EVOLUTION OF FOREIGN DIRECT INVESTMENT IN COLOMBIA AND WHY IS COLOMBIA BECOMING AN IMPORTANT DESTINATION OF FOREIGN DIRECT INVESTMENT.

A Capstone

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EXECUTIVE SUMMARY

This paper aims to analyze the main elements that over the past decade have converted Colombia into a desired destination of foreign direct investment. To do so, the concept of foreign direct investment, or FDI will be revised and studied, reviewing the definitions provided by the International Monetary Fund, the United Nation’s Trade and Development Division, and the World Trade Organization. This way the benefits, opportunities and other aspects related to the concept will be exposed and then its role in emerging markets such as Colombia will be clearly evidenced.

The first chapter analyzes different types of foreign investment; direct and equity, emphasizing on the different types of foreign direct investment, or FDI. Afterwards, a bibliographical revision will take place in order to approach and try to answer the following questions:

Why is FDI important? What are the decisive elements that contribute to attract FDI flows? What is the relation between competitiveness, FDI, and development?

So, after developing an approach to the previous issues, the third chapter of this document will focus on the analysis of the Colombian case. To do so, the following systematic revisions will be posed; background description (1990-2001), exposition of reforms and institutional changes, FDI evolution in Colombia (1990-2010), categorization into wide sectors receiving FDI in Colombia in recent years, and a comparative analysis against other economies. Finally, a series of conclusions and recommendations will be offered regarding this paper’s main concerning issue: Why has Colombia evolved into an important destination of Foreign Direct Investment? Also, the reader will have a final briefing related to the actual state of FDI in the country, as well as perspectives on how the flows are expected to behave in the foreseeable future.

In general terms, most of the companies investing in Colombia have been very successful in terms of the accomplishment of the objectives traced. The country, as this paper will try to show, counts with very appealing characteristics that make it a very attractive country for international investors. As a general feature, the Colombian economy is one of the few that
has defended itself against the international financial crisis. This aspect is highly regarded by investors who look for economical stability, as well as maintained GDP growth rates as a signal of a healthy economy. This paper will evidence how the different benefits offered by the Colombian government, as well as an ideal environment oriented towards business and private development has actually become a decisive factor towards the attraction of FDI flows, which eventually turn out to generate jobs, and improve many aspects of the local economy, while the foreign corporations make a profit too.
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PURPOSES

General Purpose

The general purpose this paper is trying to reach is to evidence what foreign investment is, what are the main advantages and benefits of receiving it, and to determine why has Colombia evolved and converted into a preferred destination for international investors.

Specific Purposes

The purposes this paper tries to approach are the following:

1. Firstly, explain what Foreign Investment is.
2. Know the diverse conceptualizations of Foreign Direct Investment, according to relevant international organizations.
3. How is Foreign Investment Classified.
4. What types of Foreign Investment exist.
5. Why is FDI important, specifically for Colombia.
6. Examine FDI flows received by Colombia from 1990 to 2010.
7. Determine how did FDI benefit the main economical sectors in Colombia.
8. Evidence the most important reasons why Colombia became one of the most important FDI destinations in the region.
9. Expose the advantages associated with investing in Colombia.
GLOSSARY

**Balance of Payments:** An accounting record of all transactions made by a country over a certain time period, comparing the amount of foreign currency taken in to the amount of domestic currency paid out.¹

**Equity Investment:** Money that is invested in a firm by its owner(s) or holder(s) of common stock (ordinary shares) but which is not returned in the normal course of the business. Investors recover it only when they sell their shareholdings to other investors, or when the assets of the firm are liquidated and proceeds distributed among them after satisfying the firm's obligations.²

**Foreign Currency:** The currency (i.e. money) of another country. A foreign currency account is a bank account in the currency of another country (e.g. a dollar account in Colombia).³

**Foreign Direct Investment (FDI):** A component of a country's national financial accounts. Foreign direct investment is investment of foreign assets into domestic structures, equipment, and organizations. It does not include foreign investment into the stock markets.⁴

**Investment:** The act by which goods are acquired with the purpose of perceiving an economical benefit or profit throughout a period of time.⁵

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⁴ [http://economics.about.com/cs/economicsglossary/g/fdi.htm](http://economics.about.com/cs/economicsglossary/g/fdi.htm), June 18th 2011.
INTRODUCTION

In today’s economy, most countries offer economic incentives to international companies or multinationals in an effort to persuade them to invest in that nation, and establish their commercial operations or industrial production there. These stimuli come in different types, and are classified in a wide range, from private property protection to economic support, tax rebates, and inexpensive labor costs.

In that sense, Foreign Direct Investment, or FDI, implies a strong influence in a nation’s economy, and that way the foreign investor has certain power over a country’s policy and policy makers. Often, a country’s regulations may be shaped according to what international corporations may be looking for, in a way that benefits both the private investor and the public sector in such country.

The nature and origin of such investments comes from mutual benefits obtained by both the investors and the receptor of FDI flows. The investor increments the productive efficiency of his business through a reduction in the costs associated to its economic practice, and also permits the usage of its assets in foreign markets, diversifying the natural risk inherent to its business. On the other hand, the country that receives such flows has an increase in employment rates, its economy is boosted and that way the economy becomes more dynamic, productive, competitive, and experiences a knowledge and technological exchange that by the way generates a positive environment for other businesses to develop.

This paper aims to analyze the elements that concurred to convert Colombia in a major destination of FDI flows. It is justified by the necessity of identifying such variables attracting investment capital, to design policies and strategies oriented to improve the standards hereby identified, and that way more foreign investment flows may be interested in Colombia.
1. DEFINITION AND CONCEPTUALIZATION OF FOREIGN INVESTMENT

1.1 Definition of Foreign Investment

Foreign investment may be defined as “the allocation of long term capital in a foreign country, for the creation of agricultural, industrial or commercial businesses, with the purpose of internationalizing their model”\(^6\) These type of foreign investment may be analyzed from a double standard, first, from a micro economical point of view in which companies generate migration, and technological transfer. Second, from a macro economical viewpoint, aspects such as balance of payments as well as national economical politics, in relation to monetary and exchange strategies.

Foreign investment allows the exchange of goods in between different markets; it permits a close approach between the international investor, who has an excess of capital, and the country that lacks those resources. As an example, foreign investment is absolutely necessary in a country like Colombia, where it is a vehicle to implement technologies that allow the operation mechanisms that create environments where businesses can develop, and the nation’s economy can grow and generate workplaces.

Finally, it is important to highlight the fact that every country establishes its own legislation and regulatory schemes autonomously. Those laws are designed according to the country’s necessities and long-term strategies; this means that countries in need for foreign investment would have legislations favoring international capital, rather than national resources. On the other hand, industrialized countries that do not seek massive capital inflows would tend to establish restrictive legislation and tax schemes that are not internationally oriented, and rather prefer protecting the national industrial tissue.

As for the Latin American area, and especially Colombia, policy has been oriented towards attracting and actually receiving FDI inflows, adjusting and restructuring their economical structure in order to perceive more foreign capital and improve competitiveness. Thus,

Latin American countries have received up to 50% of FDI worldwide, being first world nations such as the US, the biggest investors. This process is also known as zone openness.

**Table 1: LATIN AMERICA: FDI INFLOWS BY COUNTRY, 2000-2010 (USD Millions, percentage)**

Source: CEPAL, on the basis of estimates and official figures until April 15, 2011

As it is well known, the United States is still the main investor in the region, responsible for up to 17% of all FDI flows received during 2010. Second in the order is the Netherlands, with 13%, then China, accounting 9%, and finally Canada and Spain, both with 4%.
1.2 INVESTMENT TYPES

Due to its nature, foreign investment may be classified into direct and equity. Next, a brief definition will be provided, in order to deepen on foreign direct investment, which is the main focus area of this paper.

Direct investment, as its name tells, is the type that comes from a foreign country; it may come from a person or company, and has long-term objectives, looking to extract an economical profit from it.

On the other hand, equity investment, it is generally understood as the kind of capital investment realized through the stock market, and materialized by the purchase of bonds, stocks and other titles. Evidently, the target is to make a profit on short and mid-term. This sort of capital does not stay in the country of destination for a long time; rather, it is retrieved after the main goal has been reached.

Finally, a comparative table is presented that contrasts direct and equity investment.

Table 2: COMPARISION BETWEEN DIRECT AND EQUITY INVESTMENT.

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Direct Investment</th>
<th>Equity Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Duration</td>
<td>Long term.</td>
<td>Short, Mid-term.</td>
</tr>
<tr>
<td>Investment type</td>
<td>Direct, through the actual entry of capital to the receptor country.</td>
<td>Through the stock market.</td>
</tr>
<tr>
<td>Kind of Investment</td>
<td>Formal and rigid.</td>
<td>Informal and flexible.</td>
</tr>
</tbody>
</table>
1.2.1 Direct (FDI)

Direct investment may be divided into four main categories, in function of the characteristics associated to it. These are:

1. Risk-sharing Alliance
2. Acquisition of existing companies
3. Enterprise creation
4. Franchising

Risk-sharing alliances are contractual agreements designed to share the control of a business by both the foreign and national partners, in such a way that the natural risk associated with running the company is evenly distributed. By sharing control, an interesting exchange of knowledge, skills, and technology is generated and as a result, the company is benefited by becoming more efficient, competitive and therefore solidifies its position against competitors out in the international market.

A different process takes place when multinationals or foreign investors acquire national companies. This is one of the most common ways of investment because it gives the investor a great economical advantage in the sense that promotional, branding, distribution and other costs may be significantly less than those associated to the creation of a new company from scratch.

In that particular case, known as green field, because of the way the investment is done, from the purchasing of a vacant lot, foreign capital flows are directed specifically to that purpose; the creation of a brand new enterprise. The main advantage this process offers is that it lets the investor optimally take advantage of the productive process when establishing from the beginning the standards and operational methodology of the company.

Finally, in relation to franchising, international investors sell to local companies the right to exploit their brand, knowledge, technology, etc. One of the most important advantages for the international investor is that without needing a large amount of money, and without
having much risk, he can actually penetrate a foreign market and develop his brand construction there. On the other side of the deal, the local manager can have access to an optimal agreement, as he can enter the market using a well-positioned brand, lowering the risk and also the marketing costs.

As it is evidently exposed, direct investment generates an improvement in a country’s productivity through the technological and knowledge increment derived from the actual exchange. In the following section, for a deeper and clearer understanding of the concept of direct investment, a series of different definitions posted by different international organizations are exposed.

1.3 IMF

According to the International Monetary Fund, “The term describes a category of international investment made by a resident entity in one economy (direct investor) with the objective of establishing a lasting interest in an enterprise resident in an economy other than that of the investor (direct investment enterprise). ”Lasting interest“ implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the direct investor on the management of the direct investment enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.” 7

It can be clearly identified that two elements are absolutely necessary for direct investment to exist. First, the resident international investor must be a fundamental part. Second, that the investment is stable and projected in the long term through a lasting interest.

1.3.1 United Nations Conference on Trade and Development (UNCTAD)

According to the United Nations Conference on Trade and Development, “FDI refers to an investment made to acquire lasting interest in enterprises operating outside of the economy

of the investor. Further, in cases of FDI, the investor’s purpose is to gain an effective voice in the management of the enterprise. The foreign entity or group of associated entities that makes the investment is termed the "direct investor".8

The necessity of a long-term investment (lasting interest) is indispensable if direct investment is to take place.

1.3.2 World trade organization (WTO)

The definition provided by the world trade organization (WTO) does not differ much from the ones exposed earlier, although it does point out interesting issues. According to the WTO, direct investment “occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset. The management dimension is what distinguishes FDI from portfolio investment in foreign stocks, bonds and other financial instruments. In most instances, both the investor and the asset it manages abroad are business firms. In such cases, the investor is typically referred to as the “parent firm” and the asset as the “affiliate “or “subsidiary””.9

The most interesting part of the WTO’s definition is that the way in which the asset is acquired would in fact determine if it falls into the category of direct or equity investment.

1.3.3 World Bank

According to the World Bank “Foreign investment means acquiring long term interests in a business that operates in a different country from that of the investor. The purpose of the investor is to have a voice participating in the management of such Enterprise”10

Thus, for the World Bank, the duration of the investment would determine the classification between direct and equity investment.


10 http://www.miga.org/screens/about/convent/comment.htm, June 18th 2011.
1.3.4 Definition of foreign investment according to Colombian legislation

In the Colombian case, legislation defines foreign investment. In that sense, the decree number 2080 of 2010 breaks the concept into different categories, whether direct or equity investments.

Article 3 establishes in its first paragraph that the following will be labeled as foreign investments:

“i) The acquisition of participations, stocks, social quotas, representative capital contributions or bonds mandatorily convertible to stocks.

ii) The acquisition of autonomous equity rights constituted through commercial trust contracts as a way to develop an enterprise.

iii) The acquisition of estate, as well as participation titles emitted as a result of an estate securitization process of estate or construction projects or through estate funds according to the pertinent legal regulation, whether through a public or private offer.

iv) The contributions realized by the investor through contracts such as collaboration, concession, administration services, license, or those implying technological transfers, when that doesn’t represent a participation in a society or the rents generated by the investment.”

In a direct form, the decree establishes that foreign direct investment will be the term that describes long-term investments, regardless if they are made through the stock market. The law states that acquisitions must be representative, which under the current worldwide conditions, is synonym of a long term commitment.

The second paragraph describes equity investment as being all “stock, convertible bonds, and other titles subscribed under the national title registry, according to the established on

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title III, chapter III of this decree."\textsuperscript{12} Therefore, a representative purchase is not necessary, or specifically required by law, which may be understood as a short-term commitment, common, as we have seen, in the equity investment model.

\textsuperscript{12} IBID
2. BENEFITS OF DIRECT INVESTMENT FOR A COUNTRY

2.1 IMPORTANCE OF FDI FOR THE INVESTOR

As it was introduced earlier, both the investor and the receptor of the capital flows obtain a series of advantages when the deal is made. Here, a set of examples will be named and explained.

**Conquering new markets:** Companies and international investment groups have understood the need to open new markets in order to increase the production volume and take advantage of scale production, and the lower costs associated to it. In that sense, enterprises usually undergo a process in which at a certain point, their growth rate suddenly decreases, and then the need to reach new markets and conquer new sources of income becomes a pressing issue. As a natural response, most companies are motivated to go abroad and analyze the possibility of entering international markets, securing a larger market, reducing fixed costs, and in the long run, surviving while keeping the company profitable.

Also, when conquering a new market, the company experiences a process of accumulation of new knowledge and skills, oriented towards the implementation of international processes, which by the way improves its competitiveness in its market of origin, as well as globally, leading to an increment in market participation, both locally and internationally.  

**Significant reduction of production costs:** Today, companies around the world are constantly looking for locations where operational costs may be reduced, whether through a lower cost in supplies or cheaper labor costs. This way, one of the main goals that countries searching for FDI have in common is an important reduction in fiscal and social security expenses, in an effort to lighten the payload and turn themselves more appealing to multinational corporations.

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However, the downside to this pro-business policy is that when trying to maintain wages low, social welfare may be seriously hurt, as well as national per capita income. Therefore, a national economy must aim at a balanced policy that is not counterproductive, having an adequate balance between social programs and business attracting strategies. This way, the economy should generate enough and varied aggregates to be able to attract and retain foreign investors and multinational corporations. 14

**Risk Diversification:** Every corporation’s goal is to generate a profit and add value to its equity. As a part of that central reason of being, companies try to diversify risk. In that fashion, when an international enterprise opens new markets, it diversifies its sources of income, and by doing so, it lowers the risk of an eventual drop in revenue due to a shock in its country of origin, or one of its traditional markets, relying on the recently opened ones to compensate for the eventual sales decrease.

It is clear that there are very powerful reasons to justify a foreign investment from a company’s point of view. In general, it presents itself as a fundamental condition for growth, consolidation, and further sustainability of an organization.

**2.2 BENEFITS OF FOREIGN DIRECT INVESTMENT FOR A COUNTRY**

Numerous studies have been carried out that deeply analyze the benefits of foreign direct investment in a country. Next, some of the main benefits will be exposed, going from financing, employment, knowledge, and technology, to improvement of life qualities within the local population.

**Financing:** FDI is an efficient instrument through which external financing may be accessible. This is especially true in nations where local savings are simply not enough to develop the projects being started locally. Investment is usually stable when directed to

long-term projects, and also, it is less volatile than the financial markets, which have recently disenchanted many actors worldwide.\textsuperscript{15}

**Growth and employment:** When international capital is injected to local businesses, or used to create new companies abroad, unemployment rates tend to go down. Stable, qualified, and log-term jobs are thereby created.

This important factor means a steady growth rate may be projected for the receiving country, and in most likeliness poverty will be reduced as a direct consequence of FDI. Also, other national companies improve their competitiveness indirectly. They too implement improvements in their internal processes, all in the atmosphere of steady, well-paid jobs.\textsuperscript{16}

**Technology and knowledge:** When FDI inflows enter a country, so does technology and knowledge, due to the fact that the investor performs improvements in terms of the way that different processes are carried through within the company’s varied ranges. In short, and middle term, those technological enhancements carried out by enterprises in a specific sector have the objective of maintaining and incrementing the competitive level and market participation through cost reductions and productive developments of a foreign company.\textsuperscript{17}

**Life quality improvement within the country:** Evidence suggests that foreign corporations tend to pay higher wages to their employees than national companies do. That way, national companies are forced to improve their hiring conditions in order to retain human talent. This competition for qualified labor implies a direct improvement in the country’s national per capita income, thus, reducing poverty and generally incrementing the standards of living in that particular country.\textsuperscript{18}

In summary, foreign direct investment implies a maintained economical growth, a decrease in unemployment rates through the generation of secure and quality jobs, besides the fact

\textsuperscript{15} De Lombaerde Phillipe. La inversión extranjera en Colombia: régimen jurídico y análisis económico. Fondo de publicaciones de la Universidad Sergio arboleda 2001.

\textsuperscript{16} IBID.

\textsuperscript{17} IBID.

\textsuperscript{18} Sistema económico Latinoamericano. Negociaciones Internacionales sobre inversión extranjera directa: Perspectivas de América Latina y el Caribe. 2004
that a dynamic flow of capital creates an environment favorable to business and therefore more likely to generate a larger gross domestic product.\textsuperscript{19}

\textbf{2.3 DECISIVE ELEMENTS THAT GENERATE FOREIGN DIRECT INVESTMENT.}

FDI has been widely studied due to the advantages it provides both for countries receiving it and for corporations that carry it out. Therefore, nations across the entire world have designed and executed policies and national strategies aiming towards attracting such important flows.

In that sense, two different schools of thought have emerged and may be clearly identified. The first considers that foreign investment is attracted due to intrinsic national characteristics that every country possesses. The second one contemplates national policies and strategies as crucial towards generating a more appealing environment for transnational corporations to arrive.\textsuperscript{20} In the following section, a wide variety of strategies to attract foreign investment will be exposed and studied.

Firstly, a brief introduction of the history of national policies designed to attract investment will be done. It used to be widely believed by governments around the world that foreign investment could seriously damage the national industrial tissue, and this erroneous belief made them wary of international capital. It meant that the policy was to stop or somehow limit the entry of investment.

A very clear example of the policy described above, may be evidenced through the “Acuerdo de Cartagena”, specifically Decision 24, adopted by the Andean Pact. The decision established that any foreign enterprise must be mandatorily controlled (in terms of

\textsuperscript{19} IBID.
stocks) by national owners, up to a maximum of ten years. Thus, imposing an absolute limitation to long-term foreign capital.

During the post-war decades, specifically the 50s and 60s, this school of thought was widely adopted. Economical structuralism adopted a system that awarded industrialization a special relevance, and considered it a fundamental requisite to improve national competitiveness, development opportunities and the improvement of life quality within the local population. In Latin America, this policy was known as industrialization through import substitution, or ISI, for its meaning in Spanish. The entire system was expressed by a variety of tariff acts intended to protect the national industry. At the same time, multiple exchange rates were implemented, depending on the type of goods or services, and in broader terms, a protectionist approach rejecting international corporations was the rule.

As it was previously mentioned, there are certain factors that attract foreign investment and they present themselves independently from the policy designed by the nation. As a way of example, the following two cases are exposed:

**Country Size:** A country with a large territory has a greater growth potential, as well as a wider access to natural resources. Therefore, it would be a more appealing site for foreign investors.

**Geographical Location:** This characteristic would determine the climatic, agricultural, mining, and logistical conditions favorable for the activities related to the sort of business the company does.

On the other hand, there are factors in which governments may influence the decision a multinational corporation makes. The main factors are:

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1. Educational level
2. Infrastructure
3. Policies referring capital inflows
4. Others

To have a better understanding of what those policies are, and which ones are actually being taken into account by nations, these policies will be divided into two main groups:

1. Structural or Institutional Policies
2. Incentives Policies

**Structural or Institutional Policies**

The structural or institutional policies that a country may develop, are the following, and will be later explained thoroughly.

1. **Improvement in the economic fundamentals**
2. **Infrastructural provisions**
3. **Working legal and regulatory frameworks**
4. **Educated labor force**

**Improving the economic fundamentals**: Investors look for stable economies, with low volatility, and good and strong economic performances. That makes the countries having those characteristics would ultimately become more appealing for international investors, and that means countries wanting those standards would try to establish policies that tend to the following:

1. Stable economic environment
2. Healthy public finances
3. Transparent exchange regime

**Infrastructure Provision**: An adequate infrastructure is fundamental to obtain a considerable volume of FDI flows. This is a classical example to show how countries with an excellent geographical location do not successfully attract investment. The contrary occurs in places like Singapore, where optimal infrastructure is a key element of foreign
direct investment attraction. In this precise aspect, an adequate system of airports, roads, railroads, etc., is a decisive factor of FDI attraction.

**Working legal and regulatory frameworks:** The necessity of a stable, dependable regulatory system, that guarantees property rights as well as judicial security, is fundamental to attract foreign investors.

It has been evidenced that those states with authoritarian regimes, where democracy is not the law, and the legal system is bended according to the regime’s necessities or impulse, receive significantly less FDI flows. It is quite clear that a foreign company will not take the risk of allocating its resources in a country where they may be nationalized, expropriated, or considerably diminished due to a sudden change in the rules, such a different tax code, mercantile or bureaucratic restraints that necessarily imply a loss, or profit reduction.  

**Educated Labor Force:** The level of education of the available workforce is a variable strongly associated with productivity. The direct relation establishes that the higher or better educated the human resources are, the greater the productivity in that territory would be. Not surprisingly, this phenomenon is carefully studied by multinational corporations looking for places to establish their operations overseas.

A certain line of thought in economics considers that labor costs are the fundamental factor in the process of attracting FDI. However, it has been shown that foreign enterprises need a mid-level educated workforce in order to efficiently realize certain activities requiring specific skills that are not easily learned. Finally, it is important to precise that this variable has not been thoroughly taken into account by governments looking to attract FDI flows.

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As it was previously shown, multinational corporations internationalize their resources and processes looking for further specialization, economies of scale and optimizing geographical concentration, being these possible through foreign direct investment, and thus establishing a win-win situation as it was described before.

To conclude, it could be said that the development of an adequate and stable environment is an efficient instrument that attracts foreign direct investment, as long as competitive advantages present themselves that make the entrance to the country attractive to a transnational corporation.

**Incentives Policies**

The incentives policies are classified into three main categories according to their nature, these are:

1. Fiscal Incentives
2. Financial Incentives
3. Promotion Policies

The first two policies represent expenses for the nation, as they suppose a cost in the country’s finances, or the perception of less income due to less tax recollection. The third type of incentive is considered neutral, as it is usually less expensive.

Next, the different types of incentives are described and analyzed:

**Fiscal incentives:** These are tributary privileges that are often given to companies that establish their operations as foreign direct investors. Such incentives come in a wide variety, but the most common ones are:

1. Income tax rates reduction.
2. Grace periods in tax duties.
3. Accelerated depreciation rates.
4. Exceptions in import or tariffs.
5. Deductions in social security contributions.
6. Special reduction in other taxes.

It is then evidenced that fiscal incentives such as the ones described earlier are determined to increment the profitability of foreign investments. However, the main concern associated to them is the so-called discrimination of national or local companies that do not receive the same benefits that foreigners do.

Financial Incentives: These are mainly subsidies or economical support granted by the nation when a company is created with foreign resources, the target is to create employment in a specific region. Several examples of financial incentives are listed below:

1. Donation of land.
2. Buildings, warehouses, headquarters given to foreign companies.
4. Credit lines, and credit guarantees.
5. Subsidies in wages.
6. Subsidies in public services such as water or electricity.
7. Infrastructural developments dedicated to specific projects.

Promotion Policies: Such policies are aimed at boosting the entrance of foreign capitals, the most common ones are:

1. Diffusion of investment opportunities.
2. Giving information to possible investors.
3. International tours promoting such opportunities.

Most economies looking to attract FDI flows usually combine different strategies to secure their objectives efficiently. As an example, the establishment of SEZ, or Special Economic Zones has been a successful strategy. In such zones, oriented towards exportations, fiscal and financial privileges are granted to investors. In the Colombian case, it is important to point out to “Zonas Francas” around the country, which have given very good results throughout the years, and have boosted the entrance of foreign capital into the country.
In general terms, it is evidenced that a huge competition is presented between countries to perceive as much foreign capital flows as they can, carrying out diverse strategies oriented to outweigh other competing nations, motivated by benefits such as:

1. Technological transfer.
2. Employment.
3. Capital flows.
4. Improvement of competitiveness.

In relation to the importance of establishing strategies to perceive FDI is convenient to quote Etienne B. Yehoue:

“In order to attract foreign investment, many developing countries have enacted significant policy reforms. They went through what are known as the first and second generations of investment promotion policies. In the first generation of investment promotion policies, many countries adopted market-friendly policies. They liberalized their FDI regimes by reducing barriers to inward FDI, strengthening standards of treatment for foreign investors, and giving a greater role to market forces in resource allocation. Virtually all countries have taken steps in this direction to varying degrees. In the second generation of policies, governments went a step further by marketing their countries. This approach led to the setting up of a number of national investment promotion agencies. The World Association of Investment Promotion Agencies, established in 1995, now has more than 100 members.”

Also, Gulhati and Nallari express themselves in terms of these incentives:

“The main justification to offer additional fiscal and financial incentives to foreign companies is that this somehow covers the gap between private and social benefits of their investments. Beyond the distortions created by this type of incentives and its following pernicious effects on domestic investment, it is considered that this type of policies may create an environment for an unexpected competition between governments to offer the best incentives. In the long run, this competition may have a negative effect over the receiving

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economies, due to the costs they would have to incur in to attract a certain amount of FDI. Hence, it is considered that it is possible that this policy drives to an undesirable equilibrium in which all countries interested in attracting FDI offer generous incentives for investors and where the anticipated benefits of FDI are diluted as a result of growing incentive costs.”

This way, the best strategy to attract FDI is to improve a country’s economical competitiveness, improving FDI as well as domestic investment, being therefore policies that in the long-term would offer the best results for the nation. However, for developing countries or emerging markets, the improvement in competitiveness is practically impossible, and thus, the need to adopt policies like the ones previously described becomes bigger, at least in the meantime, while it perceives an increase in FDI, technological exchange, and gradual improvement of their environmental conditions mentioned earlier.

2.4 RELATIONSHIP BETWEEN FDI AND DEVELOPMENT

Numerous studies have evidenced the relation between foreign direct investment and development is not quite clear. In fact, they have often been found contradictory. Some authors suggest they have demonstrated that FDI stimulates economical growth in receptor countries, while other economists show no effect in that same case in point.

For years, it has been generally believed that if emerging markets benefit from allocating scarce resources into the attraction of FDI, this strategy would in long-term increment the productivity and effectiveness of that economy, therefore creating wealth within that specific population.


As an example, a government agency may concede subventions to a certain product or productive activity if it is considered to generate positive externalities, or favorable secondary effects. These may include management, workforce training, massive learning processes, technological or knowledge exchange, and other demonstrated effects by which a single investor may persuade others to invest in that particular country.  

Another aspect that has been analyzed by economists is whether FDI has a direct influence in economical growth in the receptor country. Most specialists conclude that according to the implicit factors of every economy and the extent to which FDI attraction strategies take place, this particular phenomenon will have a direct impact on the economical performance of that nation, whether it grows or not.  

Considering that FDI produces different results depending on the particular conditions every country has, every single case must be considered separately. Having said that, it may be stated that most countries with protected and distorted economies find FDI flows harmful for their economical wellbeing. Where those conditions persist, but FDI is very low, the harm is mitigated. On the other hand, where FDI is important and big, the adverse effect on the economy is also larger. By the contrary, in countries with lower commercial boundaries or restrictions to international trade, large international companies may increase the efficiency of the existing economical activity, as well as the introduction of new associated practices with a very favorable balance for the host country. As a direct consequence, governments are keener to adopt free trade policies, and more business friendly regulatory schemes.

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On a different front, countries receiving FDI must avoid competing against each other while granting fiscal incentives to foreign investors, given that such a contest would trigger a price war, compromising the financial viability in the long-term, due to the reduction in tax income.\textsuperscript{31} Regarding developed countries, specialists recommend them to perceive only the type of FDI that promotes economic welfare within the local population, especially through the creation of high quality, well-paid jobs.

In summary, foreign direct investment by itself does not necessarily imply higher development rates for the country receiving it. That nation must adopt a series of strategies that guaranty that those investments actually result in a life quality and economical improvement in the country within the country’s population. Today, countries jump into the market, competing with other nations and granting different types of benefits, provoking investors to make a decision based on where can they obtain the lower operational costs, rather than specialization or competitiveness of the economy. Often, this phenomenon represents a serious threat for the country because if that rule were actually true, investment would eventually leave the country in search for better cost-related patterns.

Therefore, the strategies leaning towards attracting foreign direct investment should suggest answers on how to maintain that investment in the long run. Also, they should be oriented towards an accurate definition of the type of economy that country needs, employment policies related to the investment structure, and other socially related themes relevant to the practice. That way the country can have a clearer stand regarding the convenience of fiscal and financial benefits given to foreign investors, and how to approach the issue.

3. ANALYSIS OF DIRECT INVESTMENT IN COLOMBIA

This chapter will analyze foreign direct investment in Colombia, making a special emphasis in the detection of the variables that result fundamental in the attraction of foreign capital and what measures should be taken to maintain these long-term policies.

3.1 FOREIGN DIRECT INVESTMENT IN COLOMBIA

3.1.1 Background Description (1990-2001)

In 1991, the economic opening that took place in Colombia came along with the adoption of a series of regulatory changes that eased tariffs and trade restrictions, opening the nation to the global economy, and thus exposing it to the arrival of foreign flows. That way, FDI grew progressively and almost exponentially. It went from a total of US$ 438 millions in 1991 to US$ 2,244 millions in 1994; it took only three years to fifth-fold, and later reaching almost three billion during 1996.  

This sudden growth had a very positive effect in the country’s capitalization, as well as its growth rates. During that period of time, the total value of FDI in Colombia grew considerably. The government successfully attracted international investors, foreign capital entered the country, and key sectors were boosted through national programs destined to create wealth.

However, those investments did not turn out to be as beneficial for the country as it was first expected. Most of them ended up extracting natural resources without even generating any sort of income for the nation. At that time, the central government used to grant extraction rights over very large territories, in order for that individual or corporation to obtain as much as they could, while the enormous profits went straight to the owners of the company, not distributing it or even generating a prosperous environment in that region.  

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1992 was the year that saw the greater entrance of FDI in the petroleum sector, specifically in the digging wells locally known as “Cusiana” and “Cupiagua”, representing up to 75% of the total FDI flows for that period of time. By then, a very clear governmental favoritism allowed oil corporations to perceive enormous fiscal advantages, subsidies, and all sort of guaranties.

Ironically, it took only one year for the sector’s participation over total FDI flows to decline, since other sectors began investing more, and therefore quickly reshaping the composition. In 1993, oil went down to 39% participation over total FDI entering Colombia, and to 27% by the end of 1996. However, it is important to mention that in 1994, the oil industry amounted a total of US$855 millions in direct investment, which is the largest registered so far.  

From 1995 on, a massive entrance of new sectors took place, ranging from tourism, to healthcare.

“It may be said that, at least in principle, FDI in Colombia is beginning to show a new tendency explained by different factors: in first place, the privatization process, specially the financial sector, and recently, some public services; in second place, the importance gained by modernization and restructuration processes within the subsidiaries of transnational corporations; and finally, a greater investment and diversification of the financial system”  

“Then, for example, the entrance of important capital flows, specially short term ones, and afterwards, the increase in foreign private and public indebtedness, contributed to the establishment of a clear revaluation tendency of the Colombian Peso. Most of the capital influx went directly to finance the substantial increase in public spending, as well as the fiscal deficit, and the increase in private consumption.”

34 IBID, July 13th 2011.
36 Ibid
3.1.2 Exposition of reforms and institutional changes

The beginning of foreign direct investment in Colombia may be pointed out to occur during the second half of the XIX century as a direct consequence of the exploitation of gold mines, development of railroads, steel mills, and textiles. However, that period didn’t count with a clear regulatory scheme that neither controlled nor stimulated FDI. Thus, the entrance of private foreign capital was a result of opportunities spotted out by entrepreneurs or investing groups, not because the country promoted it in foreign lands. It was only in 1931 when the first laws regulating foreign investment were introduced in Colombia. Their content was still very soft and tolerant, limiting only to register movement in international capital towards the country. Many years had to go by before the Law 444 of 1967, and law decrees of 1973 finally regulated FDI. Then, the government subscribed to Decision 24 of 1971 that made part of the Andean Pact, which had a very specific objective; to prohibit FDI flows towards strategic sectors such as:

1. Energy infrastructure
2. Communications
3. Public Services
4. Basic sanitation

Clearly, the general policy was to apply restrictions on foreign investment, applying a decided protection of the selected sectors in an effort to defend national programs oriented towards the strengthening of industrial tissue, securing economical growth, and boosting social programs along the way.

This meant that the transnational corporations were forced to “turn into mixed enterprises over a period of time, and technological transfer was conditioned with the price of royalties they received for it, in the same way, a restrictive internal credit control was imposed, leaving them only with access to short term credit, according to the conditions set by the Commission of the Cartagena Agreement. This must have influenced the low productive
investment flows that the country received during that period of time. In a certain way, the existing regulation must had incentivized external private debt.”\(^{37}\)

That way, with the normativity set, the National Planning Department was in charge of approving of denying the authorization of FDI inflows, considering the following standards:

1. Export Diversification Patterns
2. Creation of Jobs
3. Impact on the Balance of Payments

Besides, the Council of Economical and Social Policy (CONPES, for its Spanish abbreviation) had the faculty to determine the entrance of national capital in the foreign investment, in order to maintain certain control over it. An additional factor affecting transparency and the movement of capital flows was the particular regimes inside the Andean Group for labeled as sensitive or strategic.\(^ {38}\)

The problems surged in the Andean Group, which became aware of the imminent failure of its interventionist and integrationist policy that lasted around a decade and a half. After the 80s, the Latin American economies found international capital markets closed, and saw themselves in need of attracting FDI flows as a mean to generate foreign exchange, as well as the opportunity to improve their unfavorable Balance of Payments.\(^ {39}\)

By 1988, in the midst of the industrialization process that took place along the different economic sectors in Colombia, two important decrees are emitted. The most important one, Decree 1265 of 1988 regulated FDI in a fashion that conceived it as a limited activity that meant sovereignty loss. It was believed that FDI generated a deterioration of the national industrial core when the entrance of groups with larger financial power, more knowledge and technology entered the market. This piece of legislation illustrated quite clearly the

\(^ {37}\) Hommes, Montenegro y Roda, 1994
\(^ {39}\) Ibid
government’s conception of FDI for that period of time, which in fact was not that long before the great opening of 1991.

Also, the Decree of 1988 was reinforced by Decision 24 of 1970 of the Andean Parliament, by which “the participation of foreign investment in sectors such as infrastructure, electric energy, communications and telecommunications, public services and basic sanitation was not allowed. It was also prohibited that the existing investments in the financial sector be greater than 20%, forcing such investors to yield up to 80% of their capital to locals. The foreign participation in sectors that competed with national activity was forbidden, or in such sectors where the State did not consider it necessary. On the other hand, the maximum profit wiring and capital remittances were topped at 10% while the repatriation of dividends was denied.”

The conception of foreign investment as a national sovereignty loss and deterioration of national industry had to change during the 80s, where investment was needed and gradually considered an effective and mechanism to obtain foreign capital in order to ease the huge deficit the country had at the time. To receive the flows that now became important, the process was simplified, fewer procedures were necessary and the outflows of profits were reassured once again. In that context, the Andean Parliament established through the Decision 220 of 1987 that “the right to send profits would be authorized to sectors where it was previously forbidden, the obligation to sell investments to nationals was abolished, access to credit was deregulated, and every country that made part of the Andean Pact was allowed to design its own foreign capital policy.”

However, some sectors like the financial, in fact opposed the entrance of foreign capital because they feared they could lose the importance they had in the national economy. That way they actually prevented that the measures described before turned into higher volumes of FDI flows.

In 1987, Decisions 220 and 224 of the Cartagena Agreement were adopted; they became significant steps towards the improvement of the conditions in which international investors could approach the national industry. Through the applied rules, the regime actually

41 Decisión Andina 220 de 1987 sobre inversión extranjera directa.
became more flexible, although it maintained the rigid structural intervention and controls through the previous authorizations system. Similarly, the time required for those enterprises to turn into mixed-capital companies, while other sectors were opened for international investors. However, such changes did not actually have a direct impact on the attraction of FDI flows into the country.

It was only from 1991, when the actual Constitution was established that FDI flows began entering the country massively, with legislation that intended to create the necessary conditions for multinational corporations and foreign capital to enter the country. This was a major change that actually reversed the tendency that had taken place until that time. That same year, the Cartagena Agreement Commission approved the Decisions 291 and 292 that derogated previous Decision 220 of 1987, thus eliminating the few restrictions remaining that limited capital flows as well as technological exchanges. Also, the country took part of international agreement to minimize political risk, with the intention of penetrating global capital markets. Under this new legal scheme regarding FDI in Colombia, new opportunities appeared, both for national companies as well as for foreign investors. Although several FDI incentives were created, it is important to mention that it was too in 1991 that under article 58 of the new Political Constitution, that a legal nationalization method was approved, that contemplated expropriation without compensation the grounds of equity for the people.  

42 In that sense, law 9 of 1991 established a system of foreign investment fundamental on the investment capacity through three main principles that were later reinforced by different policies implemented by several governments:

1. Equality: through this principle, the law gives equal treatment to both national and foreign investors in terms of fiscal conditions, formalities, etc.

2. Universality: the law allowed the entrance of foreign direct investment in any economical activity, with the object of maximizing total capital netted as well as development on different sectors.

3. Automaticity: the law eliminated precious concepts of the National Planning Department, to authorize the entrance of new investment. Thus, any investor could enter the country to locate it in any sector.

The only condition in terms of institutional process consists on the obligation of foreign investors to register their capital with the Central Bank, having the main objective of granting their exchange rights. In a similar way, legal measures were made more flexible in terms of exchange rates, suppression of maximum profit relocation, capital reimbursement, and payments due to technological transfers, with the additional guaranty of maintaining that decision beyond possible legal modifications afterwards.  

The measures described before were complemented with a very large campaign realized in foreign countries in order to “restore” Colombia’s image as a country. Also, the following modifications were implemented:

1. Exchange regime substitution. Financial institutions were now allowed to realize investments in other insurance and financial companies located internationally, therefore having foreign capital.

In 1994, as a direct consequence of the insufficiency in the FDI flows registration, a modification on the International Investment Statute was taken into place through Decree 1812 of 1994. The decree allowed to register capital extemporaneously, as long as such capitals were declared as foreign investment at the time the capital actually entered. Two years later, with decree 1295 of 1996, the national structural legislation regarding FDI was approved. It was a complete package that regulated both international capital entering the country as well as national capital going overseas.

On the tributary aspect, Colombia had been characterized for imposing elevated tax rates, compared to its neighboring Latin American Countries. This naturally turned into a barrier

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43 IBID, August 10th 2011.
towards the attraction of investment flows. To prevent this from happening, the 1995 tributary reform represented mainly on Law 223 established the following:

1. Elimination of social development and inland security bonds (established on 1992).
2. Tributary stability contracts were created, offering security to investors.

It is important to highlight Decree 24 of 1995, which eliminated authorizations for mining and hydrocarbons sectors, that way the sector was actually liberalized, allowing the entrance of large transnational corporations to enter the national market through exploitation and commercialization in massive quantities. Also, the following determinations were taken:

1. Remission of supplementary capital to subsidiaries of foreign corporations.
2. Allowing the institutional foreign funds to acquire titles coming from a process of real state securitization.
3. Equity investment was also made even more flexible.

Law 9 of 1991 adopted a new exchange regime and a different model concerning FDI. The law approved three main basic principles through which the main goals were to be reached. Literally, the law said: “first, the principle of equality, through which discrimination between nationals and foreigners is eliminated in terms of the treatment received as well as investment opportunities; second, the principle of universality, through which the entrance of capitals to all sectors of the economy, including public services, communications, generation and distribution of electric energy, internal transportation of passengers, and home building; and third, the principle of automaticity, according to which special authorization from the National Planning Department is eliminated, except for certain aspects related to national defense”. 45

45 Ley 9 de 1991
With the established legislation, the following extents were achieved:

1. Elimination of maximum profit wiring.
2. Elimination of payments for technological transfers.
3. Generation of judicial security, establishing that the entrance conditions may not be changed in a way that the investor was hurt.

The preexisting problem concerning the difficulty in access to credit from foreign companies was fixed by Resolution 51 of 1991 emitted by the banking commission, which granted internal credit lines to international corporations.

Most of the decisions described before were then complemented with the negotiation of international agreements, “In that sense, bilateral agreements –Bilateral Investment Treaty-, or agreements towards the promotion and protection of investments, which had as an objective the granting of judicial security to foreign investors through the inclusion of the following guaranties: 1) A fair treatment clause is taken into place; 2) National respect to security and protection of investment, as well as most favored nation treatment; 3) Discriminatory measures are excluded for nationality reasons; 4) Determined facilities are established aiming at the authorization of transfers towards exterior, according to real benefits, net interest rates, dividends, total liquidation, reimbursements for expropriation, nationalization or other causes; 5) For nationalization or expropriation cases, the reimbursement must be quick, effective, and adequate”.

Colombia has developed a great political labor, realizing and developing many different agreements with a wide range of countries. The most significant ones are:

1. Spain
2. Peru
3. United Kingdom
4. Germany
5. Argentina

The agreements subscribed have had an unconstitutional character according to the Constitutional Court. Several decisions such as C-358/96, C-379/96 and C-08/97 have encountered vices such as the obligation to reimburse foreign enterprises in case of expropriation, while paragraph 5\textsuperscript{th} of Article 58 establishes the possibility to expropriate without reimbursement on the grounds on common interest, to which congress responded modifying the Constitutional article and thus allowing the possibility to force the nation to reimburse a foreign company in case of expropriation. Evidently, this maneuver intended to attract foreign capital, and the determination to do so goes as far as modifying the constitution if needed.

Specifically speaking about mining and hydrocarbons, the following regulatory scheme rules those very important sectors:

1. International Investments Statute
2. Mining Code
3. Petroleum Code

The legislation forces a previous approval from the Ministry of Mines and Energy for exploration and exploitation of oil and natural gas. This authorization need was later removed by decrees 517 of 1995 and 1295 of 1996, besides allowing a supplementary capital remission to subsidiaries of foreign corporations, as well as authorizing securitization and further equity investment.\textsuperscript{47}

On the other hand, in terms of tributary and fiscal legislation, actually, foreign enterprises have an income tax of 35%, similar to that of national companies, and it is so independently

\textsuperscript{47} http://129.3.20.41/eps/it/papers/0404/0404003.pdf, August 10th 2011.
from the country they come from. On a related subject, foreign companies wishing to send their profits back home must face a 7% remittance tax.

A common strategy implemented by countries, including Colombia, has been the development of double taxing agreements, which have as an objective the avoidance of taxing the same person or company two times for a single operation. Normally, such treaties are based on the distribution of available materials, in a way that every state that makes part of it owns certain exclusivity over a specific mater, sharing taxation in an organized way.

Double taxing agreements subscribed by Colombia satisfactorily meet the principle of no discrimination, according to which “the tax payer’s situation may not be made greater that that provided by national legislation.” This principle is basically grounded on equality of conditions in tributary issues. Specifically in Colombia, the income, equity, and sales taxes have been negotiated in order to generate a fiscal benefit to foreign corporations through double international taxing, besides eliminating the following barrier:

1. Capital Flows
2. Goods Flows
3. Technological Flows

In that context, Colombia has created a strategy that canalizes foreign investment through the simplification of formalities required for the establishment of a new company. Thus, the legislative teams have articulated four types of societies, or types of private companies that a foreign investor may choose from:

- Society of simplified stocks
- Limited responsibility society
- Anonymous society
- Subsidiary of foreign society.

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48 IBID, August 10th 2011.
The first one, Simplified Stocks Society, or SAS for its meaning in Spanish, offers very wide advantages to investors, compared to other types of legal figures, such as the following:

1. This type of company may be constituted through a private document, also allows the modification of standards, and therefore savings in costs and time.  

2. It allows the company to limit the responsibility of the partners without going to the Anonymous Society figure.

3. The model offers the possibility to create different types of stocks: ordinary stocks, divided preferential stocks, no-vote stocks, multiple-vote stocks, privileged, fixed divided stock, etc. As well as allowing a simple method for the entrance of new partners.

4. Initial contributions for the constitution of the society may be deferred up to a period of ten years, without having a minimum quota to become operational.

In relation to subsidiaries of foreign corporations, congress designed this figure in order to expedite the construction and operation of companies formed by foreign capital, as described in the following point highlighting the most important aspects of the figure: its constitution. It is realized through society a contract in which basic information must be recorded. That way, for certain types of societies, the existing regulation demands the creation of the company through a public document, a step that is clearly avoided by the use or implementation of this legal figure.

To summarize, it is evidenced that in Colombia, several strategies have been taken into place in order to simplify processes and formalities aimed at a higher stimulation to the arrival of foreign investment. As a result, international people or companies may enter the country and have a legally constituted enterprise within a ten day period.

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Today, foreign direct investment is allowed in every single economical sector in the country, except obviously for defense and national security. In that context, as it has been previously explained, the Colombian Political Constitution grants equal rights to both national and foreign investors. Thus, foreign investors may apply for incentives and benefits offered by governments programs. The guiding principles referred to are the following:

1. Equality in treatment
2. Universality
3. Automaticity
4. Stability

**Equality in treatment:** according to this guiding principle, discriminatory conditions or treatment may not be imposed in any sort of way to favor foreign nor national companies. That way, the law establishes a double security standard for both parts.

**Universality:** As it was previously described, all sectors in the economy are accessible for FDI flows except for national security and defense, and the processing or disposal of toxic, radioactive or dangerous waste not produced in the country.

**Automaticity:** FDI does not require, as a general rule, the previous authorization of a competent authority. That way, the investor may enter the country easily without any type of obstacle.

**Stability:** According to this principle, the conditions that were valid at the time the company entered cannot be modified in a way that affects the investor negatively. The goal is to grant a stable legal regime in terms of economical conditions, in a way that the investment is protected, and the entrance to the local market stimulated.
In accordance to those principles, congress has passed legislation protecting the international investor from sudden normativity changes. Law 963 of 2005 was passed regarding Stability Contracts, and dealt with the necessary requisites for an investor to opt for such a contract. Such conditions are:

- Investment amount larger than 5,000 minimum wages
- Contract requirement presented to the Judicial Stability Committee
- Point out the laws to which the contract is required
- Pay in favor of the nation a total of 1% of the value of the investment.

Another instrument often used to create a favorable regulatory environment towards the foreign investor are the International Investment Agreements, which government officials wave developed policies of negotiation with different nations across the world, regarding the signature of:

- International Investment Agreements
- Agreements for the Promotion and Reciprocal Protection of Investments
- Free Trade Agreements
- Double Taxation Treaties

The agreements generated in a transparent regulatory scheme guarantee the investment from possible changes or normative, political or institutional adjustments. Those agreements define the following aspects:

- Assets that are protected
- Protection standards, such as:
  - Equality
  - Fair treatment
  - Equal treatment
  - Security
- Jurisdictional guarantee to settle legal affairs through international rulings.
Colombia has subscribed to the following agreements or treaties:

1. Multilateral Agency for Investment Guarantees
2. International Center for Solution of Investment Differences
3. Corporation of Private Foreign Investments.
4. Treaty for Cooperation in Emerging Markets

As a general rule, the treaties subscribed by Colombia present themselves with the implicit principles previously mentioned:

1. National treatment: Every country must do its best to give foreign investors the same treatment they would give to a national one.
2. Most favored nation: Every part guarantees to investors of a third, similar country, the same benefits it gives to another one. This way a healthy environment is provided, and an economical war for incentives is prevented.
3. Fair and equal treatment: this principle guarantees the equality of all economic agents, regardless their nationality, the access to fair and balanced justice.
4. Illegal expropriation prohibition: To avoid unjustified expropriation, where it is only conceivable under specific social interest or fundamental circumstances, always respecting a due diligence as well as appropriate reimbursement.
5. Reduction of obstacles for FDI: it implies the elimination or significant reduction of different types of barriers on international investment.
6. Resolution of controversies: most signed agreements contain diverse judicial mechanisms for conflict solution, normally including international neutral tribunals where companies have the right to sue the local nation, and vice versa.

Today, foreign direct investment is controlled and regulated by different authorities within the Colombian state such as the central bank, or *Banco de la República*, Societies Superintendence, and the National Department of Taxes and Duties, DIAN. The evolution of these regulations and norms has evolved responding to the dynamic necessities derived from the entrance of FDI flows into the country. In Colombia, such regulation has mutated
from being restrictive and aggressive towards FDI before 1991, to becoming a completely
opposite regulatory scheme after that period, coming to stimulate FDI, create Special
Economic Zones, and legally guarantee judicial and economical stability and security to
international corporations.

In the recent years, it may be observed that the legal framework is clearly beneficial for
foreign companies, which may generate certain uncomfortable environment within local
manufacturers. Finally, it is almost certain that the legal framework will continue to
gradually evolve, adapting itself to the necessities provided by the market and the
conditions of every moment, with the main objective of granting fiscal, tributary, and legal
advantages to international investors.

3.1.4 Evolution of investment in Colombia (1990 – 2010)

It must be clearly pointed out that foreign investment has been changing permanently
during the last couple of decades. A good part of that dynamism has its causes on the
changing regulatory framework, which has been gradually adapted to present Colombia as
an attractive capital destination over time. However, factors such as the simplification of
formalities and reduction in bureaucratic steps have also contributed to such phenomenon.

“The importance of FDI for Colombia is primarily based on the fact that it canalizes the
towards jobs generation, augmenting production, increasing technological reception, and
provided a good amount of foreign currency.”

“If an analysis on FDI growth is made, we could say that one of the factors that impulse
FDI in Colombia was the decision to open the country to the international markets made
under the presidency of César Gaviria (1990’s).”

In that fashion, a worldwide economic race took place when economies around the world
tried to offer larger incentives to foreign direct investment. It may be observed in the graph

53 IBID, September 2nd 2011.
below, that since 1994, FDI increases dramatically due to the implementation of free trade agreements, and pro-business policies. FDI may be seen from the perspective of investing countries, which may be analyzed through the distribution for 2007 provided by the Colombian Central Bank.

Table 3: FDI IN COLOMBIA 1992-2009 (Dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Direct Investment</th>
<th>Total Equity Investment</th>
<th>TOTAL</th>
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<td>1992</td>
<td>289,365,598.00</td>
<td>61,113,318.00</td>
<td>350,478,916.00</td>
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<td>1993</td>
<td>392,840,915.00</td>
<td>43,656,240.00</td>
<td>436,497,155.00</td>
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<td>1994</td>
<td>801,780,055.00</td>
<td>587,675,476.00</td>
<td>1,389,455,531.00</td>
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<td>1995</td>
<td>1,320,915,454.00</td>
<td>242,221,008.00</td>
<td>1,563,136,462.00</td>
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<td>1996</td>
<td>1,830,655,257.00</td>
<td>292,154,190.00</td>
<td>2,122,809,447.00</td>
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<td>1997</td>
<td>2,992,928,015.00</td>
<td>561,760,500.00</td>
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<td>288,192,164.00</td>
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Today, the mining and energy sectors still lead the FDI flows participation chart, with an amount of 71% of total flows during the second trimester of the year, according to the data provided by the Banco de la República on the balance of payments. 54

Between April and June, FDI flows in Colombia totaled US$3.372 millions, of which US$2.403 millions correspond to the mining and energy sectors: US$2.826 millions to oil and petroleum in general, and US$911 millions to mining and quarries. 55

55 IBID, September 2 nd 2011.
Compared to the same period during the previous year, a very large growth in that sector may be seen, with actually doubling total FDI flows for those specific sectors, as it was only US$1.114 millions in 2010, compared to the US$2.403 millions during the second trimester of 2011.  

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56 IBID, September 2nd 2011.
The previous chart shows a clear diversification tendency regarding sectors receiving FDI flows in Colombia. Also, a maintained steady growth of those sectors that have turned from being residual to obtaining a growing importance as a share of the total flows entering Colombia year after year.
As an example to that statement, the financial sector has been growing steadily, as corporations such as Falabella, or Banco Pichincha have entered the local market, demonstrating an effort from the government to attract foreign capital into this sector. Similarly, the electricity sector, social services, etc. have also been growing at very stable rates. This is how the sector diversification allows a broader economical impact of FDI flows and the results of policies orienting it.

The continuous growth rates of FDI received by Colombia during the last years is probably the most revealing indicator that points at the great economical moment that the country is going through. Undoubtedly, it is a favorable moment or juncture that must be handled in the best possible way in order to make the most of it. The recuperation of the investor confidence in the country has been one of the key elements contributing to the positive environment. However it has not been the only reason for it. A responsible macroeconomic management, a reduced fiscal deficit, as well as healthy public finances, and incentives and promotions to private investing have been crucial in the multiplication of FDI flows that have contributed decisively in the development of the country.

On the same subject, studies have shown the importance of having high educational levels as a key issue connecting increased FDI flows to a higher development and economical growth. Some economists have suggested that it is necessary to have stronger institutions together with high educational levels in order to implement policies that trigger even higher FDI flows, and to actually benefit more from them. On that front, Colombia has been realizing a very good job recuperating its national sovereignty through the recovery of lost institutions throughout the different regions of the country, as a strong pillar in the construction of a solid basis that would provide long-term development and higher growth rates. In the educational matter, although there have been important achievements, international comparisons leave Colombia in the bottom places, evidencing a huge gap between the country and industrialized nations.

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57 Borensztein, De Gregorio y Lee. 199.
The fact that Colombia went from receiving US $ 2.133 millions in FDI flows during 2002, to a surprisingly high record of US $ 9.028 millions in 2007, only five years later, is probably one of the greatest achievements in the economical aspect of the administration of President Álvaro Uribe Vélez. Besides the economical benefits described earlier, it is important to highlight that that infrastructure is one of the main variables that propitiate FDI inflows into a determined region as well as having a direct impact on GDP rates. Taking into account the fact that FDI was been one of the main sources of income to construct the physical infrastructure of the country, it may be said that the larger channel through which FDI has an influence in the development and economical growth especially through the provision of infrastructure. 58 FDI comes along with huge benefits for the country receiving it; these capital flows reinforce the productive sector, diversifies the production base, generates new quality jobs, contributes directly to technological and knowledge exchanges from corporations in developed countries to those located in Colombia. It also gives the local workforce a better training, making theme every time more and more capable and qualified to do more complex tasks, besides the fact that it contributes to a larger GDP and an increase in exports.

However, those are just the immediate effects of FDI in most countries that receive it, for the long-term positive effects are equally important. The capital flows entering the country contribute to the consolidation of a solid base in new highly productive sectors, boosting economical development in the long run. 59 Colombia, then, should focus in turning itself into a key foreign direct investment destination, and try to attract capitals that are currently going to nations such as Chile, Brazil, or Mexico, which offer very similar conditions.

Table 5: LATIN AMERICA AND CIVETS: FDI INFLOWS BY COUNTRY, (2004-2011)

<table>
<thead>
<tr>
<th></th>
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</table>

In 2004 Colombia was the fourth FDI receptor in Latin America, after Brazil, Mexico and Chile according to the UN’s CEPAL (Economic Commission for Latin America and the Caribbean). The flow increased a surprising 69% in relation to the previous year, with a total of US$ 3.052 millions. For 2007, that amount had passed the US$9.000 million mark, setting an all-time record for the country, and it has been growing since, despite the global slowdown, due to the favorable conditions for FDI in Colombia. The economical opening and the changes in the investment policies introduced that eliminated remittances controls as well as granting property protection rights, were the core basis of the positive behavior of FDI flows throughout the past years. According to Proexport, the new policy that was introduced in the early 90’s began applying the automaticity principle; the Colombian Constitution granted property rights, as well as tributary benefits for investors, Special Economic Zones, and the economical recuperation altogether created an optimal environment for FDI attraction.
The sectors that were initially promoted by the export promotion agency, and government in general, were mining and hydrocarbons. Multinational corporations arrived the country looking to expand their operations related to the extraction of raw materials, giving the sector a new dynamic and boost, although it is far from being a labor intensive activity, and has very serious environmental consequences, it is also true that is a sector that generates large amounts of money, perceived by the nation through taxes, royalties and infrastructural development. Foreign companies and private investors, generally speaking, recognized the great potential that Colombia had to offer. In fact, by 2005 Colombia was label by the United Nations Conference on Commerce and Development as the fifth most favorable economy for FDI within the Latin American economies. Besides, the World Bank gave the country the second place in best climate for investments in the whole world, “by facilitating determined regulations and policies that incentive investment, productivity, and growth”.

Today, FDI is at its best point ever, between January and February this year, FDI flows grew 107% compared to the same months last year, consolidating a growing tendency despite fears of recession in Europe and America, and the generalized nervous markets. It is estimated that this positive climate for business will continue to attract further capitals into the country, and that way a very stable and long-term economical growth may be guaranteed. It is up to the nation, and governments to come, to implement the right policy and make the most of these positive times.

As it was said earlier, FDI has very positive short-term and long-term effects in the economy that receives such flows. The economical growth will be decisively pushed upwards with the capitals that will be received, besides the fact that many other economical conditions will improve as a direct consequence. Life quality of the Colombian people will improve as they will benefit from lower prices in the local market due to higher competition, more jobs will be created, and they will be better paid. Also, with FDI flows come new technological advances as well as knowledge that may be exchanged, and in general terms, the entire system is considerably improved.

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60 Ministry of Commerce, Industry and Tourism
4. FDI IN COLOMBIA AND LATIN AMERICA

4.1 FOREIGN DIRECT INVESTMENT IN COLOMBIA COMPARED TO LATIN AMERICA

In the following section, diverse analysis and graphical support will be presented in order to contextualize foreign direct investment in the Latin American countries. Naturally, neighboring countries as well as those presenting similar characteristics to Colombia are to be the first international referent when a comparison is needed to broaden perspectives. Today, Colombia has a key role in South America, being in the top spots when FDI flows are ranked by nation.

The graph hereby presented represents the main countries participating as FDI investors in the region.

**Figure 1: MAIN COUNTRIES INVESTING IN SOUTH AMERICA.**

It may be observed that not surprisingly, the United States of America is the country that does the larger investment in Latin America, both in the number of projects as well as the total amount those investments represent. The second largest investor appears to be Spain,

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with a total of 10% participation in number of projects, and an important 12% in the amount of their investments.

From the graph it may be also concluded that the diversification in FDI flows regarding the countries from which it comes from is actually very wide. The most important ones are USA, Spain, México, Canada, Italy, Germany, Japan, United Kingdom, Australia, France, etc. The importance of such diversification is made very clear when the risks of depending on a single country come into first hand, especially during periods of crisis.

Next, a graph is presented showing the main countries receiving FDI flows, both in terms of number of projects, and the total amounts of those investments.

Figure 2: MAIN COUNTRIES RECEIVING FOREIGN DIRECT INVESTMENT.  

In terms of number of projects, Mexico leads the data with a large 28% participation, in second place is Argentina with 17%, and Colombia is third, having a participation of 16%. However, this order is quite different when it comes to investment amounts, measured in dollars. Colombia holds the fourth place, having 14% of the total, but Chile is first and it has a participation of 29%, while Argentina reaches second place on 21%, and Mexico is third with 20%.

It is very interesting to see that Brazil, despite being one of the largest countries in the region, and one of the most important economies as well, does not even qualify into this table. Also, the fact that the number of FDI projects does not necessarily match the total capital invested in the different countries is noteworthy.

Next, a set of graphs is presented that show into which sectors do the different countries invest in. As it can be inferred, those sectors vary depending on the country where the investments come from, relying basically on what their companies are betting at.

**Figure 3: MAIN INVESTMENT SECTOR OF THE COUNTRIES THAT INVEST IN LATIN AMERICA.**

Relating the United States, it may be observed that its foreign investment is highly diversified, participating on sectors such as communications, transportation, machinery, equipment, food, tobacco, financial services, BPO, software and IT services.

On the other hand, Spain presents a more focused approach, having a very large textile sector reaching 28% of foreign investments in the first place, and communications in

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second place with 15%. Then BPO (11%), and financial (7%) represent a higher concentration of the capital sent abroad.

The following graph shows the same sector destination of investments for the United Kingdom and Canada.

**Figure 4: MAIN INVESTMENT SECTORS OF THE COUNTRIES THAT INVEST IN LATIN AMERICA.**

The United Kingdom largely concentrates its foreign investment in textiles (25%) and communications (25%), together they represent half of the foreign capital flows, followed by software and services (17%) and finally automotive and financial sectors have a participation of 8% each.

Interestingly, Canada has a much different approach, sending most of its capital to the extraction of metals, mining, digging, oil, natural gas, and carbon. Evidently this natural resources, raw materials and energy investments are closely related to the sort of activities inherent to the Canadian economy. Altogether, metals, carbon, petroleum and natural gas compose up to 48% of the Canadian foreign investments.

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Now that the four main investors in Latin America have been studied in order to identify the sectors they invest in the most, it is important to determine which sectors receive those foreign capital flows in the country of destination. In the following section, the main economical sectors receiving FDI flows will be analyzed for the four countries receiving the largest amounts of foreign capital in Latin America.

**Figure 5: MAIN SECTORS RECEIVING FDI FLOWS FOR EVERY RECEIVING COUNTRY.**

Mexico is one of the most successful countries in Latin America in terms of the diversification of the capital flows it receives. The automotive sector is the one that receives the largest amounts and it only accounts to 13% of the total, along with the software and IT services sector with a 12%. The next in line is metals; participating with 9% of the total FDI flows.

Then, a very wide range of sectors appear, such as the automotive, electronic components, BPO, machinery and equipment, and massive electronics.

For the Argentinian case, the chemical sector, as well as the communications sector, have the largest participation within the graph, controlling 15% of it. On the following spot are sectors such as BPO and massive consumption products with 11% and 9% respectively.

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The following graph presents the main investment sectors for every country.

**Figure 6: MAIN INVESTMENT SECTORS RECEIVING FDI FLOWS.**

Colombia has been really big on attracting FDI flows towards the financial sector, which occupies 21% of the total capital received by the country. The second and third most important sectors in this scale are IT services and textiles, with 10 and 9 percent respectively.

On a different front, the Chilean economy has a reception of FDI flows based mainly on communications (18%) followed by metals (12%), food and tobacco (9%) and textiles (9%).

In summary, Colombia presents itself as one of the South American countries that receive the most foreign capital, in a large proportion due to clear legislative and market advantages it offers. Amongst them the clear legal protection of foreign investors, financial and tributary benefits, and a maintained growth rate as well as stable economical policies.

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4.2 REASONS WHY COLOMBIA IS AN EXCELLENT INVESTMENT CHOICE

The following statement enumerates and analyzes the top reasons why Colombia is an excellent alternative for foreign investors. In the following pages, Colombia will prove to be an excellent destination for foreign capital, making it a very attractive alternative for international investors.

4.2.1 Economic stability

Colombia has demonstrated a steady behavior in its economy in the past decade. Growth has increased at a steady rate and a low volatility has been identified when compared to other countries in Latin America. Likewise, GDP has grown nearly 4.4% in the past year, amidst what is considered to be a worldwide recession period.

![GDP Growth: Colombia vs World (2000-I sem 2010)](image)

**Figure 7: GDP GROWTH: COLOMBIA VS WORLD (2000- I SEM 2010)**

The previous graph compares Colombia’s GDP growth compared to the entire world’s average. The results are clear. Colombia demonstrates excellent behavior when compared to the world, always a few percentage points above.
Following this reasoning, Colombia is the fifth economy in Latin America, with 46.3 million people and an urbanization index of nearly 77%. Colombia’s geographical location is fundamental for its businesses. With its access to both the Pacific and the Atlantic Ocean, Colombia allows direct contact with the United States, Europe, Asia, Latin America and the Caribbean.67

This economical stability grants investors the opportunity to forge a line for the future. It allows them to create investment strategies, with higher returns and lower risks. The country presents itself as a refuge market for investors, generating high value capital without the associated risks; unlike any other country in the world, where economic forecasts are negative.

4.2.2 Trust in Colombia

According to the World Bank, Colombia is considered a “friendly” country to make business with. It’s also considered an innovator in its zone. It’s been recently labeled between the top 10 countries to execute internal affairs regarding business platforms.

![Change in Ranking for reforms to facilitate business](image)

**Figure 8: CHANGE IN RANKING FOR REFORMS TO FACILITATE BUSINESS. (2007-2011)**

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67 Brochure invierta en Colombia, Proexport 2010
Colombia is considered the third country, according the World Bank, to better improve business environments. They are known for protecting the investor among Latin American countries.

Likewise, Colombia is considered to be at a golden period for investors. The improvement in Colombia’s trust around the world has been associated to its long-term growth. Forecasts indicate traditional investment sectors will see rapid increase, with high yield percentages and growth in the medium and long term.  

4.2.3 Free trade agreement

Colombia is actually negotiating 22 international investment agreements with 48 different countries. This places them as one of the most active countries regarding businesses with foreign investors. The following map illustrates Colombia’s relationship with the world regarding Free Trade Agreements and negotiations.

Figure 9: TRADE AGREEMENT 2011

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This allows decreasing transportation costs, as well as federal taxes for investors. Delivery estimates will decrease and logistics department for enterprises will see great economical benefit resulting from the costs decrease.\textsuperscript{69}

4.2.4 Strategical Location

Colombia is strategically localized due to its proximity to the United States, Europe and other countries. The following table shows flight duration between strategical markets.

<table>
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<tr>
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<td>10:50</td>
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<td>12:55</td>
<td>8:30</td>
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</table>

\textbf{Figure 10: FLIGHT DURATION BETWEEN STRATEGICAL MARKETS}

It is evident that Colombia is one of the best-located countries, just under Mexico. This grants them the following advantages:

1. Faster deliveries
2. Less time to move capital
3. Decreased associated over costs

This aspect results in an overall reduction in costs for the investors, due to Colombia’s proximity to economic nuclei. Even when Colombia’s transportation infrastructure isn’t the best, several projects have been implemented to improve the system for the following years.

4.2.5 Human Capital

Colombia has high availability in qualified manpower with no obstacles in internal regulations and with the best flexibility in the region, granting it a fundamental asset for the investor.

\textsuperscript{69} IBID
Figure 11: AVAILABILITY OF SKILLED LABOR 2010.

The previous table shows Colombia as second in South America for qualified manpower availability, just under Chile.

This benefit translates into greater levels of productivity regarding invested capital in all internal affairs for the company. Characteristics like this one allow for investors to become productive agents in the country, with reasonable variable costs under the concept of manpower.\(^{70}\)

4.2.6 Improvement in Security

Colombia has dramatically increased its overall security, decreasing homicide indexes, kidnappings, etc. In this sense, we see that the total homicides have been reduced by 45% between 2002 through 2009.

Figure 12: HOMICIDES IN COLOMBIA (2000-2009)

\(^{70}\) IBID
Figure 13: KIDNAPPINGS IN COLOMBIA (2000-2009)

Kidnappings and homicides have drastically diminished in the past decade due to ex-president Alvaro Uribe’s security policies.

This translates into greater security for the investor and its capital, as well as security for foreign employees, who will be more comfortable residing in Colombia. All of these, thanks to the states warranties in security. 71

4.2.7 Investor’s Incentives

According to actual legislation, the following tributary and fiscal benefits are granted to investors:

1. Unified fee for fiscal year income tax equal to 15%, allowing local market sales.
2. No tributary taxes are paid. (IVA, ARANCEL).
3. No IVA for commodities or inputs.
4. Customs-free area exportations benefit from international commercial agreements.
5. Foreign machinery pays no taxes.

The following sectors see most benefit in the previous advantages:

1. Tourism
2. Ecotourism
3. Crops

IBID
4. Forrestal
5. Editorial

This characteristic represents a higher benefit margin and value generation. This way, the foreign enterprise will be more competitive both in the interior as well as in the exterior market. This is thanks to the tributary and fiscal benefits. Foreign Direct Investment benefits are constant in time, reason why projections are possible to decrease maturity in the investment. 72

4.2.8 Life Quality

In that order of ideas, every foreigner living in Colombia may have access to the following benefits oriented towards high living quality standards:

1. 26 schools running the SAT “Reasoning Test”
2. 19 schools with the International Baccalaureate Organization (IBO)
3. 3 schools subscribed to the Baccalauréat.
4. 3 Colombian universities in the top 30 Latin American universities.
5. Luxury shops and 45 golf courses.
6. Social security coverage of over 90%

These benefits turn into higher standards of living for foreign employees, and therefore, the international corporation will have a better chance of hiring capable executives in their country of origin in order to ask them to work for them in Colombia, and that way having a better control of the investments made in the country. 73

4.2.9 Investment Opportunities

The national Ministry for Trade, Industry and Tourism has developed policies to reinforce the traditional productive sectors in the country, investing in high potential sectors. In that sense, receiving FDI capital flows is crucial to satisfactorily reach those objectives.

72 IBID
73 IBID
Investment opportunities become more and more important every day as the evidence confirms the growing need for such opportunities to be present in the country. As a result, the following sectors have received tributary and fiscal advantages:

1. **Biofuel**
   1. Exemption of income tax for ten years.
   2. 6.5 million acres in production.
   3. Colombia is the fifth world producer in palm oil.
   4. Actually, Colombia has a production of 9,000 liters of ethanol per year.
   5. It is estimated for the year 2020 a production of 1,400 million liters of ethanol, and 1,200 million liters of biodiesel annually.

2. **IT Services**
   1. Over 27,000 students graduated of Business Administration and 13,000 graduated of engineering every year.
   2. Colombia possesses a neutral Spanish accent.
   3. IT market has grown 42% in only 3 years.

3. **Tourism**
   1. 1,45 million foreigners visited Colombia during the year 2008 on tourism.
   2. Tourism growth rate in Colombia (15%) more than doubled world’s (6%).
   3. Income tax exception for new, refurbished hotels.
   4. Exports of health services.
   5. Colombia is the second largest country in terms of scientific infrastructure, and Health infrastructure.
   6. 3,000 general doctors graduated every year.

4. **Infrastructure:** project that on a yearly basis go over 25 billion US dollars.  

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74 IBID
75 IBID
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### 4.2.10 Key Statistics for Colombia

<table>
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<th>Variable</th>
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<tr>
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<td>Unemployment (%)</td>
<td>11.8</td>
<td>12</td>
<td>11.2</td>
<td>11.3</td>
<td>12</td>
</tr>
<tr>
<td>Exports (Billion USD)</td>
<td>21.2</td>
<td>24.4</td>
<td>29.9</td>
<td>37.6</td>
<td>32.8</td>
</tr>
<tr>
<td>Imports (Billions USD)</td>
<td>21.2</td>
<td>25.2</td>
<td>32.9</td>
<td>39.7</td>
<td>32.8</td>
</tr>
<tr>
<td>FDI (USD Billions)</td>
<td>10.2</td>
<td>6.4</td>
<td>9</td>
<td>10.6</td>
<td>7.2</td>
</tr>
<tr>
<td>Exchange rate (vs. USD-End of period)</td>
<td>2.320</td>
<td>2.357</td>
<td>2.078</td>
<td>1.966</td>
<td>2.044</td>
</tr>
<tr>
<td>Inflation</td>
<td>4.9</td>
<td>4.5</td>
<td>5.7</td>
<td>7.7</td>
<td>2</td>
</tr>
<tr>
<td>Population (Millions)</td>
<td>42.9</td>
<td>43.4</td>
<td>43.9</td>
<td>44.5</td>
<td>44.9</td>
</tr>
</tbody>
</table>

Source: Dane, Letonfocus, Economist Intelligence Unit (EIU, 2009)

**Figure 14: KEY STATISTICS OF COLOMBIA (2005-2009)**

**Figure 15: FDI BY SECTOR (1994-2009), MAJOR COUNTRIES WITH INVESTMENT IN COLOMBIA (1994-2009)**

Colombia is currently experiencing a stage of maintained economical growth, a cycle that allows investors to introduce new capital into the country and obtain a profit over the years. Besides, Colombia has been represented as a country where capital can be secure, far from the volatile markets of developed countries where recession fears generate dangerous economical uncertainties.

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The data shows that Colombia will continue to have an excellent behavior, and therefore it will generate value to investment placed in this market. That way, the country may be considered as a safe heaven, protecting international capitals from recessions, and granting maturity, growth, and profitable returns. 79

4.2.11 Climate Change

The Colombian legislation clearly establishes, with respect to the environment, a very tough regulatory framework relatively speaking. The Colombian Political Constitution of 1991 has been catalogued as a green constitution, due to its strong measures controlling CO₂ emissions, and pollution in general, becoming one of the most important elements when ratifying international agreements with different countries.

According to the IMD World Competitiveness, Colombia is the 10th country in the world on environmental performance. The graph below shows the comparison to other Latin American countries in this ranking.

![Environmental Performance Index, 2010](image)

Source: Environmental Performance Index 2010, University of Yale.

Figure 16: ENVIRONMENTAL PERFORMANCE INDEX, 2010.

Every time, consumers are more and more worried about the environment, thus, it is important to make it clear that investing in Colombia is a synonym of respect towards the environment while realizing commercial or industrial activities responsibly. International

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corporations to advert their positive image as companies that care for the environment use this overwhelming fact. In the same way, the local market will show itself receptive towards product investment in ecological ways, which evidence the companies’ compromise in the conservation of planet earth.  

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5. SUCCESSFUL CASES

Throughout the years, many foreign companies have arrived in Colombia achieving their main objectives in terms of market participation, profit growth, while taking advantage of the geographical location of the country towards global trade, logistics, benefits offered by the government, etc. However, this could only be evidenced through the exposition of cases in which the different companies have successfully invested in Colombia, and benefitted from it.

According to the Colombian economists and other analysts, the main causes for these massive arrivals include the necessity of geographical diversification in order to reduce risks in their local markets. In that sense, the fact that Colombia is one of the largest markets by the size of its population (around 45 million people) is a key factor in this decision. As it was previously stated, the implementation of Special Economic Zones, or Zonas Francas has played a very important role. For example, the multinational corporations Kuehne Angel, a logistics provider from Germany, and Winpack, a firm dedicated to the production of plastic materials that invested over 5 million dollars in its first investment in the Country, decided to locate their operations in the Palmaseca Special Economic Zone, near the city of Cali.

One of the sectors of the economy with the higher investment rates is the minerals sector. The gold mining sector is attracting the interest of more and more multinational corporations. Iamgold recently invested in three major mining projects in the gold sector through strategic investments in Colombia Crest Gold, Bellhaven Copper and Gold, and Tolima Gold. This is very powerful evidence supporting the fact that acquisitions and mergers are one of the main entry mechanisms for international companies.

In the same sector, exploration and extraction of gold, the Swiss group Glencore acquired the operations of the Colombian firm Prodeco from the mining group Xstrata, in an

operation that is believed to have passed the 2 billion dollars mark. Also, the mining corporation Drummond, dedicated to the exploitation and commercialization of carbon and coal, received the environmental license required to begin one of the world’s largest carbon projects in a place called El Descanso, at northeastern Colombia. The project would involve resources for over 1.5 billion dollars. The successful investments made by different companies within the sector has incentive its competitors to enter the country too, in an effort to keep up with the ones already taking advantage of the extraordinary benefits associated with their operations in Colombia.

The engineering sector has also received major capital boosts from foreign investors. Recently, the Canadian SNC-Lavalin acquired the Colombian company Itansuca Proyectos de Ingeniería, which is focused in the energy sector and has over 1.110 employees. The tourism sector has also received enormous capital investments. Last year, foreign investors started a tourism complex developed in Cartagena, worth over 90 million dollars. During the same period, nine different companies announced their intentions to locate their operations in Bogotá, Colombia’s capital city. According to the experts that referred to this topic, the sustained economic growth of the national economy and the business opportunities in the capital have been the main attractive for companies wanting to establish their operations in the local market.

Earlier this year, the Colombian authorities gave the green light to the Spanish Endesa, which is dedicated to electricity supply, to initiate the construction of the hydroelectric El Quimbo, with an estimated investment of 700 million dollars. Around the same time, the American Phillip Morris announced it bought the Colombian Prostobacco, for a total of 452 million dollars. The French group SEB bought 68% of the Colombian firm Imusa, which produces and distributes home articles. The French firm is another example of international

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companies using the merger and acquisition strategy to enter the local market.\textsuperscript{86} Also, the Swedish car manufacturer Volvo, leader on preventive security, inaugurated a new facility in Barranquilla, a coastal city in the Atlantic, aimed at the expansion and reinforcement of its presence in Colombia, with an additional 200 million dollars investment. Finally, the Swiss conglomerate Holcim, one of the world’s largest concrete companies, initiated the improvement and renewal of it cement factory in Nobsa, creating over 600 new jobs with an investment of 100 million dollars.

In general terms, the companies present in the Colombian market are taking advantage of the benefits offered by the government plans. In most cases, the companies have been so successful that they have begun plans to expand even more the operations they already have in the country.

\textsuperscript{86} http://www.inviertaencolombia.com.co/casos-de-exito/215-casos-de-exito.html
6. CONCLUSIONS

From the previous analysis, it may be safe to conclude that Colombia is an important destination for foreign direct investment in the world. In that sense, every time there are more and more foreign enterprises that include Colombia in their internationalization plans.

The key elements defining the success Colombia has had attracting FDI flows are the following:

1. Legal Security: the different governments throughout the years have tried to create a judicial framework in order to strengthen the world’s confidence on Colombia, and its government. That way, businesses know they will not face legal barriers, or even the feared expropriations that are frequent in other Latin American countries such as Bolivia or Venezuela, under more radical countries.

2. Colombia has created a local culture of acceptation to foreign goods and services, in a way that foreign companies are motivated to enter the local market, with high-income potentials.

3. The global economic crisis has affected Colombia in a much lesser way than how it has hit the developed countries, and in that sense, the nation has turned into a sort of refuge for multinational corporations.

4. There are many reasons to invest in Colombia, as it has been analyzed in the last two chapters. It is clear that the country has competitive differentiators that make it attractive for investors. That is why Colombia has experienced a boom in FDI, and actually that was one of the reasons why the country held its position during the global recession and a maintained growth rate during the past years.

5. Another advantage offered by Colombia is a strong legal consumer protection that stops the government in turn from arbitrarily expropriating
companies without a legal justification and a proper reimbursement. This way, again, the foreign investors are strongly protected.

6. Also, it is important to highlight the fiscal and financial advantages that guarantee the competitive environment that has been fundamental for the arrival of foreign companies to the country.

7. Additionally, the improvement in security conditions, highly qualified labor forces, and sufficient infrastructure has made Colombia an ideal country for multinational corporations.

8. Colombia has a wide equity portfolio along several sectors, which has created an attractive risk diversification for both national and international investors.

9. The internal market has been gradually incrementing its acquisitive power, and therefore the demand for goods and services have been continually growing at similar rates.

10. The creation of Special Economic Zones with fiscal, tributary, and social security advantages have been a crucial in the framework of the entire strategy developed by the government.

Despite these powerful elements, it is also important to recognize that Colombia still has a long way to go; several elements will have to be modified and improved in order to attract larger FDI flows. Those aspects include:

1. Traditional FDI absorbs most of the foreign capital; therefore Colombia must stimulate the opening of new economic sectors in order to inject capital flows into those sectors.

2. The international image of Colombia must be restored in order to improve the markets’ confidence in the country. Terrorism and insecurity have played a major role as a threat to infrastructure as well as foreign workers.

3. Today, the country’s infrastructure is insufficient to solve the current transportation needs required by most industries within the national territory. It is almost
surprising to know that transporting a barrel of oil is more expensive than producing it. The deficient road network and the lack of coverage of the main oil duct adds to the total costs of Colombian crude, subtracting benefits to both the regions where it is produced, and the companies dedicated to its extraction.

In relation to the recommendations in order to increment the benefits and volume of FDI flows into the country, the following strategies are presented:

1. Stimulate mergers or partial acquisitions of national companies by multinational corporations in order to maximize technological transfers as well as knowledge exchange.

2. Design a fiscal benefits plan in order to generate even more high quality employment in Colombia. In that particular issue, the strategy must be to focus in attracting those companies in sectors that create the most jobs, instead of those sectors that are not labor intensive.

3. Continue the stimulus and creation of new Special Economic Zones throughout the country, successfully attracting FDI flows.

4. Incentive the entrance of corporations looking for a real development option instead of just a cheap place to produce their goods. This will prevent those companies from leaving the country as soon as a better option is presented, and instead, allowing companies to growth together with the economic development of the nation.

Finally, the previous analysis allows a forecasting of the Colombian future, will may be pointed out as a future where foreign investment will continue to arrive into the country, attracting larger FDI flows year after year.


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