: the shares should be first proposed to them under preferential financial conditions[1] (see Chapter 2).

According to the 1999 Privatisation Law, the shares of State-owned enterprises to be privatised can be ordinary, preferential or non-voting preferential. The State does not enjoy or plan to reserve any particular rights, such as "golden shares" with the power of veto, or allowing it to impose decisions contrary to the majority of shareholders. Colombia does not apply any restrictions on the acquisition and sale of the shares of former State-owned enterprises or issued by them either in the primary or the secondary market.

The most important privatisation deals realised in the period 2005-10 include:

- Oil: *Ecopetrol*, the formerly State-owned company is now a publicly traded firm; in 2007, 10% of the State-owned stock was proposed in a highly successful public offering, followed by a second round which ended in August 2011. As a result, 20% of the company is currently privately-owned.
- Gas: the State-owned company *Ecogas* was sold in 2007.
- Power generation: more than 19% of the State-owned stock of *Isagen*, a power generation company, was sold in a successful public offering in 2007.
- Power distribution: following the sale of the State shares in 2003 in local distribution companies in the departments of Caldas and Quindío, the State sold power distribution companies located in the departments of Cundinamarca, Santander and North of Santander in 2009.
- Telecommunications: State-owned *Telecom* was liquidated and *Colombia Telecomunicaciones* created, with a private firm as controlling shareholder in 2003; the State-owned post company *Adpostal* was dismantled in 2005; further privatisation in the sector is planned.

As a result of the privatisation process, the weight of the private sector has increased to represent 85% of Colombia's GDP (see Annex A). Privatisation and significant foreign investment in recent years have also changed considerably the profile of Colombia's financial sector: it consists in majority of private banks (22 out of 23) of which 9 are foreign-owned. Foreign-owned banks represented in May 2011 almost 20% of the country's total bank assets and 19% of total deposits (see Annex A).

Note

1. Constitution, Article 60: "The State will promote access to property in accordance with the law. When the State sells its interest in an enterprise, it will take measures to promote the democratization of the ownership of its shares and will offer its workers and the workers' organizations special terms to make it possible for them to accede to the said proprietary shares…"

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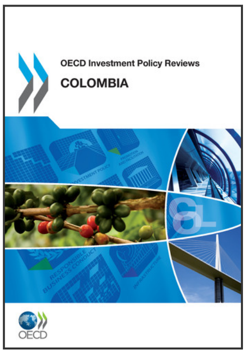

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