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PUBLIC CORPORATE DEVELOPMENT UNDER STRUCTURAL ADJUSTMENT: THE CASE OF ECOPETROL IN COLOMBIA

A Research Paper presented by

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(Colombia)

In Partial Fulfilment of the Requirements
for Obtaining the Degree of

MASTER OF ARTS IN DEVELOPMENT STUDIES
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ABREVIATIONS

BP	British Petroleum
DANE	Departamento Administrativo Nacional de Estadísticas (National Administrative Statistics Department)
DNP	Departamento Nacional de Planeación (National Planning Department)
ECOPETROL	Colombian Petroleum Company
FDI	Foreign Direct Investment
IMF	International Monetary Fund
KBPD	Thousand barrels per day
NIC	New Industrialised Countries
NRF	National Royalty Fund
OECD	Organisation for Economic Co-operation and Development
PSE	Public Sector Enterprise
RER	Real Exchange Rate
SAP	Structural Adjustment Program
TFP	Total Factor Productivity
TNC	Trans National Corporations
WB	World Bank

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CHAPTER 1

INTRODUCTION

1.1 Introduction

The paper aims at analysing the impact that the Structural Adjustment Program has brought to the Colombian Economy, with particular emphasis on the case of the State-owned company Ecopetrol.

This paper is conformed by 6 chapters, the first one states the research problem, hypothesis, main objectives and methodology of the research; the second chapter shows a theoretical background, beginning with SAP, Foreign Direct Investment, Industrial Performance and rationale for Public Enterprises; chapter three starts the analysis of SAP impact in the economy in general, emphasising on FDI and oil industry. Chapter 4 presents a brief description of the Public Sector in Colombia under SAP followed by chapter 5 that presents the case analysed, the public company, ECOPETROL, and finally chapter 6 presents the conclusions.

1.2 Problem Statement

The process of internationalisation of the Colombian economy has been taking place under a rather uncertain context, due to the ongoing economic reordering of the world. After the import substitution industrialisation (ISI) model showed its limitations in the 1980s, Colombia shifted to an outward-oriented development model by the early-1990s. As far as policy is concerned, this new model has been highly influenced by a structural adjustment program (SAP).

In 1990 the SAP included the following measures: the reorganisation of the public institutions that were, in one way or another, linked to the external sector; liberalisation of the exchange regime; elimination of the mechanism of import tax; and, an opening of trade through a decrease of one third in the trade barriers. Incentives to the commercial integration processes within the South American region also began to be granted. In 1994 the Government pursued to increase the levels of competitiveness and therefore proceeded with more measures to achieve a better technological adaptation, skilled human resources and adequate finance for the industry.

These policy changes affected the local industry, which had to compete with foreign companies for the local market share. In 1999 the private sector lost US$600 millions and decreased its capital value in US$4.700 millions. (EIU, 2000). In many cases companies could not cope and went bankrupt. In 1999, The *Superintendencia de Sociedades* (Business Superintendence) communicated that at least 131 companies closed, while 963 were reported to have gone into receivership. The change in the economic model which some of its consequences just mentioned here, as well as the economic crisis which is phasing Latin America in general, are two important factors to explain why Colombian companies are seeking Strategic Alliances with multinational corporations, in order to obtain foreign investment and overcome their difficult situation.

The public policy has been oriented towards the opening of frontiers for the entry not only of products, but also of capital flows, allowing Colombian companies to invest in foreign ones, and foreign ones to invest in Colombia. However, after one decade, the results have not been the expected by the government and the supporting international organisations. Private investment fell by 65.4% in 1999, year in which the estimated decrease in demand was of 11.4% and the rate of unemployment was around 20%. (Londoño, 2000) This contraction in investment reflected mainly in construction, manufacturing and retailing due to the decrease of consumer spending. This recession pushed hundreds of companies out of business in 1999, and the outlook for the year 2000 is not very pleasant. The Colombian major economic groups faced losses of US$373 millions, and lost US$3.500 of their value which means 23% of their capital; this shows the scale of the crisis. (Dinero, 2000).

As can be seen in table 1, the Capital Account has also seen a decline in investment inflows, reflecting the collapse of confidence in the Colombian economy. As a result questions have been forwarded on the effectiveness of the structural adjustment policies in bringing about improvements to the economy. Further analysis of this subject will be made in chapter 3.

Table No. 1.1
Colombia's Capital Account

CAPITAL ACCOUNT (US$ M)	1998(a)	1999(b)
Current Account balance	-5.910	-1.020
Total net capital inflows	4.743	497
Net medium - long -term inflows	4.595	1.787
Net short-term inflows	148	1.290
Net errors and omissions	210	-78
Change in net international reserves (- indicates increase)	1.374	445
Net international reserves	8.739,9	8.186,1

(a) Preliminary
(b) Estimates
Source: Banco de la Republica; DNP. (National Planning Department). (forecasts)

Important implications in the functioning of the economy also derived from the current armed conflict between the State and two *guerrilla* groups, FARC (Armed Revolutionary Forces of Colombia) and ELN (National Liberation Army). As a result, the image of the country has been deteriorating and therefore increasing the lack of confidence by foreign investors, not to mention the consequences on the increased public expenditure and the diminished quality of life of Colombians under such 'civil war' circumstances.

With the spread globalised world economy, and with pressure coming from international forces, Colombia liberalised its economy in the beginning of the 1990s. This liberalisation measure included the reduction of trade barriers and the granting of incentives to foreign direct investment, among other policies. The effect of these policies on the productive capacity of the country remains unclear, since outcomes are expected to take place on production, commercialisation and distribution of goods and services, which at the same time involves many key actors from different sectors in which competitiveness factors are uneven.

Under this complex scenario, the continuity of public and private corporate businesses is uncertain; lack of efficiency implies low competitiveness and therefore inability to cope with international market forces and unfavourable domestic economic fluctuations. Only the most efficient and financially solvent, or public actors, have managed to survive throughout a decade of openness and adjustments.

One of these cases is the state-owned Oil Company ECOPETROL. This company has shown poor productive infrastructure and lack of scientific and technical know-how to properly conduct oil exploration and drilling. Because of this, the need for technology transfer has been the main determinant factor of this company's special policy scheme of international integration with multinational corporations for the extraction of oil. For ECOPETROL, the implementation of the SAP was thought as the means of bringing more association opportunities and international agreements for its production activities. However, such an expectation has faced counterproductive effects around many other institutional, political and social conditions, which go beyond the economic sphere, without discarding the economic instability. The complex situation by which corporate development has come through and the positive and indirect effects of the SAP is what this study expects to analyse, in order to understand the economic, social and political impact that the policies implemented have brought about on public corporate development, focusing on the case of ECOPETROL.

1.3. RESEARCH HYPOTHESIS

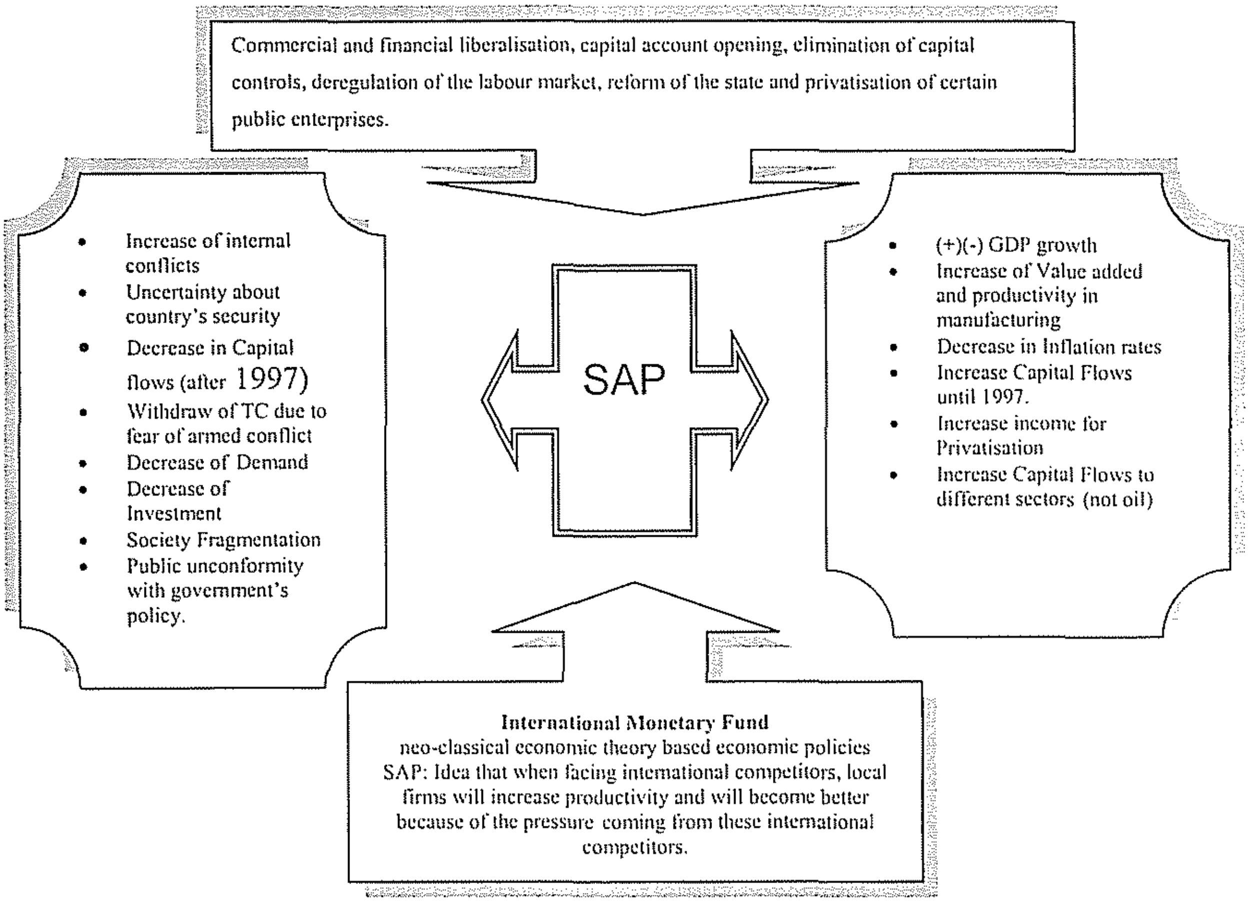
1.3.1 Research hypothesis

The main hypothesis to be tested in this research can be stated as follows:

> The structural adjustment brought about positive effects to some Colombian public corporations through integration with foreign companies. However, there has been a recent withdrawal of foreign corporations, for which the boom that the public corporate sector experienced in the early-1990s has been hampered. Consequently, it has also led to worsening the economic, institutional, political and social situation of the country creating an unstable environment to invest.

In chart 1.1 it can be seen a diagram of the main argument of this research paper. The SAP brought about some positive and negative effects, which are in the right and left sides of the diagram.

Chart No. 1.1 Main Argument of the Research Paper

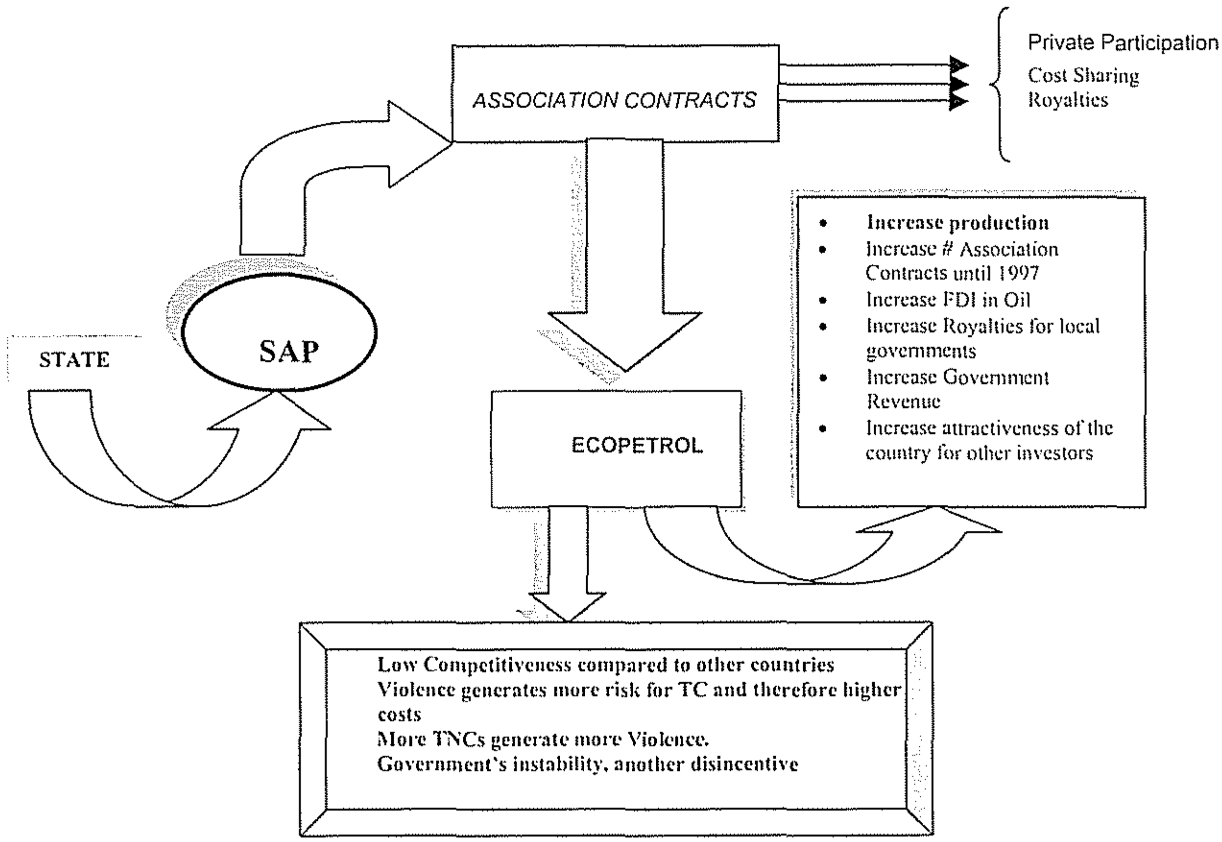


Sub-hypotheses

The main hypothesis applies to the case of ECOPETROL, which is a public company that although has received benefits, through its association contracts with foreign corporations and government's support and protection, its economic performance has recently become rather questionable (See Chart 1.2 for a diagram explanation of this argument).

In this sense, the extent to which FDI by foreign corporations could be a determinant factor of financial sustainability by public firms going through reform periods, will depend on the economic, political and social environment. An implication of this is that corporate development options can be better guaranteed if the State influences directly the policy towards such development, in a context where uncertainty to invest seems to continue in the coming years.

Chart No. 1.2 Sub-Hypothesis of the Argument



1.4 Research Objectives

The general objective is to analyse the impact of the "structural adjustment Program[1]" in the performance of the public corporate sector in Colombia, with a special focus on ECOPETROL.

In addition, the following specific objectives are to be pursued:

- To Determine whether the SAP had a positive or negative effect in the development of public corporate economy
- To analyse the package of policies of structural adjustment, which have aimed at the modernisation and reorganisation of the economy.
- To establish whether structural adjustment policies have led to instability at the economic, political and social level.
- To establish the factors determining the implementation of "structural adjustment" policies towards the international economic integration of Colombia.

[1] SAP includes policies for the reduction of trade barriers, elimination of import tax, restructuring of the State, privatisation of some public enterprises and incentives to the local industry for competitiveness among other policies.

- To find out the importance of the performance of the oil industry for the Colombian Economy.
- To determine the external factors that have influenced the results obtained by ECOPETROL after the implementation of the liberalisation policies.
- To detect what specific effects has ECOPETROL experienced from these policies.
- To establish the relation between the SAP and uncertain economic, political and social environment.
- To analyse what would have happened with the development of the oil industry in Colombia if the SAP had not been implemented.

1.5 METHODOLOGICAL ASPECTS OF THE RESEARCH

This research will be partly descriptive and partly explanatory, based on previous research work and in secondary data, which will include the following:

* Official policies formulated by the government. Gathered from the World Wide Web's pages of the different national institutions of Colombia like the National Planning Agency, the Central Bank, and the Federation of the Development.
* Unofficial policy analysis made by other institutions like the IMF, the World Bank.
* Literature about Structural Adjustment, Multinational Corporations, FDI, Public Sector enterprises and Globalisation: All gathered from the library, documents brought in advance from Colombia and others downloaded from the Internet.

This research will compare the following Macro Indicators:

* Gross National Product (GDP)
* Capital inflows as a percentage of the GDP
* Change in Exports and Imports growth
* ECOPETROL's production as percentage of GDP and their growth.

Along with the above information, the following indicators will be compared in the micro sectoral level:

* Association Contracts: Signed per year
* Production of Oil (Barrel per Day)
* Investment made by Ecopetrol and Multinationals.
* Ecopetrol's exports and imports.
* Royalties paid.
* Financial data: Revenue, Tax and Transfers, Net Profit.

CHAPTER 2

STRUCTURAL ADJUSTMENT POLICIES AND INDUSTRIAL PERFORMANCE: THEORETICAL REVIEW

2.1 Introduction

This chapter presents an overview on some of the main theories that give support and explanations to the hypothesis of this research paper. First a literature analysis on Structural Adjustment, its origins, main policies, and the role of the state under it is presented, then issues such as impact on efficiency and investment, capital flows, multinational corporations and determinants on investment are analysed, followed by an assessment of the industry performance, its measurement and factors that affect it.

2.2 Structural Adjustment

2.2.1 Origins of SAPs and Their Main Foundations

Since the late 1950s the International Monetary Fund (IMF) has been suggesting monetarist economic policies based on a neo-classical economic theory as a condition for lending money to less developed countries facing balance of payments problems. Later on, these policies complemented with the World Bank's policies, composing a package of policies known today as Structural Adjustment Policies.

Countries in Latin American, applied "structuralist" development policies during the 1950s, 1960s and 1970s. The rationale of these polices was basically that poor countries were structurally different from advanced industrial economies. The structural difference was an outcome of the colonisation by Western European imperialist nations. Advanced economies needed Keynesian policies and the fragmented economies were considered as a 'special case': developing economies. (Rojas, 1997). The origins of these policies, according to Rojas (1997), must be sought not merely in the deteriorating of the international economic environment of the 1970s, but also in the evolution of policy thinking within the World Bank.

2.2.2 Theoretical Underpinning

The policies included in the 'structural adjustment program' (SAP) brought along a preconception of being a prerequisite for credit access to countries in the 'south'. The World Bank defines structural adjustment lending as: *Non-project lending to support programs of policy and institutional change necessary to modify the structure of an economy so that it can maintain both its growth rate and the viability of its balance of payments in the medium term.* (King, 2000:3)

However as argued by Balassa (1981), the package that is being implemented now as 'structural adjustment' bears no resemblance to its original conception. Far from being a discrete response to a discrete shock, this has been turned into a standard bunch of policies, applicable anywhere anytime, without any reference to any shock. One loan follows another as a continuous exercise and the entire package has become solely the concern of the poor countries of the South. The role of the North is almost exclusively as the guiding force behind the World Bank and the IMF, and not as a group of countries sharing the burden of adjustment as a global problem (Balassa, 1981: 1-2; World Bank, WDR, 1980: 3-12; in Dasgupta, 1998: 67).

The main idea of liberalising and deregulating is to leave the management of the economy to the market, and prices to be determined by the free interaction of demand and supply forces. The role of the State is to withdraw its intervention in the economy. As Dasgupta (1998: 93) puts it, "*any intervention by the state - in the form of controls, subsidies, selective protection, etc. - would distort prices and make the resulting allocation inefficient, thus hindering economic growth. Controls, by restricting flows of commodities or capital, involve high social costs, distort priorities, and involve rationing in some form or the other. Further, controls create opportunities for rent-seeking and bribing on the part of licence-seekers or for accumulation of social/political power*". According to this, the SAP restrains the state to intervene the economy. This, without considering that its implementation was to be carried out in third world countries, with severe market imperfections and externalities. Yet, the implementation of these packages was a requirement for accessing loans from the World Bank and the IMF, and therefore none underdeveloped country under a debt crisis and economic problems could successfully afford oppose such an 'imposition'.

2.2.3 General Effects of SAP

The belief behind the SAP is that when facing international competitors, local firms will increase productivity and will perform better because of the pressure coming from these international competitors. Dasgupta (1998: 113) also argues that global trade is free and competitive, with few trade barriers, all that a country needs is to identify commodities in which it enjoys a comparative advantage. In fact, the elimination of such controls and incentives leaving the private actors to interact alone, encourages domestic and private companies to 'move in'. The SAP discourages subsidised investments in heavy industries and supports production in line with the comparative advantage of the country, which at the same time encourages specialisation in lighter industries like textiles and garments. (*ibid.*: 116) These arguments support the idea that SAP were intended to have a positive effect in the economy, encouraging the local industry to become more competitive and specialised in those sectors in which the country posses comparative advantage.

2.2.4 Main Policies of SAP

Five main measures in World Bank adjustment programmes are expected to facilitate an economic environment favourable to the activities of globalised production presumably controlled by transnational corporations. (Rojas, 1997:1) These policies are:

1. Promotion of outward-oriented growth;
2. expansion of the private sector's role as the growth process's driving force;
3. removal of barriers to international capital flows;
4. diminishing economic role of the state; and
5. deregulation and restructuring of domestic labour markets.

The main package of policies of SAP is noted in the following table, which is based on Rojas (1997):

Table 2.1 SAP Package of policies

COMPOSITIONOF SAP	MAIN POLICIES	MAIN ACTIONS
STABILISATION	1. Fiscal Policy 2. Monetary Policy 3. Devaluation	Adjustment of Exchange rate, reducing the fiscal deficit, contracting money supply.
STRUCTURAL ADJUSTMENT	1. Resource Mobilisation	Liberalising the allocation of credit, improving incentives to save.
	2. Public Sector Allocation	Increase the productivity of public investment (charging for services, abolishing subsidies), improving the efficiency of public enterprises.
	3. Market Liberalisation	- goods market - current account - domestic financial markets - capital markets - internal factor markets - return to market-determined price - removal of qualitative restrictions - promotion of private sector operations - limitations to the role of government.
	4. Institutional Reform	Decentralisation, reducing the size of the State, Privatisation.

Source: Rojas, (1997:2)

2.2.5 Role of the State under the Implementation of a SAP

The neo-classical economic theory, which exerts a lot of influence on World Bank's policy, suggests that the government should not intervene and should let the market forces set prices. The supporters of the intervention of the government argue that the state should intervene to correct market failures or externalities such as imperfect information. Precisely in situations characterised by structural uncertainty, in which it is impossible to formulate contingent contracts, the market becomes substituted by diverse organisations[2], being this mechanism of substitution the most appropriate for the allocation of resources (Garay et al.., 1998).

It is also argued that the state intervention also presents failures. The supporters of the public choice theory say that public servants and politicians will not seek public interest but only their own self-interest. In the same way is also believed that the action of the state does not only bring about inefficiencies in the resource allocation, but also diverts these resources towards non productive activities, which in many cases can be truth, specially in under-developed countries, where resources are so scarce, and a mis-direction of these can lead to more under-development.

Garay (1998) suggests that in a model of internationalisation of the economy, it is evident, that the economic reforms *per se* have become insufficient to achieve a greater level of development; thus, it is necessary to consider the important role that the state plays for the institutional arrangements of the development, planning and implementation of the policies. He also suggests that whatever is the size of the State, it should function under the logic of the new capitalist regime of open competition, with the will to contribute to the development of the new model, so that it provides not only greater efficiency and competitiveness to the economy, but also economic and social stability, an adequate income distribution, and the efficient provision of public goods (Garay et al., 1998).

Therefore, the first function of the State should be to seek the improvement of the regime of open capitalist competition, through the implementation of a set of regulations, norms, provisions and punishments of a legal, economic and procedural nature. The second function has to do with a good performance of its role as "rationaliser" of the public interest and social servant. The good exercise of both

[2] Such organisations could be the State, the Trade Unions, the NGOs, or the Co-operative Sector institutions.

functions should lead to achievement of an adequate distribution of income, provision of social services and provision of public goods.

The opening of the markets in a country also leaves several sectors that were not prepared, unprotected from the flow of international competition which in the end will demand more intervention of the state to guarantee their survival. Around this, Garay (1998) argues that despite of the fact that it was presumed that the globalisation would favour the reduction of the State, this integration has led to a greater exposure to external risks, and therefore, to a larger need for government programs to diminish the effects faced by the least favoured groups when facing external competition. In this sense, the argument of the creation of dynamic competitive advantage is based on the assumption that the existence of wrong prices is the reason why the intervention of the State is required to provide adequate market conditions that can offer producers proper conditions to face external competitors (Garay et al., 1998:83).

However, it is also argued that SAP and all the globalisation trend have diminish the role and importance of the State. "*A declaration prepared by NGOs attending UNCTAD IX stated that globalisation and liberalisation have succeeded in increasing the power and rights of multinational corporations while decreasing the role of the states. The statement further argued that the structural adjustment programmes designed by the IMF and the WB, which have 'shifted inequalities and political stability', had been intensified in their effects by the Uruguay Round's liberalisation*" (Davis and Bishop, 1998:165).

Contrary to some of the arguments presented above, the public sector plays in the case of the oil industry in Colombia, more than a provision of a service. It is to provide a co-ordination process in the interactive construction of the oil exploration and drilling infrastructure. For this particular case the government seeks technology transfer through strategic alliances with multinational oil exploration corporations, but remains control of the whole operation. It is therefore hared to escape the conclusion that explanations of or justifications for the continued existence of public enterprise must be in terms of correcting market failure and achieving particular distributions of payoffs (Rees, 1984: 6).

2.2.6 SAP Related Industrial Policies

The structural changes have reached to the very roots of the industrial structure. The actual debate on industrial policy in Latin America is centred in the competitiveness issue. The Industrial policy has been guided towards the generation and diffusion of technology and the increase in productivity. In order to be able to cope with globalisation, governments are aware of the need of strengthening national industry, establishing competitive advantages. Garay (1998) suggests that in Latin America, governments have followed two types of industrial policy:

- Horizontal Industrial policy to level the market through the correction of market failure
- Industrial policy to increase employment and economic growth based in the effectiveness of industrial policies in the NICs.

As part of the efforts made to increase competitiveness and reduce the size and scope of government, privatisation of public provision of various goods started to be carried out in the 1980s and 1990s in order to make it more efficient. It is argued by Hemming and Mansoor (1988) that liberalisation cannot proceed successfully without privatisation. The poor performance of public enterprises, the corruption, and the bureaucracy are some of obstacles that privatisation aims to overcome. According to Hemming and Mansoor (1988) privatisation is seen primarily as a means of improving the efficiency of enterprises. Because it is believed to limit the scope for political interference in decision making, to increase managerial incentives by making managers responsible to shareholders, who will monitor their performance better than governments. Privatisation is also beneficial to reduce the power of public sector unions.

Privatisation practically affects all economic sectors. Even activities traditionally reserved for the public sector are increasingly being entrusted to private operators. Most transactions have occurred in strategic sectors that used to be publicly controlled: utilities, such as telecommunication, power and gas; natural resources including hydrocarbons and mines; railways; steel, -and financial services including banking insurance. In countries like Colombia, the progress at privatising the State Petroleum Company has been uneven, in part due to nationalistic views towards energy resources like oil.

2.2.7 Specific effects on Industry as expected by policy makers

In considering the impact of SAPs on the industry, the OECD (1987) questions this effects, on how these could generate higher long-run economic and social costs than those they were designed to obviate. SAPs are expected to bring sound policies that provide a proper business environment for industrial development.

2.2.5.1 Efficiency

It is arguable that when firms are faced to international competitors, they will improve efficiency and productivity, as there is another type of incentive. This change is expected to bring up the creation of technological capacities, because international competition encourages firms to reduce costs, improve quality, introduce new products, take advantage of economies of scale and acquire information for design and processes.

In the case of public enterprises, one rationale for their existence is based on the need of the government to supply the so called public goods, to which every citizen should have access to, and especially because there are high costs in establishing supply networks for services such as water, gas, electricity, rail transport, telephone services. According to Rees, (1984: 3) "*it would be prohibitively expensive to have two or more competing firms constructing alternative networks so that each consumer would have a choice of supplier. A single network then has been taken to imply a single seller. If the seller is a profit-maximising monopolist, theory predicts that price will be raised above marginal cost and output of the good will be restricted below its optimal level*". In the case to be analysed in this research, the public enterprise takes care of the exploitation and drilling of oil, and to some extent to the production of gasoline.

2.2.5.2 Investment

The main effect that SAP has had on investment is that it has increased its availability, it has reduced the cost of financial resources for firms; therefore firms have implemented new technologies and production policies (OECD, 1987). The liberalisation of the economy will bring about capital inflows, which according to Jansen and Vos, (1997) are supposed to increase the investment ratio and public sector investment. They also argue that increased capital inflows and the subsequent increase in aggregate demand may lead to an increase in domestic prices and appreciation of the real exchange rate (The Dutch Disease). In contrast to these arguments, Jansen and Vos (1997) also suggest that several studies have shown that after years of structural adjustment, private investment stayed below desired and expected levels.[3]

The Determinants of private investment have been strongly affected by debt crisis and SAPs. (Jansen and Vos, 1997:114):

- *Expected Demand: The decline in public sector spending, reduces aggregate demand. Privatisation drive (part of SAP) tends to open opportunities for private investment*
- *Opportunity Cost: The cost of capital is likely to increase. The financial problems of the public sector are likely to be reflected in high interest rates. SAP is a likely to contribute further to increases in interest rates. Furthermore, the decline of infrastructural investments by the public sector will increase the cost of investment and production.*
- *Availability of investment finance: The public sector's financial imbalance make substantial claims on domestic financial markets, and the debt overhang may reduce access to international financial markets.*

It can be argued then that some of the effects of SAP on investment are positive and some negative, and it can be better seen on empirical evidence for each particular case (Jansen and Vos, 1997).

2.2.6 Dilemma of SAP in the context of Colombia

In countries with such market imperfections like Colombia, this paper's author believes that it is essential to balance between the market forces and the state intervention. It is likely that the SAPs bring some of the good effects mentioned above, but it has also had some other effects, which will be further discussed in chapter three. Colombia is one of those cases where the local economy was not ready at all to compete with the rest of the world. The more traditional exports were coffee, flowers, bananas, and most important of all oil. But a great part of the rest of the industry in many cases has collapsed, perhaps due to a lack of protection from the government, which in order to follow up the agreements made with the IMF and the World Bank has overlooked the real situation of small and medium size enterprises.

According to Davis and Bishop (1998:159) "Since 1960, World Bank Projects and International Monetary Fund (IMF) Structural Adjustment Programmes have

[3] See World Bank, 1990; Mosley et al, 1991; Serven & Solimano, 1992; Chhibber et al., 1992. (Jansen

helped double the gap between rich and poor countries. The protectionism of the North, masked as it is by the rhetoric of 'free trade', reduces national incomes in the South by about twice the amount of official aid to the region".

2.3 Multinational Foreign Direct Investment

This section will analyse the current debate on the role of Multinational Corporations (TNC) as key players in the new market structure after the SAPs implementation and will also approach the arguments on the impact of FDI in developing countries. It will focus on discussing the negative and positive effects that TNC can bring, as well as the costs and benefits of FDI .

2.3.1 Multinational Corporations in the globalised economy

TNC have played a very important role in the recent development of Latin American economies. After the end of the ISI model, when countries started to open up their markets, these companies started to enter, and were expected to provide these countries the benefit of their technological development. The new opportunities for market expansion that Latin America offers, the chance to establish factories at lower operating costs, and the establishing of trade blocks like Mercosur and NAFTA are some of the reasons why TNCs enter Latin America.

De Mello (1997) argues that TNCs generate FDI as a corporate profit maximising strategies to overpass competitors in market domination, facing cross-country differences in productivity factors and allocation of resources. The market structure of the host country can be considered as a determinant of this decision, and the degree of monopolistic competition, which could affect to the extent that investors can cover the sunk costs of production, and subsequently lead to a gain in market share.

The profit-maximisation behaviour of TNCs is supposed to help the host country to enhance its economic conditions. As De Mello (1997:9) puts it "Through capital accumulation in the recipient economy, FDI is expected to be growth-enhancing by encouraging the incorporation of new inputs and technologies in the production function of the recipient economy".

In a study carried out by De Mello (1996) it is tested the hypothesis of increasing returns due to FDI for the five Latin American economies (Brazil, Mexico, Venezuela, Chile and Colombia) that absorbed most of the FDI in the region during

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and Vos, 1997:112)

1970-91. The findings suggest that both directions of causality between FDI and output growth depend on the recipient economy's trade regime, ranging from import substitution to export promotion. Also, both open-economy performance variables (for example, terms of trade, foreign debt, etc.) and domestic policy variables are shown to affect FDI and growth in the long run. Overall the findings allow us to compare and contrast two extreme possibilities in the relationship between FDI, Total Factor Productivity (TFP) and output growth in Latin America (De Mello, 1997).

Another important benefit on TNCs is that when entering monopolistic sectors, these firms can contribute to reduce market distortions and increase the competition among firms. FDI also helps local firms to penetrate international markets, since the TNCs have a better commercialisation net, better knowledge of consumers in different markets, and higher levels of investment in product differentiation; the so called dynamism and diversification of host country's exports.

According to Lizondo (1991), "Hymer (1976) argues that the very existence of multinational firms rests on market imperfections: structural imperfections and transaction-cost imperfections. Structural imperfections, which help the multinational firm to increase its market power, arise from economies of scale, advantages of knowledge, distribution networks, product diversification, and credit advantages. Transaction costs on the other hand make it profitable for the multinational firm to substitute an internal market for external transactions" (Lizondo, 1991:71).

2.3.2 Capital Flows

Since the mid-1980s, because of the globalising world environment and the implementation of structural adjustment packages, many developing countries have applied the liberalisation of the capital account. The argument in favour of such a policy is that capital inflows are expected to flow in and therefore positively affect the country's economy. Such an argument is strongly supported by Helleiner (1996: 9) when saying that "*capital inflows are generally welcome in developing countries for their role in financing investment, and thereby assisting in long-term development, and/or in shorter-term smoothing of consumption*".

According to Garay et al. (1998), capital flows are classified as long term, like foreign direct investment, and short term like credits at short term. There is controversy around the disadvantages of short-term flows, such as the crowding out-effect, the instability of the economy due to the speculative capital flows in the short term, and a restriction in the macroeconomic management especially under a fixed exchange rate. The main benefits of short-term flows would be obtained through the diversification of portfolio, incentives to investment because of a more competitive exchange rate, increase in foreign investment, more freedom for private initiative and a greater competition between domestic and foreign capitals, the possibility to have access to international credit, and a better use of the benefits of the commercial liberalisation.

Among long-term capital flows, there is the Foreign Direct Investment (FDI) and Portfolio Investment. There is a big debate about the analysis of costs and benefits of the FDI, on this Garay et al. (1998) argues that one of the main criteria to value the costs and benefits of FDI and transnational corporations is their contribution. The increase in competitiveness and productivity of domestic activities in the host country. The costs of FDI for the host country could be the incentives given by local governments to attract foreign investors, the restrictions imposed by head companies in terms of supply of inputs, the transference prices among filials, diversity in the quality of products, type of technology used, and research and development carried out by the transnational (See Table 2.2 to complement).

On the other hand, other authors like Davis and Bishop (1998:164) suggest that "FDI itself is no guarantee of success and may prove a hindrance by creating economic instability and balance of payments difficulties. Without any controls over profit repatriation, foreign investors may take out of an economy any profits generated and so may prove to be a drain rather than a reservoir of foreign exchange on which countries rely to purchase imports." They also suggest that the advanced industrial countries of the North established their present economic strength under cover of strict control of capital flows, which have been relaxed only recently, if at all (Davis and Bishop, 1998).

Table 2.2 SOME POSSIBLE CONTRIBUTIONS OF FDI TO THE ACHIEVEMENT OF GREATER COMPETITIVE ADVANTAGES OF HOST COUNTRIES

POSITIVE CONTRIBUTION	NEGATIVE CONTRIBUTION	HOST COUNTRY CHARACTERISTICS THA FAVOUR THE POSIVITE CONTRIBUTION
1. Giving resources and capabilities like capital, technology, market access	Can provide few resources and assets, or the wrong type. Can be an obstacle for local firms to the access external markets. Can fail in the adaptation of the productive activity to the local needs	Availability of local resources at low real costs, particularly those required by foreign firms. Structural distortions for the improvement of local assets. Development strategies that contribute to promote dynamic comparative advantages.
2. Providing new ways of business organisation, organisational culture and more competitive and dynamic practice.	The inadaptability to the local business and culture on behalf of the foreign business styles. The introduction of foreign procedures and industrial relations can generate tension in local firms. The utilisation of anticompetitive practices can generate concentration of the market.	The policies implemented by host governments to promote the local entrepreneurship and the work ethic; the nature and efficiency of the capital markets, the effectiveness of the market policies. It is easier for the bigger countries to develop some of this conditions compared to the case of small countries.
3. More efficient allocation of resources, competitive incentive and benefit from externalities to suppliers and/or clients of the FDI can contribute to improve the domestic capabilities and productivity of local firms in diverse activities related to those of foreign firms.	It can limit an improvement of the local resources and capabilities through the restriction of the local production to just low value added activities and to a dependence of the import of intermedium goods with greater value added. It can reduce the opportunities to benefit of agglomeration domestic economies.	The efficiency of macro-organisational policies and administrative regimes. The benefits from FDI depend of the provision on behalf of host governments, of adequate legal framework, of commercial and labour policy that contribute to improve the human and technological capabilities, and to favour the creation of regional clusters.
4. Increasing the GDP of the host nation through the above reasons (1-3) and generating extra tax income to local governments.	Restricting the GDP through the above reasons (1-3) and reducing the paid tax to local governments through the transference of prices to others.	The establishment of adequate tributary policy to minimise the abusive behaviour of the transference prices.
5. Improving the balance of payments through the import substitution, increase in exports or investments that generate efficiency.	Worsening the balance of payments through the limitation of exports and the promotion of imports.	The central objective of the policy is not the balance of payments per se, but the contribution of FDI to the economic efficiency, the stability and growth.
6. Contributing to insert the local economies in the global market and to generate economic growth through a more efficient division of labour.	Promoting a division of labour based on the global interest of the foreign firms that can result in inconsistencies with the dynamic comparative advantages of host countries.	The application of government policy to promote investment firms, to improve activities that generate value and to invest in activities that support the dynamic comparative advantages of local resources.
7. Exposing the local economies to the economic and political systems from other countries, to the values and structures of demand of the foreign consumers, to the new labour practices, to industrial relations and foreign employees, and to many other practices and norms of behaviour of international society.	Causing tension in the political, social and cultural arenas because of the introduction of unacceptable values and the direct interference of foreign firms in the political regime of in the electoral process of the host countries.	In the way that the host society is solid and stable to adequate to the changes in the technological and political level. Also the quality of the regulations and government's norms, the nature of the objectives of the host country's policy, its sovereignty and cultural autonomy.

Source: Dunning (1994) in Garay et al. (1998:159)

The access to FDI has been argued to be a determinant to technological development, Garay et al. (1998) says that the access to flows of FDI is fundamental in the context of industrial and technological policy and adequate infrastructure. In the same way, Hirschman (1971) considers FDI to have negative and positive effects. The positive ones are the bringing of capital, entrepreneurship, technology, management and other skills, and international market connections, all of which are either wholly lacking in the poor countries, or are inadequately. The negative ones on the other hand, are the "danger of economic plunder and political domination which are the stock-in-trade of the various theories of imperialism, but a number of other, more subtle, yet serious effects and side effects which can handicap the development efforts of countries placing prolonged and substantial reliance on private investment from abroad" (Hirschman, 1971:226). Hirschman (1971) also argues that FDI can supply factors of production that are not found in the receiving country, as in most developing countries the scarcity of several factors of production is found very often. "*More generally, foreign investment can make it possible for output to increase sharply, because it provides the recipient economy with a larger quantity of comparatively scarce (if not entirely missing) inputs*" (Ibid., :227). There is also an important argument made by Hirschman (1971) about the case when the components or inputs generated by FDI may enter to compete with local industry, therefore preventing its growth, specially when the local industries are not very developed.

2.3.3 Determinants of Investment

The main determinants of investments are said by de Mello (1997) to be demand variables, such as market size, economies of scale and relative factor prices. On the other hand, inflation is considered a variable to measure overall economic instability, which increases the user cost of capital in the recipient economy therefore affects the profitability of FDI negatively. Another important variable to consider is the exchange rate, which can affect FDI as its application affects a firm's cash flow, expected profitability and the attractiveness of domestic assets to foreign investors. In contrast, it can be expected positive impact if the domestic currency is relatively weak compared to that of the foreign investor.

Several studies made by ECLAC show that the deregulation and liberalisation are not enough to attract capital flows. There should be other mechanisms such as the protection of foreign investment to offer investors secure conditions to carry out their investments; the elimination of treatments such as the double taxing; and, the design of programs that allow foreign capital to have trust and perspective in the development of productive activities (Garay et al., 1998).

There are countries that represent risk for TNCs. In order to overcome this, foreign investors can diversify their portfolio of investments in different countries. Lizondo (1991) argues that a firm could reduce its overall risk by undertaking projects in more than one country. FDI can therefore be viewed as international portfolio diversification at the corporate level.

Finally, Lizondo (1991) suggests that FDI depends on the ownership and internationalisation advantages of the country's firms and also on location advantages that can be provided by the host country. This sort of advantages could be availability of natural resources, good transportation systems, good communication systems etc.

2.3.4 Concluding Remarks

It is important to note that TNCs bring benefits and also benefit from their international operations. Along the positive effects for the host country are the technology transfer, capital accumulation and increased competition. TNCs benefit from low costs, market expansion and profit maximising. It is also worth mentioning that the host's country's market structure and domestic policy are determinants of the investment made by TNCs.

Capital Flows have positive and negative effects: Among the positive are: financing investment, assisting long-term development, increase competitiveness and productivity and technological development, some negative effects are the crowding out effect, economic instability and exchange rate devaluation. This theoretical approach suggests also that it depends on the country's policies to attract Capital Flows and benefit from them.

2.4 Industrial Performance

This section explores the factors determining the industrial performance in the context of oil exploration, the way in which is carried out in Colombia, (state-own monopoly working with TNCs as partners). As it is an industry which has to compete within international markets, it will first be analysed the competitive advantage variables, followed by an analysis of the measurement of industrial performance, like productivity, profitability and costs, and the factors affecting it.

2.4.1 Competitive Advantage

Michael E. Porter (1990) suggests that the international competitiveness of companies can be analysed on the basis of four interrelated variables:

1. Strategy, Structure and Rivalry: The level of the sector rivalry and competition within any one country. The more competitive the sector within the country, the

more competent may that country's industry be to handle competition within a wider international context.

2. Demand Conditions: Porter suggests that there is a direct relationship between a) the relative strength and sophistication demand for the products of any particular sector in a country, and b) the likely dominance of that country's industry within world markets.
3. Factor Conditions: International competitive advantage will be based upon access to, or the possession of particular factors of production such as: Human resource skill and competence; physical resources, location and sources of energy; knowledge resources; capital resources; and infrastructure.
4. Related and supporting industries: Porter suggests that a country may derive competitive advantage from clusters of related and supporting industries. Activities within these clusters support and stimulate activities elsewhere.

In the case of Oil Production in Colombia, the one and only company in charge of the production of Oil is ECOPETROL. Therefore, inside Colombia, ECOPETROL does not face any rivalry. At the international level, there can be considered to be high competition among oil producer countries, competing not only for the positioning of the product in the market, but also in attracting multinationals to invest in the country. The demand is almost guaranteed when the production mode is a joint venture. The other factors that Porter mentions could be determinants on the attractiveness of the country for TNCs. In this matter, Colombia as a developing country lacks some of the factors. This difficulty is contrasted in some way with the Association Contracts with TNCs. Porter's point is relevant because the degree in which ECOPETROL is competitive depends on these variables, and one of the goals sought with the implementation of SAPs, is the increase in competitiveness of the productive capacity of the country.

2.4.2 Measurement and Factors affecting the industrial performance of public enterprises

The measurement of industrial performance of public enterprises according to Rees (1976) centres on their losses or, if profitable, on the level of their prices. However, he argues, both losses and profits arouse public criticism. Losses are seen as an indicator of inefficiency and profits are regarded as having been generated by use of monopoly power. It is also discussed that public enterprises show higher levels of costs, compared to the private sector. Public enterprises, though, are capable of responding efficiently to the stimulus of competition.

On the other hand, the performance of public enterprises is according to Prokopenko and Pavlin (1991) linked to bureaucratic and unbusinesslike conduct. They describe the existence of a vicious circle, which indicates "*structurally in-built rigidities*" in public enterprises. It starts with lack of managerial autonomy, which leads to weak financial discipline that results in financial crisis, leading to less managerial autonomy and accountability and further strengthening of central controls and decision making. In the case of the oil industry in Colombia, this circle applies, as ECOPETROL, has the characteristics of the public enterprises described by Prokopenko and Pavlin.

Rees (1976) also considers that are 4 objectives which are what governments mean by public interest:

1. Economic Efficiency: divided in Managerial and technological efficiency and allocative efficiency. The first is concerned with the relationship of inputs and outputs, readiness and ability to eliminate waste and exploit new technological and market opportunities. The second is concerned with welfare economics and allocation of resources in an economy. It is inefficient when some people are better off; it is efficient when there is no one better off.
2. Profitability: It is defined the *gross trading surplus*, which is the excess of its total revenue over its operating costs. *Profits* are the excess of its gross trading surplus over interest and depreciation provision.
3. Effects on income distribution: Governments have specific views on the distribution of real income, and it will be reflected in its policies for public expenditure. Real incomes are to be redistributed.
4. Relationship with macroeconomic policy: Public enterprises' potential macroeconomic effects have become a matter of concern. Certain variables under public enterprises may be viewed as instruments of macroeconomic policy. Generally when formulating macroeconomic policy, attention is mostly focused to: level of unemployment, rate of inflation, surplus/deficit on the balance of payments and rate of growth of national output.

. Millward et al. (1983) suggest that there are 3 commonly found measures for enterprises performance: a)Productivity, b)Costs, c)profits. And they to measure the objectives of maximising the income of owners and economic efficiency in the allocation of resources. For them, productivity means to measure the volume of resources used to produce a given pattern of outputs. It is usually presented in the form of growth rate or indexes. One of the problems with measuring productivity is for comparison with other firms, as different firms have different characteristics and factors that affect them.

Another factor that according to Rees (1976) affects public enterprises is that the control and monitoring process of them is sufficiently weak that it allows interest groups within the public enterprise to pursue their own objectives, which tend to imply inefficiency and high costs. This is the case of the power of the union in Ecopetrol as it is mentioned in chapter 5. In chapter 5, it will also be measured the performance of ECOPETROL, in terms of production (KBPD), number of wells, production per well, exports, imports, share of GDP, and royalties. Little attention will be given to the financial performance (profitability) due to the volatility of international oil prices.

2.5 *Analytical Framework*

This chapter, supporting the main argument of this paper has suggested that the SAPs have brought about important changes in developing countries. After having identified its origins back in the 1950s in the IMF, and having distinguished its main policies, it was established that SAP generated particular effects in the economy. In theory many of these effects are positive, like higher investment levels, technology transfers, increases in public investment, higher demand, etc.

Unfortunately, in my view, SAP is a standardised set of policies aimed at opening up the economies of the less developed countries, without any particular considerations of each country's specific economic structures, and competitive and comparative advantages. Theoretically speaking, a SAP is supposed to lead to economic and social development, but there are differences in the structures of each country, and even within a country there are differences between the sectors, thus some sectors may have benefited from SAPs, whereas others may have not.

The role of the State under SAPs is reduced, consequently there is privatisation of many PSEs (public sector enterprises), and those which are not privatised are restructured in order to reduce bureaucracy and increase economic efficiency. It is also important to consider the argument that when there is a crisis, the

State has to intervene to cope with the resulting problems, and nowadays that has been the case, as with the SAPs the State withdraws, but when crisis arise, intervention is needed to correct the market failures.

The importance of TNCs in the context of SAPs is said to be the generation of FDI, enhancement of the host country's economic conditions and reduce market distortions. Another SAPs' effect is the attraction of capital flows, which are viewed as an important source of investment, but also bring some negative effects like revaluation of the exchange rate, and capital flight among others mentioned in section 2.2.2.

Further advantages have arisen from the potential economic stimulus that PSEs have received from the government to increase their competitive advantages and economic efficiency, in order to correlate more effectively within the globalised context. Summarising, in theory about Structural Adjustment policies, there is controversy about correlated effects. In the following chapters an attempt will be made to evaluate the significant changes in the overall economic performance, the social context and the PSE ECOPETROL, that are directly or indirectly linked to the implementation of SAPs.

CHAPTER 3

COLOMBIA BEFORE AND AFTER THE SAP

3.1 Introduction

From the mid-1980s, Latin American countries have undertaken a strategic change in their economic model. Colombia started this process in 1990, when President Cesar Gaviria supporting a change in the constitutional framework through a referendum, and a National Constitutional Assembly that lead the country to implement a package of policies, given the fact that Colombia could no longer proceed with its inner market oriented model. It should be noted that the success of this change has been counter-argued by many, and it has come across obstacles not only in the economic sense, but also in the political and social levels.

Having reviewed the main theoretical background of the SAP in chapter 2, this chapter describes the process that took place when the government of Colombia changed its economic model with the perspective of entering to the globalised world economy and healing the macroeconomic instability that had been undergoing. Complementarily the effects that the SAP has brought about in the particular political and social context of Colombia are analysed.

3.2 Change in the Development Model and implementation of SAP

This section presents the elements of the overall historical framework of the implementation of the SAPs in Colombia. The emphasis is placed in describing the different measures taken in the process of changing the development model, and not in the reasons behind them, as they were discussed in chapter 2.

By the mid-1970s, the stage of rapid growth that was achieved since the 1950s in Colombia, showed limitation signs. During this period, the country achieved high growth rates due to the technological learning process and industrialisation that took place, as never before. In the beginning of the 1970s, there was an oil crisis and better on by the late 1970s an external debt crisis which subsequently deteriorated the terms of trade and increased international exchange rates (Stumpo, 1998:16). This made evident that there was a delay in catching up with the world's technological and industrial development, lack of competitiveness, resulting in economic instability accompanied by high inflation.

In order to face the negative economic context, a SAP was implemented. The first generation of adjustment policies were the following: commercial liberalisation, capital account opening, elimination of capital controls, financial liberalisation, deregulation of the labour market, reform of the state and privatisation of some public enterprises. The second generation of adjustment policies where those of an institutional nature, with the aim of creating an efficient and effective socio-economic system. Among these policies are those made to the justice sector, the civil servants, labour (including the trade unions, corporate and government), the social security, and the political-administrative organisation of the State through decentralisation (See table 3 for chronological description of facts).

The program to open up the economy adopted in 1990 also included the following measures: the reorganisation of the institutions related with the external sector, the liberalisation of the exchange rate, the elimination of import licensing, reduction of the import tax through reducing protectionism by one third. The integration with neighbouring countries was also promoted.

To the same extent, after 1994, the government designed an industrial policy strategy towards the increase of competitiveness, through co-ordinating efforts between the public and private sector. Under such scheme there were designed strategies for technological development and innovation; and productive, commercial and infrastructural modernisation, with the aim to acquire sustainable competitive advantages. In 1994 the exporter plan was implemented to deepen the reforms of the opening process, orienting the strategies toward the generation of competitive advantages, granting incentives to commercial negotiations and exports.

Besides the commercial liberalisation, the legislation provided the government instruments to carry out processes of economic integration, like the revitalisation of the 'Pacto Andino' (Andean Pact) as a customs union (nowadays the Andean Union). Other integration policies are the co-operation agreement between Chile and Colombia, liberalising completely bilateral trade; and the agreement with Mexico, Venezuela and Colombia (the group of the three), in which a timetable has been set up to reduce import tax gradually.

The Sectoral Agreements for competitiveness are part of the Government's strategy to increase competitiveness, these agreements involve representatives from different sectors of the economy, and aim to co-ordinate efforts towards improving competitive advantages; the sectors in which there are such agreements are: clothes, siderurgy, metalmechanics, capital goods and automotor sector, petrochemicals, plastics, paper and editorials. To support this, the National Council of Competitiveness was created to generate synergy between the government and the corporate sector, in topics of productivity and quality for competitiveness.

It is also worth mentioning that the privatisation of some public enterprises was accompanied by a restructuring of the social security system, with the aim of making it more competitive and also provide a better service to the public.

Table No. 3.1 Chronological Sequence of Policies in Colombia

YEAR	POLICIES and/or EVENTS
1930-1946	Liberal Republic. Conservative split in election of 1930 brings the Liberal party to power, initiating period o social reform, economic development, and growing tension between parties.
1946-1966	Period Conventionally defined as the Violence. Whole period of economic growth paced by high coffee prices. Restrictive legislation further limits power of organised labour.
1958-1974	National Front. Liberal and Conservative parties alternate presidency and share power.
1974-1978	Regime's neo-liberal economic policies generate powerful urban protest in 1977. Green Revolution in coffee production and bonanza from high coffee prices pace continued growth to the economy.
1978-1982	Failed attempts to make deal with guerrillas, Drug trade emerges as important factor in economy. Charges of clientelism and corruption plague administration
1982-1986	Economic downturn, government concentrates on peace negotiations.
1986-90	Liberal president Virgilio Barco presides over continued growth and liberalisation of the economy, implements social welfare measures and large scale development projects, pursues negotiations with guerrillas and engages in bloody war against drug Mafia.
1990-1994	President Gaviria starts the implementation of SAPs with commercial liberalisation, capital account opening, elimination of capital controls, financial liberalisation, deregulation of the labour market, reform of the state and privatisation of some public enterprises
1994-1998	SAP's second generation policies of an institutional nature, with the aim of creating an efficient and effective socio-economic system. Reforms to the justice sector, the civil servants, labour, the social security, and the political-administrative organisation of the State through decentralisation. Industrial policy strategy towards the increase of competitiveness. Privatisation.
1998-current	President Pastrana starts with a new peace process with the guerrilla, 'Plan Colombia' which is an aid plan through which Colombia will receive USA aid for combating guerrilla wars and for other social objectives. Deep economic recession.

Source: Bergquist et al. (1992) and Author's elaboration.

3.3 Political Economy in Colombia

The Colombian Political system has evolved towards a corporativism ad hoc, in which the most important decisions are taken in consultation with the pressure groups that would be more affected, and that are outside of the institutions that are supposed to be representing all these groups, that is The Congress of Colombia. The corporations, unions, and even consumers have voice in the policy decisions made in respect to salaries and all sorts of economic policy. According to Kalmanovitz (1999) the Congress of the Republic was never good to attend the requirements of all the population. In Colombia such institutions is considered by many to be corrupt, overspending the state funds, and it is not just a bad image, recently, in an investigation made, it was discovered that in the past 10 years, politicians have stolen COL$7.2 billion (around 3.6 billion US dollars) from the state own banks. (Semana, 2000) And for this sort of loss, the Colombian people is who has to pay, according to this investigation, each one of the 25 million account holders of Colombia will have to contribute with 280 thousand pesos (140 US$) to overcome the crisis.

The Colombian bureaucracy is the result of a strong feudal past, the great property, the legality of privileges and the Hispanic culture which still runs the capitalist system that has been struggling to change this inescapable past.

Colombian's lack of institutional capacity has been identified as one of the major constrains for achieving a sound development strategy. Since 1986 Colombia started to implement a decentralisation policy which up until now has achieved a new constitutional framework, electoral reform, local elections, functional and financial reform of governments, the *Ley de Competencias y Recursos* (law on local government functions and financing) and the creation of three social funds to operate on a matching-grant basis.

In the period of 1986-1990 the president of Colombia, Virgilio Barco, made of poverty alleviation its most important goal, he called his development plan "War on Poverty". Decentralisation in Colombia has always gone together with poverty reduction, the main objective of this strategy was to reduce poverty through the transfer of responsibilities to lower levels of government. Local Governments were thought to be able to identify welfare requirements better as they are closer to the community which they are willing to help. Under that current situation of Colombia, the government also sought the increase of accountability and transparency of the public sector, corruption, as mention before has been a big issue and through this strategy new control mechanisms should give a positive outcome.

Another goal of the Decentralisation strategy was to adopt expenditure co-ordination and revenue harmonisation, including proposals for tax and revenue sharing mechanisms. This has meant the redefinition of expenditure responsibilities between the central and local governments, and the creation of new credit co-financing mechanisms, in order to measure the priorities considering the local and central views. All these with the main aim to improve the provision of social services at all levels.

The new constitution of 1991 ended more than 15 years of trying to change the rigidity of the system that was influenced by the Catholic Church and Hispanic culture. The Colombian State after 1991 has more equilibrium amongst its different powers, which enables the political class to have more balance. It is also clear the State's role in economic issues is more distant than before. The Central bank is given a more independent role, autonomous, reducing in this way the government manipulation to monetary policy and credits.

The Political system in Colombia is supposed to be now a more flexible one, with more credibility and more focused towards social interests. But despite all the changes, instability, corruption and political conflicts still persist, and it does not look like it is going to get better in the foreseeable future.

3.4 The Industry Approach

Colombia has gone through two phases of industrial public policy since the beginning of the 1990s, when the liberalisation of the economy started. First, since 1991, the policy was oriented towards the efficient utilisation of factors, believing that the market would generate and strengthen the competitive advantages in order to achieve economic growth. It was also believed that the modifications to the institutions would ensure the industrial development, with increases in productivity. Under this scheme the incentives to the industry from outside the sector were not considered.

Starting in 1994, the state started to consider necessary to design an industrial policy strategy, to promote technological adaptation, human resource capacitating, financing of the sector, and support to the private sector. This phase was considered of modernisation and industrial conversion, aiming to achieve higher competitiveness of national production in international markets. The second phase was more selective, identifying the sectors that were affected by the liberalisation, and also aiming at a public and private co-ordinated effort.

The current industrial policy establishes 6 strategies aiming to increase competitiveness:

1. Support to industrial technological development
2. Diffusion of Industrial Design
3. Strengthening of Human Resources
4. Strategic Alliances and support to incipient industries
5. Incentives to complementary liberalisation processes
6. National plan for small enterprises.

All these strategies are being implemented with more or less success in the different sectors of the economy. It is believed that more attention should have been given to the agro-industry, as it has no special treatment under the policy strategies of the central government, the agriculture sector has been seriously affected by the liberalisation of the economy, in view of the low prices of coffee, many small farmers opted to grow illegal plants which leave them more money and is the only survival way.

3.5 *The Public Sector under SAP*

In contrast with the decisive role that the state played in the expansion of capitalism in the middle of the century, at this level of evolution it seems that the State's role has been diminished by the importance given to the role of the market forces as regulators of the economy. However, it has been argued that in imperfect markets there is a need of a State to correct such imperfections.

In Colombia, after the implementation of SAP the size of the state was intended to reduce. The government started to privatise traditional inefficient public corporations like the public and co-operative banks, the Colombian ports, and the electricity providers among others. This although was good in terms of increasing efficiency by allowing the private sector to improve the performance of this corporations, it also raised the polemic about the state giving up the provision of public services, and in a country like Colombia this generated conflicts and protests, and worsen the conformity of the poorest parts of the population that thought would be exploited by the private sector.

In the following table it can be seen the income for privatisation that received the government in 1993-1995, as a portion of FDI. In 1993 it was 26% of total capital flows and in 1994 it went down to 11%, it was an important source for the government's finances in these years.

Table No. 3.2
INCOME FOR PRIVATISATIONS
1993-1995 (Millions of Dollars)

	1993	1994	1995	TOTAL
Income for Privatisations	247	170	0	417
Total Capital Flow	950	1438	2019	4407
Inc/FDI (%)	26.0	11.82	0	9.46

Source: World Bank, 1996. External Finance for Developing Countries.

Table No. 3.3
CENTRAL GOVERNMENT DEFICIT

CENTRAL GOVERNMENT Surplus (+) / Deficit (-)		% of GDP
YEAR	With Privatisations	Without Privatisations
1981	-2.94	-2.94
1982	-4.06	-4.06
1983	-3.51	-3.51
1984	-4.44	-4.44
1985	-2.65	-2.65
1986	-1.33	-1.33
1987	-0.47	-0.47
1988	-1.45	-1.45
1989	-1.82	-1.82
1990	-0.89	-0.89
1991	-0.26	-0.26
1992	-1.94	-1.94
1993	-0.86	-0.86
1994	0.72	-1.37
1995	-2.29	-2.30
1996	-2.97	-3.71
1997	-3.35	-3.70
1998	-4.87	-4.87

Source: DNP

Table No. 3.4
SIZE OF THE STATE
Own Incomes and Expenses. % of the GDP

	1992	1993	1994	1995	1996	1997
Incomes						
Non Financial Public Sector	**26.3**	**27.8**	**27.8**	**31.8**	**35.5**	**34.7**
National Government	11.7	13	13.1	12.6	12.9	12.4
Social Security	0.8	2.9	4.1	5.5	6.5	5.9
Local Public Sector	4.7	4.6	4.4	7.8	8.3	8.1
National Companies	7.2	5.8	4.6	4.8	5.1	5.4
Public establishments	1.3	1.2	1.3	1.3	1.2	1.2
Adjustment	0.6	0.3	0.4	-0.2	1.5	1.6
Expenses						
Non Financial Public Sector	**27**	**28.6**	**27.6**	**32.3**	**37.5**	**36.9**
National Government	7.9	8.8	8.7	8	9.5	9.6
National Government without interests	6.7	7.5	7.3	6.5	7.3	7.2
Social Security	3	3.8	4.5	5.7	6.5	6.8
Local Public Sector	10.5	10	9.8	12.5	15.2	14.7
National Companies	3.9	4.1	2.7	3.6	3.8	3.2
Public establishments	1.7	1.9	1.9	2.5	2.6	2.6

*Does not include privatisation

Source: Base NPD -UIP -defed. Model NPD – Umacro

More clear in table 3.3, it is shown the fiscal deficit of the central government as a percentage of GDP, and in 1994 when the highest income for privatisation came in the country, the government actually had a surplus of 0.72% of GDP.

In terms of size of the state, the above table shows the incomes and expenses of the public sector without privatisation. It is evident that the income as well as the expenses have increased, but in different proportion. The expense and income that has increased the most is the social security, the income for national companies has been reduced due to the privatisation. But overall the Public sector's total expenses and incomes have increased as a percentage of GDP, contradicting the stated aim of SAP of reducing the size of state.

3.6 Effects of the SAP in the social and political contexts.

It has been an important ideological premise that SAPs are a very positive thing that bring us all together, as the world becomes globalised; but this is an extremely misleading believe, as SAP has been a primary cause of societies fragmentation, and violence. In the case of Colombia, it has been especially relevant the effects that SAP has had whether they are direct or indirect.

As it has been argued before, Colombia is in economic free fall, and the effects of the policies implemented have two faces, both vile. The first the economic neoliberalism, preaching the virtues of uninhibited trade, open markets, privatisation, structural adjustment. The consequence, social devastation, the other face, is that of military repression, with fresh US cash, the Colombian military is reinforcing itself to combat the guerrilla, but could this be the best way to finish the war?.

The immediate cause of panic is the strength of Colombia's main insurgency, run by the Revolutionary Armed Forces of Colombia (FARC). In a peace-feeler several months ago, President Andres Pastrana effectively ceded the FARC control over a 6.000 square mile peace of territory in south central Colombia, about the size of Switzerland. Pastrana's decision to cede the facto control of a slice of territory to FARC, infuriated the military, which has been increasingly humiliated by guerrilla strength that recently brought FARC forces as close as twenty-five miles from Bogota. With a nominal force of 40.000, the Colombian Army currently has around 6.000 to 7.000 front-line troops who are paid only a third of what FARC's fighters receive. FARC can afford such a military budget because of its taxes on drug cultivation and shipments in the zones it controls, not to mention the money the get for kidnapping wealthy farmers and business people in the major cities.

In Colombia, political killings of peasant and labour leaders, teachers, journalists, priests, nuns, lawyers, women rights leaders, human rights workers and citizens, carried out mainly by the government and its affiliated paramilitary arms, were estimated by human rights watchers at over 3.800 in 1998. This figure is far larger than the number of Albanians killed in Kosovo prior to the beginning of NATO bombings in March. (Herman and Zarate-Laun, 1999)[4] The number of internal refugees is estimated at some 1.5 million.

Colombia has been increasingly important in the world economic order, due to its oil and mineral wealth, it also represents a threat the drug production and commercialisation that takes place in Colombia; the US has been deeply involved more recently in this, because it is directly affected by the drug trafficking. The "Plan Colombia" has been designed to strengthen Colombia's army to combat the guerrilla and therefore the drug cartels. Colombia will receive billions of dollars from the US, and technical assistance to fight the revels; it has even been questioned whether Colombia will be the next Vietnam.

The arrival of TNCs has also been a counter-effect of SAP, at least for some. Throughout Colombia indigenous tribes, peasants, and small miners stand in the way of oil drilling, agro-business, and large scale mining which cause their dispossession and severe environmental damage; as a matter of fact, oil pipes have been one of the most important targets for bombs by the guerrilla, they intensely opposed to TC, as they believe they take Colombia's natural resources for their own benefits. Occidental Petroleum has had a long-standing dispute with the U'wa Indian tribe that opposes their drilling on Indian lands. Exxon's giant El Cerrejon[5] coal mine, and other nearby mines in Venezuela, have had injurious effects on a half dozen local Indian tribes that have opposed their operations.

The Choco area in the Northwest par of Colombia, is very rich in minerals and oil, and contains one of the world's last pristine rain forests. It is being rapidly opened to mining, oil, and timber exploitation. The local peasants are resisting, and the paramilitaries, army and other drug warriors have been quietly pushing them out.

Like the cases mentioned above there are many more, fighting development and progress is the most important characteristic of the violence that occurs nowadays in Colombia, and this is closely linked to the new global economic order which supports the interaction of TNCs in less developed countries. In addition it is worthy

[4] Edward Herman is an economist and media analyst; Cecilia Zarate-Laun is co-founder and program director of the Colombia Support Network.

[5] El Cerrejon is one of the biggest open mine of coal in the world. It is situated in the north coast of

to note that by way of contrast, this generates negative effects, that can further create more instability, perhaps in a greater way that the benefits it generates, counteracting as a result the expected results from the SAP.

In general the legal framework in Colombia since 1990 has aimed to generate incentives to FDI, but there are other factors like corruption, and violence in general that affect negatively the decisions of foreign investors. (Garay et al., 1998) Factors like insecurity, violence, threats, kidnappings, etc. stop foreign investors from investing in Colombia. But beyond the economic problems that are generated by external effects, there are other sort of problems equally tragic. In the past year more than 900.000 employees in urban areas lost their jobs, more than 2 million became poor, the consumption of food decreased by more than 5%, more than 2 million children were left out of vaccinations and almost 300.000 students withdrew from school (Londoño, 2000) The social impact of this current crisis is more critical than it seems, all the redistribute measures taken in past decades have been lost, it is believed that the Gini coefficient has increased 5 points in the past two years, and the most affected ones are the 20% poorest people of the country. According to Londoño (2000) the unemployment rate in this portion of the population went up to 52% in September 1999.

To have failed to take advantage of the richness of the country in natural resources, and the opportunity to develop the industry to interact in the globalised world is in my point of view the mixture of many factors. First there was lack of appropriate design of policies to support internal development. Second, the violence as a result of a long political conflict is now playing a more important role than ever as a diminisher of political, economic and social stability. Third, external crisis shocks have also affected the country's internal financial system. Fourth, there has been inability by the government to react fast to the ever-changing economic environment.

3.7 Concluding Remarks

The empirical analysis of this chapter, on the change of economic model brought about with the implementation of the SAP in Colombia, is not meant to be a substitute of the economic analysis of the next two chapters. The analysis carried out has helped to determine the process of change that took place. It has been described

Colombia.

the chronological implementation of the SAP. Also it has been assessed the performance of the public sector under the main trends that the SAP brought about, focusing on the privatisation of PSEs, and the reduction of the public sector. A final point was made on the external effects of SAPs, which was mainly focused on the non-economic factors; those of the guerrilla insurgence and the government's inability to cope with this movement's strength. In the following chapter, the economic effects of SAPs on the country's economy with a focus on FDI flows will be analysed.

CHAPTER 4

THE IMPACT OF SAPs ON THE ECONOMY: A FOCUS ON INVESTMENT

4.1 Introduction

This chapter will focus on analysing the impact of SAPs on investment in Colombia. After a decade of liberalised markets, Colombia has experienced a remarkable increase on FDI, and an outstanding diversification of it. Section 4.2 will give an overview of the main economic trends before and after the SAPs, and then a comprehensive analysis of the FDI in Colombia will be made.

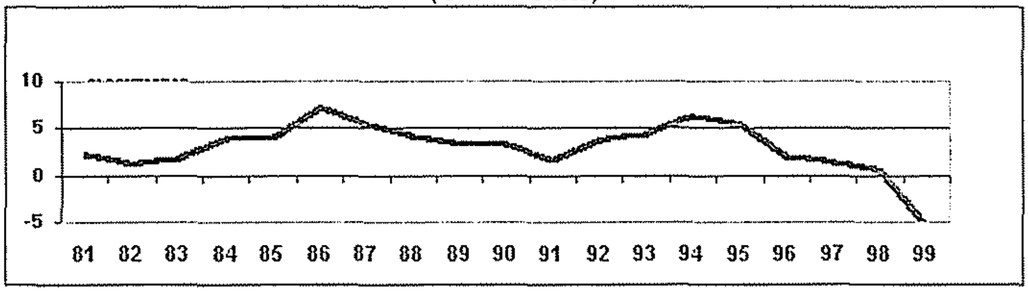
4.2 Main Economic Trends before and after the SAP

The Colombian Economy has shown a strong record of economic performance, growing on average at a pace of 4.5 percent a year in the last two decades. However, this progress has diminished since the mid-1990s; there is low GDP growth rates, high unemployment and increasing fiscal deficit.

According to the Colombian Government, the deterioration of the fiscal situation has resulted largely from the introduction of programs in the early-1990s, which entailed large increases in public spending (Restrepo and Urrutia, 1999). The government also had difficulties in fiscal management owing to widespread earmarking of government revenue, and the constitutionally mandated revenue sharing arrangements have not been properly accompanied by a reduction of central government expenditures. Hence, although the fiscal decentralisation process has helped in consolidating democracy at the local level, the central government has continued to bear much of its original spending responsibilities, with a significant proportion of its resources being transferred to territorial governments (Restrepo & Urrutia, 1999).

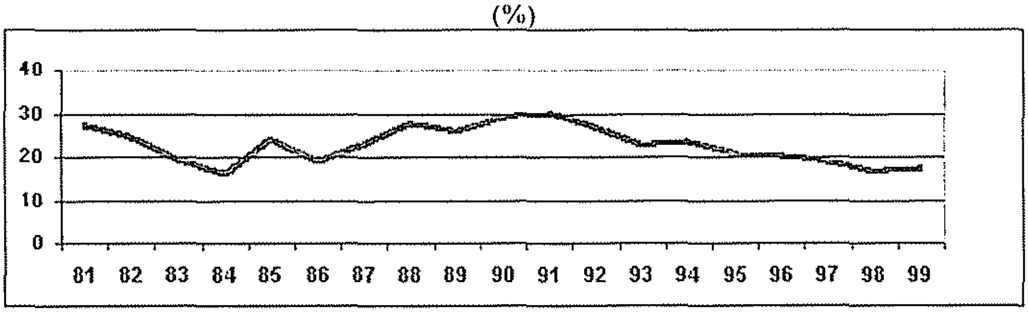
The deterioration of the economy especially after 1998 is mainly attributed to external shocks. According to the government, export revenue has decreased a great deal, and because of the lack of confidence in the economy, capital outflows have been large. There is a lot of concern about the large fiscal and external deficits. Real GDP growth was 3.1 percent in 1997 and 2.0 percent in 1996 (See Chart No. 4.1). In the first half of 1999, the real GDP had fallen by 6.7% (compared with the same period of the year before), unemployment rose to 20% in September 1999, inflation has been reduced to below 10%, despite of the fact that its average in the last 30 years was 22% (See Chart No. 2). The non-financial public sector (NFPS) deficit was expected to be 6% of the GDP in 1999, 2 points higher that the year before.

Chart No. 4.1
Evolution of GDP
(Growth rates)



Source: CEPAL, 2000

Chart No.4.2
Evolution of Inflation
(%)



Source: CEPAL, 2000

Chart 4.2 shows the evolution of inflation, which has been reduced as it is one of the main objectives of the monetary policy. It reached a peak point in 1991 at around 30%, and has been reduced to 16% in 1999. A good inflation indicator as this would indicate stability in the economy; however, low inflation rates in Colombia seem to be the result of a decrease in demand and a deep recession.

Table No. 4.3
VALUE ADDED COMPOSITION
1973, 1991, 1996

	1973 %	1991 %	1996 %
VALUE ADDED COMPOSITION			
Metalmechanic	5.8	5.8	6.2
Transport Equipment	2.5	3.6	6.5
Other	13.8	13.7	12.3
Sub-Total	22.0	23.1	25.0
Food and Beverages	26.9	28.0	29.5
Commodities	13.9	18.9	19.4
Sub-total	40.8	46.9	48.9
Marginal	37.2	30.0	26.0
Total	100	100	100
Value Added Variation	100	186.6	213.3

Source: Stumpo (1998)

Table 4.3 shows the composition of the value added in three different periods of time: 1973, when the ISI model was in practice; 1991, when the liberalisation of the economy; and 1996, which was the latest data available. It can be seen that the share of the metalmechanic sector remains almost unchanged, whereas that of the transport equipment sector has increased sharply. In the first subtotal, the sectors of the industry that could be more favoured by the interaction with TNCs are grouped. Their share in the value added increases far more than the marginal sectors, which are those not related with TNC. With this data, Stumpo (1998) shows the benefits received by the manufacturing sector, which is explained to a large extent by the investments made by TNCs.

Table No. 4.4
PRODUCTIVITY (Variation %)
1973, 1991, 1996

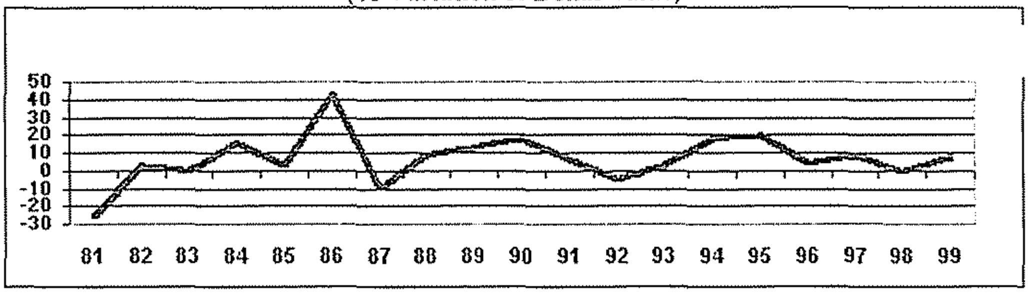
	1973	1991	1996
VARIATION OF PRODUCTIVITY			
Metalmechanics	100	141.4	166.9
Transport Equipment	100	212.0	424.6
Other	100	172.1	169.8
Sub-total	100	163.2	194.6
Food and Beverages	100	145.5	156.2
Commodities	100	189.3	213.0
Sub-total	100	160.5	175.1
Marginal	100	143.1	171.4
Total	100	160.4	191.3
Value added Variation	100	186.6	213.3

Source: CEPAL, PADI Program, in Stumpo (1998).

Table 4.4 shows an important increase in the productivity of the manufacturing sector, especially the transport of equipment which increased on average 4.3% annually until 1991. It is also worth mentioning the increase on commodity productivity, which was on average 3.6% annually.

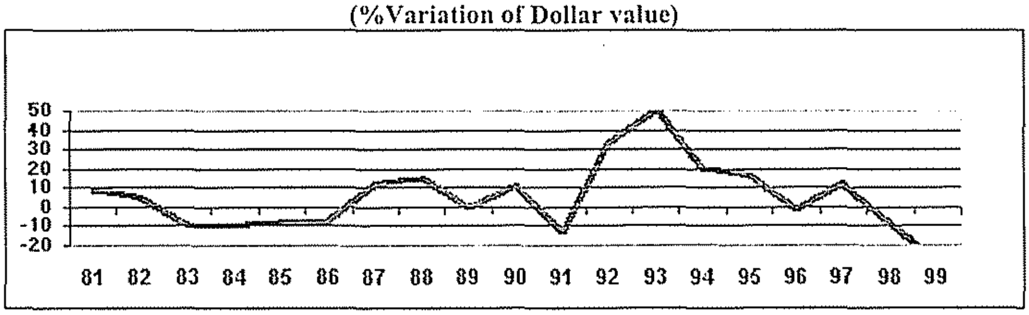
Chart No. 4.3 shows the annual variation of export value in US dollars. It can be seen that the value went from a negative growth rate of almost -30% in 1981 to around 7% in 1984, then around 1986 there was a big increase due to the oil boom and the growth rate went up to over 40%. In 1990 the export value began to decrease, contrary to what one would expect after opening the economy, but it picks up in 1993 and up until 1999 shows little variations from year to year tending to decrease. In Chart No. 4.4 it is shown the variation of import value in US dollars. It can be seen that before the 1990s there was not strong variations, due to the import substitution model, afterwards it starts to move upwards until 1993, when it reaches 50% growth, and since then it has shown a decreasing trend coming down to negative growth rates since 1998.

Chart No. 4.3
Evolution of Exports 1981-1999
(% Variation of Dollar value)



Source: CEPAL

Chart No. 4.4
Evolution of Imports 1981-1999
(%Variation of Dollar value)



Source: CEPAL

In the following table it is presented the evolution of the Balance of payments from 1990 to 1996 where it is important noting the sharp increase of the capital account balance, due to the liberalisation of capital flows. Direct investment shows an increase from U$484 million in 1990 to U$3.253 millions in 1996. Portfolio investment also shows an important increase going from U$-4.1 millions in 1990 to U$1.656 millions in 1996.

Table No. 4.5
BALANCE OF PAYMENTS 1990-1996
Millions of US$

	1990	1991	1992	1993	1994	1995	1996
1. CURRENT ACCOUNT	543.5	2346.7	875.6	-2219.4	-3112.9	-4387.5	-4784.2
Trade Balance	1971.5	2959.4	1234.1	-1657.2	-2291.5	-2698.7	-2133.1
Services	-2454.5	-2309.9	-2092.3	-1700.2	-1683.7	-2367.4	-3182.7
Transfers	1026.5	1697.2	1733.8	1138	862.4	678.6	531.6
2. CAPITAL ACCOUNT	-1.3	-773	183	2701.4	2783.2	4738.3	6759.5
Direct Inv.	484.1	432.6	678.7	719.1	1515.5	2032.9	3253.6
Portfolio. Inv.	-4.1	86	125.9	497.6	434.3	-93.3	1656.3
External Debt	-202.8	-369.4	-634.6	317.5	1672.3	1578.9	2727.6
Short Term Capital	-197.5	-926.5	13	1179.2	-803.2	1308.2	-830.7
International Org. Contributions	-81	0	0	-12	-35.6	-88.4	-37.3
3. OTHERS	92.2	349.6	234.4	326.1	-462.8	28.7	413
4. CHANGE IN NET I/NAL RESERVES	634.4	1919	1293	155.9	133.1	322.1	1572.3
5. CURRENT ACCOUNT/GDP %	1.3	5.5	1.8	-4	-4.5	-5.4	-5.5

Source: Bank of the Republic

In the following section I will focus more deeply on the effects of SAP on the economy. A focus will be put on Multinationals and FDI.

4.3 *SAP AND FDI IN COLOMBIA*

Unlike the situation in the 1980s, the 1990s were characterised by the opening UP of financial markets, therefore allowing an enormous accumulation of private foreign indebtedness, which financed both a flood of imported goods and unprecedented speculation. So far it has been seen that this led to the collapse of the financial system, the bankruptcy of many national enterprises and the generation of massive private debt, later assumed by the public sector. An important part of that debt was capital flight, as people took advantage of easy credit to access dollars and send them out of the country.

These structural reforms have been implemented less than a decade ago, Its effects can hardly been distinguished due to other factors such as external shocks, economic recession, and the social conflicts that undergoes Colombia. However some of the main effects on investment that can be appreciated will be analysed below.

4.3.1 FDI in Colombia

FDI in Colombia started to be attracted in by the mid-1940s, concentrated mainly in chemicals, metal-mechanics and paper sectors led by TNCs. Until the mid 1960s, the policy towards FDI was characterised by the presence of controls. In 1967 the decree 444 established a new series of controls aimed at regulating capital flows. In 1973 the decree 1900 established that only those mixed companies[6] could take part in the Andean group, at the same time it was prohibited the royalty payment[7] for know-how transfer.

Until 1987, the government started to release its control over capital flows allowing more freedom to TNCs to operate. In 1991, a set of norms was established to eliminate totally the capital controls, in order to allow TNCs to operate in the country with no restrictions.

In the 1980s, chemicals and metalmechanics continued their relative importance, and the sector food and beverages overpassed the paper sector. Not only the FDI was concentrated in a few sectors, but also in a small number of companies; according to Stumpo (1998) in 1975, the 30 most important TNCs represented 55.4% of the value added, 60.7% of exports and 40.5% of the total employment in TNCs.

After the ISI model collapsed, the structure of the Colombian market was characterised by the existence of oligopolies and monopolies. This favoured and facilitated the operation environment for TNCs that found the market structure set to benefit them, and which then took advantage of it concentrating even more the total output in a small number of firms.

But perhaps it is relevant to mention at this point that for a country like Colombia, the capital inflow represented new opportunities to expand the economy, as the internal demand was not increasing after the crisis in the 1980s. There was a need to incentive more FDI, even if this meant that the oligopolies of the country would gain more economic power. As a result, since 1990 the participation of FDI as a percentage of GDP has been growing sharply (see table 4.6). In table 4.6, in the case of Colombia, one of the figures does not include oil, such flows have been primarily directed towards the finance and industry sectors.

[6] Mixed companies are those that have international and national capital
[7] Royalty Payments are the share of the profit made by TNCs in the oil exploration that goes to the central and local governments.

Table No. 4.6
FDI NET INCOME AS A PERCENTAGE OF GDP
1990-1995

COUNTRY	1990	1991	1992	1993	1994	1995
Argentina	1.36	1.33	1.86	2.47	0.99	1.56
Brazil	0.21	0.29	0.56	0.30	0.57	0.88
Chile	2.07	1.61	1.71	1.91	3.41	3.11
Colombia*	0.57	0.24	0.59	0.70	1.14	1.73
Colombia	1.37	1.03	1.93	1.28	3.20	2.70
Mexico	1.1	1.69	1.35	1.23	3.01	20.4
Venezuela	0.96	3.66	1.07	0.64	1.33	0.97

Note: *Source. Banco de la Republica, without oil
Source: ECLAC, IMF.

Most of the FDI in Latin America was directed towards Mexico, Brazil and Argentina (Garay et al., 1998:166). Even though Colombia shows increasing figures in FDI, it did not reach the level of those others Latin American countries. The explanation to this is that those countries were more advanced in their public enterprises' privatisation programmes. Also, they had started the implementation of structural reforms earlier in the 1980s, had a more dynamic regional integration, and the change in strategy of TNCs which favoured those countries very much.

The following table shows the importance of FDI flows oriented towards privatisations. In Latin America the country that received more income for privatising was Argentina with 34% of their total FDI from 1993 to 1995. In Colombia only 10% of the FDI was for privatising in the same period. However, later in the 1990s the government continues to privatise more public firms as it will be discussed later in this paper. Until 1983, total annual capital flows were under US$400 millions. During the period 1984-1986 the average FDI per year reached US$754.5 millions which were allocated to the development of the oil and coal industries. In the period 1987-1991, the investment flows remained stable, despite the measures adopted in 1987 in the Cartagena Agreement[8]. Since 1991 the liberalisation of the economy brought about the flexibilisation for FDI[9]. These measures made the capital flows increase progressively from US$438 millions in 1991 to US$2.244 millions in 1994, and nearly 3 thousand million dollars in 1996.

[8] Decisions 220 and 244 were important steps to improve the conditions of international investors in the country.
[9] Law 9 of 1991.

Table No. 4.7
INCOME FOR FDI FOR PRIVATISATION OF PUBLIC ENTERPRISES
1993-1995

(Millions of Dollars)	1993	1994	1995	Total 1993-1995	Privatisation Participation in Total FDI
Argentina					
Income for Privatisations	3.137	547	702	4.386	34%
Total FDI flow	6.305	2.756	3.900	12.961	
Brazil					
Income for Privatisations	73	574	386	1.033	11%
Total FDI flow	1292	3.072	4.859	9.223	
Chile					
Income for Privatisations	351	0	0	351	8%
Total FDI flow	841	1.722	1.695	4.258	
Colombia					
Income for Privatisations	247	170	0	417	10%
Total FDI flow*	673	1.656	2.012	4.341	
Mexico					
Income for Privatisations	0	546	0	546	2%
Total FDI flow	4389	10.973	6.965	22.327	
Venezuela					
Income for Privatisations	0	3	15	18	1%
Total FDI flow	372	764	574	1.710	

Note: *Corresponds to the total FDI of the Public Sector plus the FDI in oil.
Source: World Bank, World Debt Tables, 1996. External Financial Developing Counties, Washington , D.C., 1996.

Table No. 4.8
FDI IN COLOMBIA
1970-1996
(Millions of Dollars)

YEAR	FDI IN OIL	TOTAL FDI	PARTICIPATION FDIwo* IN FDI (%)
1970		104.93	100.0
1971	7.00	51.49	86.4
1972	10.40	49.00	78.8
1973	13.10	33.44	60.8
1974	25.20	49.22	48.8
1975	17.40	65.86	73.6
1976	66.80	119.43	44.1
1977	35.20	35.32	0.3
1978	69.20	111.91	38.2
1979	129.50	242.94	46.7
1980	168.30	271.90	38.1
1981	249.40	389.14	35.9
1982	271.60	385.08	29.5
1983	146.10	263.29	44.5
1984	124.30	434.11	71.4
1985	480.90	970.43	50.4
1986	418.10	859.09	51.3
1987	155.70	476.25	67.3
1988	184.40	202.87	9.1
1989	207.50	466.63	55.5
1990	322.00	552.28	41.7
1991	337.00	438.81	23.2
1992	600.00	950.48	36.9
1993	280.00	716.50	60.9
1994	855.00	2244.58	61.9
1995	614.80	2177.96	71.8
1996	800.30	2972.51	73.1

Source: *Banco de la Republica.* *Without Oil

Traditionally FDI in Colombia has been characterised by the dynamic exploitation of natural resources like coal and specially oil. Since the 1980s, most of the FDI in Colombia was concentrated in the oil sector, only in 1988 it represented

90%, and in 1991 76% of the total capital flows. Due to the deregulation of the capital markets after the implementation of SAPs, from 1991 FDI began to allocate in different sectors rather than oil. In 1996, 73% of the total FDI went to other sectors. The FDI without oil went from 100 million dollars in 1991 to 2.172 millions in 1996. The explanation to this relies on the fact that before the SAP the oil sector had a special regime of working with international investors, and only after 1990, capital flows were allowed to be directed to other sectors. More recent data shows that FDI in Colombia fell 95% in the past two years, having a peak point in 1997 with about US$6.000 millions, and around US$3.000 millions in 1998, and falling dramatically to US$300 in 1999. This can be a major factor determining the current economic crises, and it is difficult to find a simple explanation; uncertainty, and internal political conflicts can throw some light on the causes of this significant drop in FDI, also on the fall in national investment and demand.

In table 4.9, the evolution of the concentration of capital flows in the different manufacturing sectors of the economy is presented. It is worthy to note that almost all the sectors have increased the amount of FDI, especially in the last period. This reflects the increase in the allocation of FDI in other sectors of the economy, before total FDI began to fall.

Table No. 4.9
AVERAGE ANUAL FDI IN MANUFACTURING
(Millions of dollars of 1980 at prices of 1980)

Sector	67-74	74-83	83-90	74-90	90-94
Food and Beverages	12.0	10.7	13.1	11.9	25.8
Textiles	7.7	3.3	1.2	2.3	10.3
Wood and Furniture	2.0	0.8	0.4	0.6	1.5
Paper	15.5	8.3	9.4	8.9	8.2
Chemical Products	62.8	26.4	28.8	27.7	93.0
Non-metallic minerals	8.9	3.8	3.8	3.8	9.9
Basic Metals	3.1	0.8	0.6	0.7	0.5
Metal Mechanics	22.2	22.5	12.6	17.8	51.7
Other manufacturing	0.8	0.6	-0.4	0.1	0.4
Total FDI in manufacturing	135.1	77.2	69.5	73.9	201.2
Total FDI	190.9	111.0	292.5	190.4	516.6

Source: Stumpo (1998:318)

4.3.2 FDI in the Oil Industry

Since 1984 until 1986, FDI in the oil industry increased on average up to US$400 millions per year. Between 1986 and 1990, the capital flows behaved similarly to the period preceding 1983. In 1991, year in which the largest investments in the field of Cusiana and Cupiagua were made, the FDI in oil represented approximately 76% of the total FDI. From 1993, the share of the oil industry started to decrease, due to the increase of investment in other sectors, as explained already. Nevertheless, the investment in the oil industry had the highest level in 1994, with US$855 millions. According to Garay et al. (1998:169) the latest dynamism of FDI in the oil industry is explained by the resources allocated by multinational corporations to the exploration activities in the wells of Cupiagua, Cusiana and Volcaneras, operations that were carried out specifically by private foreign capital.

4.3.3 Impact of FDI

Since 1993 capital flows have had a positive impact in the balance of payments of Colombia, with a constant surplus in the capital account. One of the negative effects that is argued is their impact in the exchange rate. The existence of a relationship between the increase in capital flows and the exchange rate is shown in the moves that this has shown in previous years. With the entry of major capital flows, specially in the short term, and the increase in the public and private indebtedness contributed to a clear trend towards revaluation; in fact, the Real Exchange Rate (RER) index went from 108.2 in 1991 to 95.4 in 1996 (Garay, 1998:170). Another positive effect worthy of noting is the increase in the average investment rate. Although it has not been a very high increase, it can be said that the SAP brought about such increase. While the investment rate was 17.1% of GDP in 1975, it wen up to 21.9% in 1995. There can also be distinguished another increasing phase during 1975-1982 which is related to the coffee boom of 1978. (Ramirez & Nuñez, 1999:10)

4.3.4 FDI Without Oil

FDI has maintained a high percentage industrial sector different than oil exploration. On the contrary, FDI's contribution to agriculture has been decreasing whereas it has been fluctuating in the other sectors. Mine exploration represented a very high percentage of FDI at the end of the 1980s due to the discoveries of coal in the Cerrejon mines, which attracted large FDI, after that the exploration has continued but no new discoveries have been made.

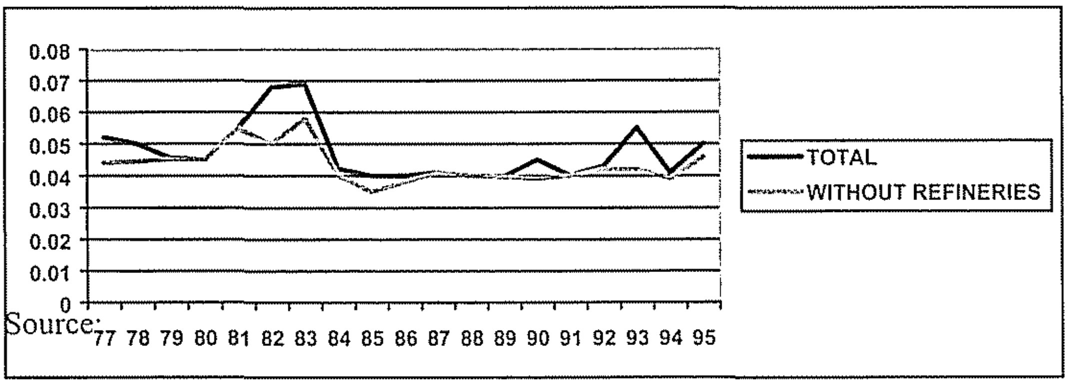
Table No. 4.10
FDI IN COLOMBIA WITHOUT OIL
According to economic activity (Average percentage) 1970-1996

Sector	1970-1974	1975-1979	1980-1984	1985-1989	1990-1994	1995-1996	1970-1996
Agriculture	1.6	0.9	0.7	0.3	2.1	1.8	1.2
Mine exploitation	3.7	8.7	23.9	65.2	1.9	5.1	19.5
Manufacturing	61.5	66.5	64.8	45.5	60.2	38.0	58.1
Electricity, gas	0.0	0.0	0.1	-2.4	0.2	4.2	-0.1
Construction	0.1	0.2	0.1	-19.4	6.6	1.7	-2.2
Trade, Restaurants and Hotels	7.5	8.5	5.1	11.7	7.5	8.7	8.1
Transport,comunications	0.5	7.6	0.3	1.9	4.6	12.0	3.6
Financial services	23.3	7.4	4.7	-2.5	14.7	27.6	10.9
Social services	0.1	0.1	0.0	0.2	0.2	0.6	0.2
Other activities	1.7	0.1	0.4	-0.6	2.1	0.3	0.7

Source: Banco de la Republica, Colombia

In the manufacturing sector, as can be seen in the following chart, the implementation of SAP did not generate the expected boom; although investment grew, it did it at a slow rate. That is excluding oil investments, for example from 1992 to 1993, investment in industry grew by 22% including refineries, but without it, it only increased by 11.5%.

Chart No. 4.5
TOTAL INVESTMENT RATE IN INDUSTRY
1977-1995



Source: Bank of the Republic

According to Ramirez & Nuñez[10] (1999) with the SAP there was a recuperation of the investment rates, an expanded industrial growth in non-traditional sectors, expansion in the productive capacity due to the necessity to compete with international competitors, and therefore there was an increase in efficiency.

The direction of capital flows towards industry shows to increase investment in this sector. Therefore, they can be a very important determinant of the impact of

[10] Juan Mauricio Ramirez and Liliana Nuñez are consultants working in the project "Crecimiento, Empleo y Equidad: América Latina en los años noventa" (Growth, Employment and Equity: Latin America in the 1990s), which is financed by the Netherlands' Government. The results of their studies may not be the standpoint of the Netherlands' Government.

the SAP; as it can be seen in the following table, capital flows have increased sharply, especially in the Chemicals and oil derivatives, which increased from an annual average of US$8.314 in the period 1974-1979 to US$197.112.197 in the period 1994-1996. Despite this increase of capital flows, many small producers were driven out of business. The entry to the country of large flows to support industries where locals were not prepared to compete can contrast the positive impact of SAP.

Table No. 4.11
Capital inflows directed to the industrial sector 1974-1996
Main activity
Annual average - Millions of dollars

Sector	1974-1979	1980-1985	1986-1990	1991-1993	1994-1996
Food, beverages, and tobacco	3.823	14.932	10.652	15.059	142.413
Textiles and leather	1.618	2.129	1.312	6.747	28.579
Wood Industry	318	649	548	682	4.525
Paper and editorials	3.588	7.214	11.124	5.266	47.319
Chemicals and oil derivatives and coal	8.314	38.595	19.227	52.932	197.112.197
Mineral, non metallic products manufacturing	1.845	4.262	3.565	8.364	21.059
Basic Metals Industry	321	872	392	1.625	3.045
Machinery and equipment	9.718	11.430	24.551	42.162	78.820
Other manufacturing	183	(413)	320	419	8.505
Total Industry	29.727	79.670	71.691	133.258	531.392

Source: Banco de la Republica

4.4.5 Portfolio Investment

In the last few years portfolio investment had an important increase, through the so-called international investment funds. Since the approval of the first investment fund at the end of 1991, it was allowed the capital inflow for portfolio investment, directed to the acquisition of shares and bonds. So the investment in portfolio must be done through an investment fund.

Portfolio FDI was directed mainly to the financial and manufacturing sectors. So the cumulative of FDI in portfolio in august 1997 was 56% to the financial sector and 34% to the manufacturing sector. This relates closely to the greater development of the stock market and the financial reform that went on in this time. (Garay, 1998:175)

4.6 Concluding Remarks

Since the SAP began to be implemented in Colombia, the country has experienced an exceptional increase in FDI. These flows had been traditionally characterised for being directed mainly to the oil sector. Nevertheless, these flows have also been directed to other economic activities thanks to the liberalisation of the markets. This does not mean that the FDI to oil has decreased, it has also increased, but up to a certain point in 1997 when it started a downfall that has resulted in the worst economic recession of the past 50 years, and which has reversed the positive effect that the increase of FDI had had in the economic indicators.

CHAPTER 5

CASE STUDY: ECOPETROL DURING THE STRUCTURAL ADJUSTMENT ERA

This chapter is devoted to exploring the performance of the state-owned Oil Company ECOPETROL during the implementation of SAP policies in Colombia. Section 5.1 gives a general background of the company in the country. In section 5.2 the current regime of association contracts under which Ecopetrol interacts with Multinational Corporations for the exploration of oil is examined., the effects of the SAP, an analysis of the factors that determine the productivity of the oil activity and other external effects on the performance of ECOPETROL, are discussed in sections 5.3 and 5.4 respectively.

5.1 Background and importance of ECOPETROL in Colombia's economy

ECOPETROL is a State-owned Industrial and Commercial Company, leading the production and industrialisation of oil in Colombia; it is attached to the Ministry of Mining and Energy, with legal existence, administrative and decision taking autonomy, and with its own independent capital.

Hydrocarbon exploration started in Colombia at the end of the last century, with the drilling of the Tubara well in the Lower Magdalena Valley basin. Between 1940 and 1960, exploration work carried out in the upper Magdalena Valleys and the Catatumbo basins permitted in important discoveries of oil and gas (See annex 1 for a map showing the different basins). Traditionally the Colombian economy was based on agriculture and cattle raising but, over the past few years, hydrocarbons have become an important source of economic growth. The share of the sales of ECOPETROL was in 1998 3.42% of GDP. The transfer payments contribute to the economic growth in the form of royalty payment, which was 595.285 millions of COL$ in 1997 (See section 5.5 for further details on royalties).

Colombia is not considered to be a major oil producer country; it participates marginally to the group of independent producers along with the United Kingdom, Norway, Mexico, Russia and the United States. Despite of this, the oil industry is important for Colombia for several reasons: it has generated resources to the country in the form of royalty payment, it has made Colombia a self sufficient and oil-exporter country, and it has stimulated the entrance of TNCs to the country to further enhance technological development.

5.2 *Oil Policy and 'Association Contracts'*

Association Contracts are an agreement signed between ECOPETROL and a TNC for the exploration of a particular area in order to find oil. The Colombian Association contract model could be defined as a composite contract because its basic structure encompasses features of some of the best-known international petroleum agreements. Thus, the Colombian model includes the royalty payments of the concession system while production is divided as in the Production Sharing Contracts, ECOPETROL pays a percentage of development costs as if it was a Joint Venture. ECOPETROL contributes with 50% of the total exploration costs of those successful wells that TNCs operate, then it also contributes with 50% of the operation costs of that well.

This Association Contracts structure has remained nearly unchanged since it was introduced in 1970. Recent small changes were intended to answer the need for balancing the distribution of profits between the country and the partners, and to make Colombia more competitive in the international oil and gas market. The Association contract lasts for 28 years, they are composed of two phases: 6 years of exploration and 22 years of production; nevertheless, there is an option to continue beyond the 28 years limit and the parts shall agree on the terms for this extension. Production sharing after a 20% of royalties is on a 50/50 basis up to 60 million barrels; there after, it will follow the R factor[11], which considers Partner's accumulated income and disbursements.

According to ECOPETROL, (2000) this regime has the following advantages:

- Signature of production bonuses are not required.
- Contracting is done via direct negotiation.
- Reimbursement of 50% of direct exploration costs prior to discovery, including seismic, dry holes and producing wildcats.

[11] The R factor is a method that distributes the resources according with the relation income and expenses. While expenses are higher, the distribution will be 50/50. The R factor determines the participation of the State according to the well's profitability and not of production. It is obtain by dividing the total expenses in the total cumulative sales; when this ratio is equal to one, it is inferred that the TNC has got all its risk investment. From then it is obtained a new distribution factor which can go up to 0.25; that is a progressive distribution of up to 75% in favour of ECOPETROL.

- Production sharing based on profitability of each contract (R factor).
- No impediment for re-exporting profits.
- No Ring Fence.

The following table shows the evolution of the number of Association contracts signed yearly since 1970:

Table No. 5.1

EVOLUTION OF ASSOCIATION CONTRACTS
1970 - 1999

YEAR	Signed during the year	In force
1970	2	3
1971	8	10
1972	7	17
1973	13	24
1974	11	24
1975	9	30
1976	11	31
1977	8	23
1978	11	29
1979	9	26
1980	18	41
1981	12	42
1982	9	39
1983	22	43
1984	23	61
1985	31	89
1986	8	77
1987	24	87
1988	23	94
1989	20	86
1990	24	89
1991	22	92
1992	13	84
1993	9	82
1994	12	72
1995	15	83
1996	18	97
1997	17	104
1998	14	111
1999	1	98
TOTAL		

Source: ECOPETROL Annual Report 1999

Even though Colombia has been contracting out with TNCs the oil drilling and production for many decades, this has shown signs of slowing down the dynamic growth that had in the mid-980s and beginning of the 1990s. The year 1999 ended with a total of 98 association contracts, that is 13 less than in 1998 (see table 7). Analysts suggest that the scheme in which ECOPETROL contracts out is not competitive internationally. In countries such as Singapore and Vietnam, the State's share in this sort of contracts is between 35% and 45% (ECOPETROL, 1999); whereas in Colombia the State's share is much greater, over 80% in most of the cases (*ibid.*). It is thought to be the highest government take in the world after Malaysia.

On average Colombia is attracting between US$160 and $200 millions yearly for oil exploration. According to Ecopetrol (1999), this amount is small as compared to countries that have similar production capacity like Australia, Angola, Nigeria and Argelia. According to a recent study made by ACO "Inversión Exploratoria: Colombia Frente al Mundo"; Colombia is placed last for investor's profitability. There are also several studies made by ECOPETROL that also place Colombia' special regime as one of the least competitive in the world. It is a very contradicting scenario, because having such disadvantaged conditions in the contracts, and in the investment environment, there have been the most important oil discoveries in the history of Colombia through the signing of these association contracts with TNCs.

The lack of competitiveness is the main reason why the foreign investment in oil exploration has gone through a decrease in the last few years; while in 1988 the TNCs operated in the country in 52 exploratory wells, whereas in 1996, there were only 14; although the number of association contracts has had an increasing trend. It is also worth mentioning that in 1988 the country had 11.956 km of oil exploration while in 1996 only had 2.200. It most be that even though there are more association contracts signed, it could have happened that: a) TNCs that remain in the country have adapted to the adverse investment environment that surrounds them, and have signed more contracts. 2) As the territory being explored has decreased, and due to the adverse investment environment, there are more contracts but each one works in a smaller exploration area.

Another factor that matters a great deal is the relative difficulty for exploiting oil in Colombia. In the main oil producer countries, the probability of finding oil is around 15 to 50%, while in Colombia is around 26%; therefore it is also required high quality exploration which involves higher costs (Ecopetrol, 1999).

The following table shows ECOPETROL's investments, directly and through association contracts:

Table No. 5.2
ECOPETROL's INVESTMENTS 1980 - 1997
(US$ millions)

YEAR	DIRECT EXPLORATION		ASSOCIATE EXPLORATION		DEVELOPMENT	TOTAL
	Geophysics	Perforation	Exploratory	Superficial		
1980	6.9	9.0	139.4	17.3	17.5	190.1
1981	9.2	38.1	176.4	51.5	39.2	312.4
1982	7.2	49.2	200.5	39.1	69.8	365.8
1983	6.7	8.3	85.9	11.7	91.7	204.3
1984	6.3	11.2	68.0	34.0	77.4	196.9
1985	7.7	18.4	146.0	29.7	586.0	817.8
1986	3.2	18.1	53.0	54.7	621.2	750.2
1987	15.2	36.5	80.5	30.4	91.0	253.5
1988	27.4	50.6	104.1	50.0	112.9	344.8
1989	27.4	29.2	102.2	40.3	129.5	328.6
1990	28.0	16.8	107.7	36.5	121.8	310.8
1991	19.8	11.5	112.9	31.8	136.2	312.2
1992	24.9	13.9	267.6	68.7	118.1	493.2
1993	19.7	14.2	252.3	53.0	360.9	698.1
1994	15.2	9.2	166.6	18.2	521.0	790.2
1995	12.2	22.1	214.4	56.1	750.8	1059.4
1996	12.9	34.0	172.0	63.5	1134.3	1433.4
1997	16.6	12.3	264.4	70.5	1182.2	1517.8

Source: ECOPETROL

It is clear that the highest investments are made through the association contracts. In this sense, the role of TNCs for the development of the oil industry, although only in the early 1990s, appears important. ECOPETROL by itself does not have enough capital and infrastructure to drill and exploit fully the oil potential of the country, therefore a sound policy of international integration is crucial for its development. The recent withdrawal of TNCs puts fourth doubts about ECOPETROLs development

5.3 *Impacts of the SAP on the oil industry.*

The performance of ECOPETROL in the recent decade is linked closely to the implementation of the SAP, because for the nature of its activities, the links with the international markets, the trade policy (liberalisation), and some how the industrial policy are very relevant to its development. SAPs related effects in the oil industry are in a general perspective an increase on investment on behalf of the State and also on behalf of TNCs in the form of an increase of FDI which can be better viewed in chapter 4, but also in the increase of participation of these TNCs in the oil exploration in Colombia which was better explained in the last section. Another important impact of SAP is that as a policy strategy of the State, privatisation of public enterprises becomes a key point for the improvement on efficiency in the provision of public goods. In the case of ECOPETROL, although it has not gone through a privatisation process, its strategic alliances with TNCs can be seen as a way of improving efficiency through the interaction with private partners. In the following sub-sections, it will be analysed the specific impact of SAP in the performance of the oil industry, trade balance, and FDI.

5.3.1 Impact on Performance

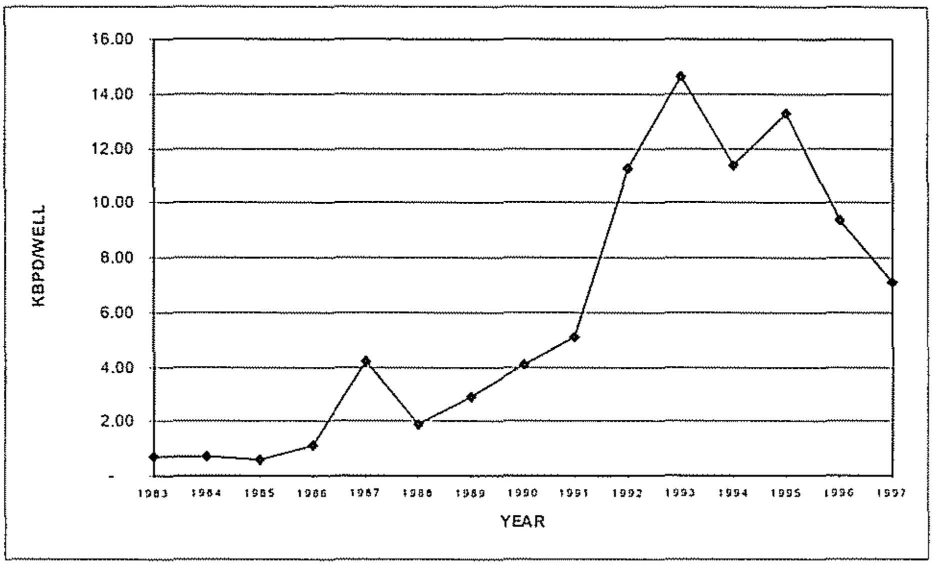
As it was mentioned in chapter 2, the most common features for measuring the performance of a firm are its profitability, and productivity. In terms of profitability, ECOPETROL has been favoured in the last couple of years from the increasing trend of the oil prices and has continuously improved its operational performance. In 1999 ECOPETROL increased its operational income by 29%, and from the period 1997-1998 it increased it by 10%. Income for exports increased furthermore by 84% in 1999. It is important to give more emphasis to the outcome in terms of production, so the volatility of oil prices is excluded from the measurement. One of the tools that can determine the productivity of the oil sector is by measuring the number of wells exploited. In the following table the evolution of wells explored by ECOPETROL and its Association partners is presented, which again shows the importance of these scheme in the current production structure of the oil sector. However, this measure runs insufficient to determine productivity improvements. Rather, it only shows the dynamism of the oil activity. For being more accurate, one measurement for productivity would be the ratio between national production of oil with respect to the number of wells exploited. This ratio of productivity is an author's calculation. See chart 5.1.

Table No. 5.3
DEVELOPMENT OF EXPLORATION 1983-1997
(No. Of Wells)

YEAR	ECOPETROL	ASSOCIATION	CONCESSION	TOTAL
1983	115	58	40	213
1984	150	38	42	230
1985	169	70	53	292
1986	216	22	30	268
1987	46	24	22	92
1988	104	62	33	199
1989	13	103	24	140
1990	8	78	22	108
1991	5	76	3	84
1992	4	35	-	39
1993	-	31	-	31
1994	1	39	-	40
1995	2	42	-	44
1996	2	65	-	67
1997	1	91	-	92

Source: Ecopetrol.

Chart No. 5.1
Ratio of Productivity of Colombian's Oil's Industry.1/



1/ Total KBPD/# of wells. (KBPD= Thousand of Barrels produced per day)
Source: Own calculations based on data from ECOPETROL

As shown in the chart 5.1, the productivity of the oil industry in Colombia has increased dramatically. From 1990 until 1993 there was a sharp increase going from 4 KBPD/well to nearly 15 KBPD/well. In 1994 it starts to decrease until around 7 KBPD/well in 1997. This may explain why a few TNCs still remain in the country. Even though the investment environment is unfavourable in the 1990s, these companies seem to have gone through a learning-by-doing process under the specific circumstances of Colombia. An example of this can be the actions taken by the TNC BP (British Petroleum), that instead of having to pay guerrilla groups a monthly allowance, they formed their own defence body to protect their employees in rural areas, and in that way reduce costs and improve security[12]. Complementarily the SAP has possibly benefited the high productivity, as the import tariff cutbacks for machinery and raw materials, as well as elimination of the "oil-exploration tax" have been important SAP policies, among others.

Before the mid 1980s, Colombia was not considered an oil producer country; it was until 1986 that Colombia started to export it. It seems that the discovery of two extremely rich oil wells "Cusiana" and "Cupiagua", play a key role in this case. And since then the production has been increasing yearly. In table **No.** it can be seen the

[12] However, this strategy of BP has generated a lot of controversy, and is in the centre of a debate with the Colombian government.

production in KBPD, since 1982, and the distribution of it, noticing that indeed, production increases in 1986 by 71%, precisely because of the discovery of the already mentioned oil wells.

Table No. 5.4
DISTRIBUTION OF THE NATIONAL PRODUCTION OF OIL (KBPD) 1982-1997

YEAR	ECOPETROL				PRIVATE COMPANIES			TOTAL COUNTRY
	Direct	Association	Subtotal	% Country	Association	Concession	Subtotal	
1982	68.0	7.0	75.0	52.9	7.8	58.9	66.7	141.7
1983	69.3	9.6	78.9	51.9	10.6	62.6	73.2	152.1
1984	69.6	16.1	85.7	51.3	15.7	65.6	81.3	167.0
1985	68.5	22.2	90.7	51.4	18.8	67.0	85.8	176.5
1986	73.3	95.5	168.8	55.9	66.9	66.4	133.3	302.1
1987	79.5	144.2	223.7	58.1	99.5	62.1	161.6	385.3
1988	80.7	138.7	219.7	58.5	95.7	59.7	155.4	374.4
1989	83.3	155.8	239.1	59.1	106.8	58.5	165.3	404.4
1990	87.5	175.4	262.9	59.8	119.4	57.2	176.6	439.5
1991	83.9	171.9	255.8	60.1	116.3	53.5	169.8	425.6
1992	90.7	181.4	272.1	62.1	120.9	45.4	166.3	438.4
1993	93.7	194.2	287.9	63.5	129.5	35.9	165.4	453.3
1994	95.5	196.9	292.4	64.4	131.3	30.3	161.6	454.0
1995	112.5	276.0	388.5	66.4	184.0	12.4	196.4	584.9
1996	115.7	297.3	412.9	65.9	198.2	15.2	213.3	626.3
1997	119.3	310.7	430.1	65.9	206.7	15.5	222.2	652.2

Source: Ecopetrol.

Within the context of the SAPs, the Government has started actions to increase public enterprise efficiency, in this sense, ECOPETROL has made a great effort in the last 5 years to optimise the efficiency of its personnel. The total number of employees has gone down from 9.968 in 1995 to 7.437 in 1999. In this sense it is also possible to measure the productivity per employee[13], which went from 0.058 KBPD/Employee in 1995 to 0.11 in 1999, which is nearly the double.

It is relevant to mention at this point that, as discussed in chapter 2, public enterprises as ECOPETROL are linked to bureaucracy, and imply therefore unbusinesslike performance. Despite all the benefits that Ecopetrol has brought about throughout the years, there is one factor that is diminishing the company's profitability: the salary and pension scheme of its employees. Ecopetrol has approximately 7.500 (in 1999) employees, their remuneration consists of a basic salary, adjusted to the market standards, plus a high additional remuneration for benefits. Ecopetrol was excluded of the social security reform made in 1993, which gave more flexibility to employers reducing the worker social benefits load. Ecopetrol has a pension scheme which does not require any contribution from the employee, it represents 75% of the last salary in the last year that the person worked,

[13] Dividing the Production in the number of employees

at the same time this percentage is increased by 2.5% per year above 20 that the person worked. By December 1997 Ecopetrol estimated a pension liability of US$2.594 millions (Ecopetrol, 1998). According to this author's view, this problem has no near solution, because the union that Ecopetrol has is the strongest in the country, and is very powerful, therefore the possibilities of reducing such liability are remote. The worker's union that protects the interests of its employees can be another factor that hampering the competitiveness of the company, because those resources that could be invested in more exploration or in the building of refineries to stop importing gasoline, are destined to cover the pension funds, and employee's benefit scheme. This argument is not to suggest that ECOPETROL's employees should have lesser benefits and no pension, but their scheme should be reviewed and equalised with the rest of the country to allow ECOPETROL to compete in international markets, which can later on bring about more benefits to the employees themselves, and more employment opportunities.

5.3.2 ECOPETROL's Trade Balance

The exports as well have increased yearly since the discovery of the Cusiana and Cano Limon wells in 1986, and even though Colombia still has to import gasoline, this has also decreased in recent years as can be seen in the following tables. The trade balance (last column in table 20) started to be positive since 1984, after that, it continued to increased sharply until 1990. From 1990 until 1994 there were decreases, but in 1995 again it picked up and has evolved very positively.

Table No. 5.5
ECOPETROL'S INTERNATIONAL TRADE BALANCE
(US$ millions CIF)

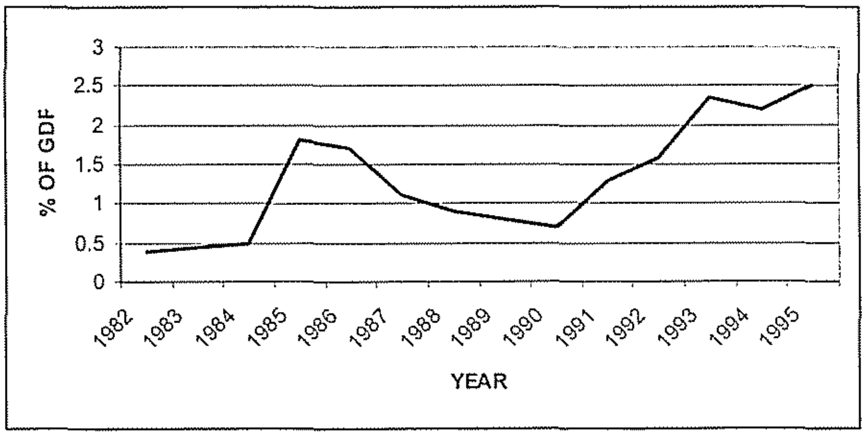
	ECOPETROL EXPORTS					ECOPETROL IMPORTS				TRADE BALANCE
YEAR	OIL	ACPM	FUEL OIL	OTHER	TOTAL (A)	OIL	GASOLINE	OTHER	TOTAL (B)	(A)-(B)
1980	-	-	238.99	70.20	309.19	213.50	291.99	195.64	701.13	-391.94
1981	-	-	265.88	70.74	336.62	262.03	223.35	200.05	685.43	-348.81
1982	-	-	283.86	65.34	349.20	248.69	353.92	61.78	664.39	-314.85
1983	-	-	378.36	60.32	438.68	380.83	210.65	32.57	624.05	-185.37
1984	-	-	443.86	44.11	487.97	272.35	166.40	4.61	443.36	44.61
1985	-	-	406.51	47.09	453.60	180.34	276.13	-	456.47	-2.87
1986	196.70	17.65	206.31	41.15	461.81	-	120.26	6.02	126.28	335.53
1987	546.69	58.92	331.02	58.81	905.44	-	90.14	9.45	99.49	805.95
1988	395.63	33.43	228.38	37.64	695.08	-	153.09	2.64	155.73	539.35
1989	560.71	49.32	304.87	42.77	957.67	-	203.17	7.06	210.23	747.44
1990	893.73	31.17	354.80	81.40	1360.88	-	274.63	24.07	298.70	1062.18
1991	627.85	56.85	240.77	76.79	1002.26	-	237.64	17.14	254.78	747.48
1992	596.24	40.94	196.66	29.25	863.09	18.14	275.78	13.54	307.46	555.63
1993	484.77	65.62	186.38	19.58	756.35	-	261.90	21.84	283.75	472.60
1994	384.24	68.89	215.25	15.89	684.27	-	265.53	5.07	270.60	413.67
1995	905.72	56.80	219.78	24.41	1206.71	-	234.90	33.58	268.48	938.23
1996	1118.64	116.29	289.02	76.55	1600.50	6.04	1.97	259.47*	267.48	1333.02
1997	1119.00	77.14	260.67	54.89	1511.70	-	2.20	314.37*	316.57	1195.13

Source: ECOPETROL

5.3.3 FDI in the Oil Industry

The following chart shows the trend of the FDI in mining and oil as a percentage of the GDP between 1982 and 1995. It is relevant to mention that the FDI has been very dynamic since the implementation of the SAP, in 1990, and there is liberalisation of capital flows, which has attracted FDI to the activity of mining and oil. As a result, the share of these productive activities in GDP has been significantly rising since then.

Chart No. 5.2
FDI IN MINING AND OIL 1982-1995 (As a % of GDP)



Source: DANE, National Accounts

5.4 External effects of the performance of the sector.

Colombia is home to some multinational corporations that continue to operate in the midst of chaos. These firms contend with the risks of notorious drug cartels and unstable government, domestic violence and left-wing insurgents. Like many developing countries, Colombia depended on a monocultural economy. Until recently, coffee exports determined the economic prosperity of the country, but coffee plays a lesser role today. Colombia has succeeded in diversifying its exports (as we saw in chapter 4), and in since 1990, oil has surpassed coffee as the leading export earner.

For the Colombian Government the exploration of oil represents good news in the sense of revenue, but there are other factors that come about from this activity. The increasing violence from "guerrilla" groups[14] has increased the operational risk of TNC, due to the fact that oil exploration generally takes place in rural and remote areas which are very vulnerable to "guerrilla" attacks and TNCs are a target for extortion and kidnappings. This obliges TNCs to increase their budgets to guarantee the security of their employees in those areas, with consequent increase in costs. The following table shows the evolution of terrorist attacks to just one of the pipes that carries oil from Cano Limon. This is one of the factors that has counteracted the positive effects of the SAP on the oil industry, mainly towards the late-1990s.

Table No. 5.6
TERRORIST ATTACKS TO OIL INFRASTRUCTURE
PIPE CANO LIMON
1986-1997

YEAR	No of Attacks
1986	23
1987	11
1988	50
1989	29
1990	23
1991	60
1992	62
1993	38
1994	45
1995	46
1996	47
1997	64

Source: Ecopetrol

5.5 Policy Implications for the Colombian Government

For the Colombian Government the Exploration of Oil has represented a high source of income, especially during the past 20 years when the oil boom started in Colombia. Nowadays, the National Government receives resources from the oil sector from 4 different instruments:

- Royalties
- Taxes and special contributions
- Consumption tax to Gasoline and ACPM
- Ecopetrol's dividends

These resources have gone up from 1.7% of the GDP in 1984 to 4.1% in 1990, and have gone down to 2.7% of GDP in 1997. (Ecopetrol, 1998).

As it has been explained before, the royalties are 20% of each barrel, and before 1990, this income was distributed among the regions and the national government, but the legislation has changed targeting a better distribution of this income, and seeking to favour the municipalities, and the ports where the oil is exported. In the constitution of 1991 the creation of the National Royalty Fund (NRF) was established, where the resources that did not go to regional governments

[14] Guerrilla groups are armed groups of rebels with a well-developed organisational structure putting pressure to the government through various forms of violence, like murdering, kidnapping, and

should go to, and which should be used for financing investment projects in the sector and in the protection of the environment. The Law 141 of 1994 created the NRF, which was reformed in 1995, assigning 80% of the resources to the development of rural infrastructure.

TABLE No. 5.7
DISTRIBUTION OF ROYALTIES BEFORE AND AFTER 1994

BENEFICIARY	BEFORE (%)	AFTER (%)
Producer Department	47.5	47.5
Producer Municipality	12.5	12.5
Port Municipality	0.0	8.0
Nation	40.0	0.0
NRF	0.0	32.0
Cormagdalena	0.0	3.2 /1
TOTAL	100.0	100.0

/1 10% of the resources of the NRF
Source: Ecopetrol

The above table shows the evolution of the distribution of royalties before and after the reform in 1994.

In this way it is believed that Colombia has one of the highest tax schemes for the oil industry in the world, and by no means this represents an incentive for TNC that could divert its investments towards more favourable taxing schemes. This, even though some other taxes (i.e. tariffs) have been favourable to TNCs as mentioned before The Colombian government's instability in the fiscal scheme creates an important disincentive for FDI, although clear efforts are seen to try to benefit foreign investors.

5.6 Concluding Remarks

As has been shown in this chapter, the context in which ECOPETROL has been carrying out its activities has over the years become relatively favourable. Yet so far it has proved difficulties in the last few years due to increasing violence which uses as targets the infrastructure of the oil industry. It is obvious that SAPs have helped to improve the amount of FDI that is directed to the sector, and therefore the performance of ECOPETROL has improved, in terms of operational profit and productivity; which have also been enhanced by the government efforts to improve competitiveness of private and public enterprises. However, given the competitive nature of oil production, coupled with the oil prices and the demand situation in the world market, which are very volatile, ECOPETROL must do better on improving the

bombing specific targets.

competitive advantage it gives to its private partners in terms of providing better conditions to TNCs so that the adverse environment in which they have to operate in the country becomes somehow better.

In general, the importance of the oil sector in the Colombian economy has been high since the mid 1980s. As a generator of FDI that not only transfers technological progress, but also provides revenue to the central and local governments through royalty payment. Through the increase of oil production, Colombia nowadays is self-sufficient, and exporter; however, it still continues to import gasoline as the existent refineries do not have the required infrastructure to supply all the country. The performance of ECOPETROL is a main determinant of the balance of payments, since the oil boom started in Colombia; it has indeed represented a high percentage of the country's exports. To the same extent, ECOPETROL special policy of royalty distribution has contributed to the decentralisation strategy that has been undertaken since the late-1980s. It is also worth mentioning that even though the performance of the company is not as efficient relative to international competitors, the Colombian government has put a lot of effort on improving the efficiency and productivity of the company, as it operates in association with private corporations.

The technology transfer that has emerged from the interaction with TNCs has helped reproduce existing production of oil. However, this interaction with TNCs is conceived by guerrilla groups as a detrimental factor for the improvement of income distribution in Colombia, which has exacerbated the violence that at the same time has influenced negatively the image of Colombia, and the results are starting to affect the economic performance of ECOPETROL, in terms of less TNCs and less FDI in the country. Consequently, SAPs can be said to have also been one the causes of increased violence which has had very negative effects on economic, social and political spheres in Colombia.

CHAPTER 6

CONCLUSIONS

6.1 General Conclusions

Globalisation is an economic, political, social and cultural process that has been expanding throughout the world in the last two decades. This process is actually conditioning the interaction between countries and societies. Colombia is currently undergoing a profound social and economic crisis that is hampering its future integration to the world economic order. In this perspective, Colombia most strive not only to build up a modern democratic society but also to provide appropriate conditions for future development in harmony with the international order.

Developing countries are at disadvantage in establishing large capital-intensive industries because of high construction costs and remoteness from major markets. The integration of Colombia to the international order can be viewed as a successful one. Behind the SAP policies is the need of the country to co-ordinate its policy-making process with that of the globalised trends that are patented by the international financial organisations (IMF and WB). This is the main factor behind the implementation of SAP policies in Colombia.

The overall impact of SAP on the performance of the Colombian Public Corporate Sector, has been positive. The case study analysed in this paper has demonstrated that the oil sector has brought about a lot of benefits in terms of royalties and technology transfer. Despite the adversities of the environment, ECOPETROL has increased its productivity. The SAP has included the reform of PSE (public sector enterprise) which is helping to improve the economic efficiency of the company. This has been regarded by many as bad, due to the fact that ECOPETROL is a PSE. Unfortunately PSE are considered as to have lower competitiveness, mainly for the monopolistic nature of their market structure, but in the case of ECOPETROL, the structure of the market is very competitive. Although ECOPETROL is the only Colombian company in charge of the oil exploration, it has to keep up its standards in order to attract investors (TNCs) to provide technological support for the drilling of the oil. The co-operation with TNCs is one of the positive effects that could be attributed in a first instance to the SAPs. However, as Waters (1995) argues, TNCs are considered by critics of liberalisation as the vehicles by which intolerable and inhuman practices of exploitation are spread across the globe, for its supporters, they are the virtuous sources of investment, technology transfer and the upgrading of the labour force. In the case analysed in this paper, TNCs can be assessed from both sides. Some people, (i.e., left-wing insurgents, some nationalist) see them as evil, and therefore reject its presence in the country, whereas the government sees them as vehicles of progress and investment, and that is why has provided incentives for their presence in the country since 1970.

In the context of non-economic effects of SAP, it is concluded that the social and political situation of the country is worse than ever, whether this is related directly to the implementation of SAP policies is difficult to determine with certainty. As Gibbon (1996) argues, the contribution of non-policy factors, or only indirectly related to the policy to the results can be very relevant. Indirectly, I believe that the SAP has been one of the main generators of instability. One of the motivators for the guerrilla is the thought that countries of the north are stealing our resources through the TNCs. Because of the eminent class division and the historical high concentration of income in Colombia, these insurgent groups wish to equalise the economic conditions of all the population, and consequently see TNCs as enemies of their cause. Then the SAPs could have intensified this conflict, as what these groups have been seeking for is social oriented policies and not trade liberalisation, which in the end, is intended to favour exporters and not the poorest population. But then again, the guerrilla's activity may have just continued even without SAPs, in the following section, a counterfactual analysis will be made and this will be discussed deeper. As poverty, violence and social conflicts have risen, there has been a disincentive for economic development, and at the same time a challenge for the government to design sound policies that help the country overcome the economic crisis and subsequently increase social standards. In this perspective, the recent government project "Plan Colombia" (Colombian Plan) has been approved, and it consists of a co-ordinated effort with the USA to combat the guerrilla and the drug dealers. Originally this plan encompassed 70% of social improvement policies, in an effort of the government to improve social inequalities of the country, but according to, it has been adjusted to 70% for military activities.

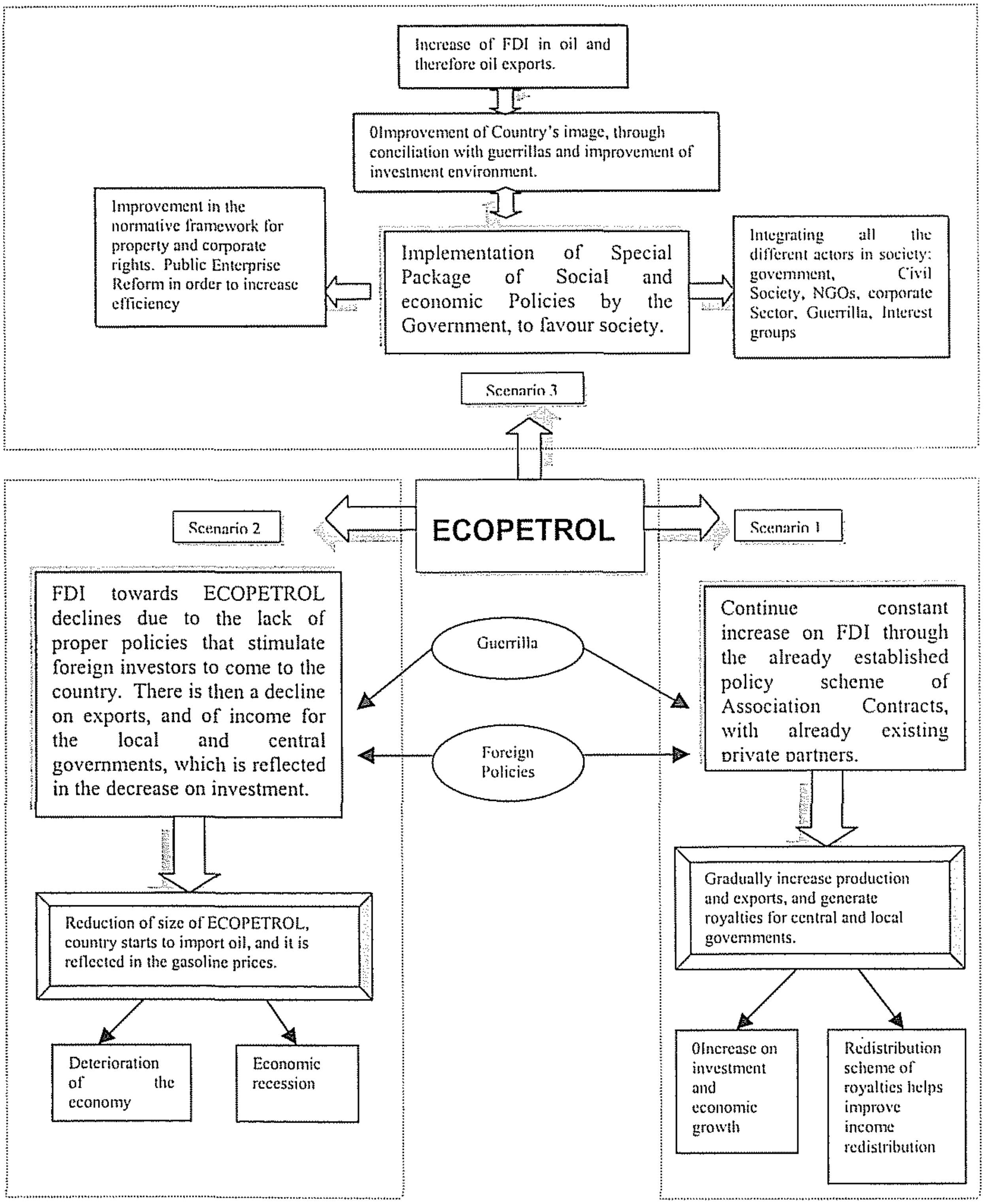
The specific characteristics of SAPs with implications for ECOPETROL are that SAPs are programmes directed to influence the whole economy through a series of particular policies that affect all actors of the economy. ECOPETROL as a PSE plays a very important role, not only for being a PSE, but also because it carries out the exploration of a very valuable natural resource that could enhance the economic performance of the country if found in large quantities. ECOPETROL is now undergoing a process of increasing efficiency, it has become more productive and profitable, and therefore generates more resources for the State which translate in an improvement of the economic conditions. In addition, ECOPETROL can improve the productivity through a decrease in its costs, reducing bureaucratic procedures, and increasing the security of its infrastructure. It is also important that the 'association contract' scheme is reviewed in order to make it more competitive at the international level. Through the development of ECOPETROL's activities, the income of FDI into Colombia can bring positive effects on domestic investment and in the generation of revenue for local and central governments through the transfers of royalties. The presence of TNCs investing in the oil industry can also attract other industries' TNCs to come and invest in Colombia, which is thought to improve more the economic conditions.

Finally, I would like to conclude that for Colombia the development of ECOPETROL in the last decade has been one of the major determinants of economic growth. The FDI generation has had positive effects in the overall economy, but at the same time has generated social unconformity and political conflicts which turned around and now are hampering the further development of the sector, by reducing the attractiveness of the country for international investors. This together with a economic recession, can explain the recent trends in the economy that have also deteriorated the social indicators. As long as the government is willing to continue working with international partners and continues to generate strategies to improve the competitiveness of the sector, there will be hope for improving the damaged conditions of the economy. More general conclusions can be drawn from the following section, which analyses the counterfactual of what would have happened without SAPs.

6.2 Counterfactual analysis: ECOPETROL without the SAP

In order to complement the conclusions of this paper, a discussion of the following counterfactual is presented: what would have been the effect for ECOPETROL if there had been no SAP implemented in Colombia?. According to Gibbon (1996), in order to analyse the effects of the SAPs it is not enough to do a 'before and after' comparison, but also between the 'after' and another counterfactual one. He argues that many of the effects could have happened anyway and may not be attributable to the adjustment itself. In the following chart, possible outcome scenarios are illustrated in order to facilitate the analysis:

Chart No.6.1 Scenario Analysis: ECOPETROL without SAPs



There are three hypothetical scenarios considered; the first one refers to a continuation of the situation as it was in the previous years to the implementation of the SAPs. In this way, the 'association contract' scheme would have continued, and depending on the availability of natural resources like oil and gas, ECOPETROL would have increased its exports and provide the country with more resources which would had promoted economic growth and equity (because of the redistribution scheme of royalties). This would have happened if we could say *ceteris paribus*[15], but considering the conflicting conditions which exist in Colombia over the last 30 years, it is possible that even without SAPs, the violence would have continued and the guerrillas would diverge the possible positive outcome. That is why the line of the arrow coming from the guerrillas circle in the diagram has been indicated.

A second scenario, which is the one in the left side of the diagram, corresponds to the possibility of a decline on FDI because of the lack of sound economic policies that incentive the entrance of capital flows to the country. As a result, ECOPETROL would reduce its production, and therefore its exports, it will stop the transferring of resources to local and central governments, which will translate into a decrease of in the GDP, and could conduce the economy to a recession. This scenario could also be worse by the incorporation of the guerrilla factor, which can deteriorate further the situation of ECOPETROL through attacks to its infrastructure. It can be observed that this scenario looks a lot like what is happening nowadays in Colombia; investment has fallen, demand has fallen, TNCs have started to withdraw from the country, but the difference is that thanks to SAPs, the government implemented policies to increase efficiency and to uplift the competitive advantage of public enterprises.

The third scenario analysed is the possibility that the government had implemented a different type of restructuring policies, which included participation from all the actors like Government, NGOs, civil society, guerrilla, paramilitaries, militaries, etc. These policies would generate a plan for social rehabilitation, land reform, redistribution of income, and reconciliation of the armed conflict's actors. This program will induce a rehabilitation of the damaged society of Colombia, which will therefore improve the image and attract FDI, in the forms of TNCs willing to invest in Colombia, it will attract tourism, and will generate more income and

[15] All other factors remain constant

investment. Under this scenario the liberalisation of the economy would not take place like with the SAPs, it will be slowly induced as the different sectors of the economy show signs of being competitive.

This analysis of counterfactual scenarios heighten the uncertainty of the real correlation between SAPs and their effects. The disappointing situation that is currently undergoing Colombia can be as related to SAPs as to the historical context of the political and economic structure of the country. Policies can induce an effect that was about to happen anyway. Nevertheless, the theoretical framework shows some evidence of the relation of SAPs with the results observed in the empirical study. The paper has shown evidence that can sustain the hypothesis forwarded in the beginning, claiming the positive effects of the SAPs, but which have been counteracted with extra-policy effects that have diminished the intended effects that SAPs could have had.

7. BIBLIOGRAPHY

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ANNEX

MAP
COLOMBIA: SEDIMENTARY BASINS