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Foreign Enterprises in Colombia

by Georg Koopmann, Hamburg *

In its October-issue **INTERECONOMICS** published an article on **Foreign Enterprises in Mexico**. The present article deals with the role of multinationals in Colombia, their merits and the complaints about them. Colombia is of particular interest as a member of the Andes Pact.

Some time ago the following report caught the attention of the press¹: In the coastal region around Buenaventura, in the south of Colombia, foreign exporting and processing firms are engaged in highly lucrative business deals involving the immense wealth of timber of this region. Their methods are those of early capitalism: in many instances they conclude double-track contracts with the timber suppliers under which the sawmills are leased to the latter but at the same time recognized as economically autonomous. In this way they circumvent a number of inconvenient social obligations. The sawmills for their part get their tree trunks from wood-cutters to whom they pay a daily wage equivalent to DM 2.55 for 12 hours of very hard work.

Such practices may fit in perfectly with the hackneyed image of the multinational enterprises as neocolonialist exploiters but are certainly not typical of the role of foreign enterprises in the economic development of Colombia. This role must be viewed against the background of the industrialization process in Colombia which since the second half of the fifties has been going through the third phase of the CEPAL scheme². The characteristic feature of this phase is an expansion of the domestic market which has been speeded up by the establishment of an investment goods industry. Proceeding behind high tariff walls and aided by the — until 1967 almost complete — freedom of capital transfers, this expansion has been attracting foreign investors into the manufacturing industry in particular. US direct investment in this sector rose from \$ 58 mn in 1955 to \$ 262 mn in 1972; its share of total US investments in Colombia advanced in consequence from 17 to 35 p.c. (in book values). The investments in the mineral oil

sector also scored a substantial increase in absolute terms (from \$ 178 mn in 1955 to \$ 327 mn in 1972) but declined in relative importance from 53 to 44 p.c.³

A comprehensive sector-by-sector analysis of the foreign investments can be undertaken only for the years from 1967 onwards because the Decree No. 444 of March 22, 1967 provided for the first time for a full record to be kept of the external transactions. Leaving the foreign investments in the oil sector aside, the inflow of foreign capital was concentrated chiefly in the industrial and financial sectors. Of the total direct investment (excl. oil) of \$ 125.3 mn between 1967 and 1973 \$ 78 mn (62.3 p.c.) went into industry and \$ 34 mn into finance, insurance and real estate⁴.

In the industrial sector the production of oil derivatives was most prominent: between 1967 and 1970 it attracted \$ 7.9 mn (22.1 p.c.) of the total direct investment in industry of \$ 35.8 mn during the same period. Chemicals (11.2 p.c.), pharmaceuticals (9.8 p.c.), wood processing (9.2 p.c.) and the electrical industry (7.5 p.c.) came next⁵.

The spread of the foreign capital over the various sectors reflects the Colombian policy of import substitution. The role to be assigned to foreign enterprises in this connection was indicated in the Decree No. 444. The foreign firms are to make a priority contribution to the easing of the balance of payments, on the one hand by saving foreign currencies (e.g. through closer integration with the domestic economy, smaller profit, royalty and interest transfers, etc.) and on the other by earning foreign currency through intensification of exports. The latter aim in particular has been gaining in importance because there is little scope for the strategy of import substitution in the relatively narrow Colombian market.

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¹ Cf. R. Rey, Die "Glücksstadt" steht nicht in den Prospekten (The "town of good fortune" is not mentioned in the prospectuses), in: Frankfurter Rundschau, No. 166, July 22, 1975.

² The CEPAL — Comisión Económica Para América Latina — distinguishes four phases of economic development. Cf. CEPAL: El proceso de industrialización en América Latina (CEPAL: The industrialization process in Latin America), New York 1965, p. 26 ff.

³ Calculated from: Department of Commerce: Survey of Current Business, various volumes.

⁴ Cf. Deutsche Oberseische Bank, Wirtschaftsbericht (Economic Report), May 1974, p. 27.

⁵ Departamento Administrativo Nacional de Estadística (DANE): Boletín Mensual de Estadística, Vol. 20 (1970/71), No. 239, p. 79.

The policy of expansion and diversification of exports is also significant from the point of view of providing employment which is currently receiving top priority because of the rising unemployment in the country. The Colombian Government is therefore making increasing efforts to interest foreign enterprises in the establishment of labour-intensive export industries so as to make better use in this way of the comparative advantages of the country — a relatively cheap and proficient labour force and a comparatively favourable geographical situation ⁶.

These sectors apart however the foreign capital is still to be confined to "essential" industries which are short of capital, technologies and qualified management and kept from hampering the development of efficient domestic enterprises. The foreign investors are expected to strengthen the indigenous firms by linking up with domestic capital and promoting the establishment of a national industry supplying accessories.

Investment Policy Measures

The following are the principal measures set out in the Decree No. 444 as means of attaining these objectives:

- All foreign investments require registration and authorization. Criteria for this are: the net effect on the foreign exchange, the consequences for employment and training, the technology contribution, the number and production capacity of existing suppliers, and the forward and backward linkages which may be expected to result from the investment.
- All imports are subject to licence.
- Contracts regulating the transfer of technologies must be officially approved.

The Colombian Congress has restricted the scope left to the competent Colombian authorities by the Decree No. 444 further by adopting the Decisions No. 24, 37 and 37 A of the Commission of the Andes pact, of which Colombia is a member, which are a codification of the common policy of the Andean countries towards foreign capital. The following provisions are of special relevance in this respect:

- All foreign enterprises which wish to avail themselves of the benefits of the trade liberalization inside the Andean area must be gradually, according to a precisely fixed time schedule, converted into joint or domestic enterprises (with the participation of at least 51 or 80 p.c., respectively, of domestic capital).

⁶ Cf. A. Lopez Michelsen: Speech to the Asociacion Nacional de Exportadores, in: Camara de Comercio de Bogotá: Revista, Year 4, December 1973, No. 13, p. 75.

- The annual profit transfer must not exceed 14 p.c. of the invested capital.

- The technology transfer is subject to strict control; licensing agreements must not contain restrictive clauses such as supply commitments or export restrictions.

These and other measures were taken when the foreign investments, which until 1967 had not been subjected to significant restrictions, aroused increasing criticism. The main complaints voiced about the foreign enterprises were that they were

- causing substantial foreign currency losses to the country;
- evading tax charges by the State;
- making only a small contribution to reducing unemployment; and
- supplanting indigenous enterprises in the market.

The available empirical data are insufficient for a detailed examination of these complaints. The following observations are therefore necessarily provisional and moreover confined to certain aspects.

Disagreement on the Balance of Payments Effects

The effects of the foreign capital on the *balance of payments*, for instance, cannot be determined with exactitude. If only a capital inflow-profit outflow comparison is undertaken, as is often done, the foreign investments will be seen to result in a loss of foreign currency. According to IMF data, the direct investments in Colombia during 1960–1974 totalled \$ 446 mn whereas the transferred profits amounted to \$ 711 mn, leaving a foreign currency loss of \$ 265 mn ⁷. Measured in this way, the foreign currency effect varies greatly from sector to sector, as can be seen from the financial transactions of US enterprises in Colombia: while a foreign currency loss of \$ 37 mn was thrown up by the oil sector, manufacturing industry yielded a surplus of \$ 8 mn. The overall loss was \$ 47 mn.

The foreign currency outflow brought about by the financial transactions is magnified by the external trade business of the foreign enterprises: in 1967–1970 they accounted for imports of \$ 427.5 compared with exports of \$ 129.6 mn ⁸. This means that 30.3 p.c. of the foreign currencies spent on imports were recouped by export earnings. The following figures pertain to individual industries:

- Metal fabrication 13.1 p.c.
- Pharmaceuticals 14.6 p.c.

⁷ Calculated from: International Monetary Fund, Balance of Payments Yearbook, various volumes.

⁸ Cf. DANE, op. cit., p. 85.

- Rubber 79.3 p.c.
- Electrical industry 13.3 p.c.
- Chemicals 26.9 p.c.

More detailed information about the *export policy* of the foreign firms in Colombia emerged from an investigation of the Banco de la República which related to 67 p.c. of the foreign companies registered with the Oficina de Cambios on December 31, 1972⁹. The salient points established by the investigation which covered the years 1969–1971 were the following:

- The exported products are for the most part (61.3 p.c.) intermediates; 24.4 p.c. were consumer goods and 14.3 p.c. capital goods.
- The export trade is concentrated largely in the hands of relatively few and – in terms of employment provided – large firms.
- The other countries of the Andes bloc (47 p.c.) and the USA are the principal foreign customers.

Data concerning the *export intensity* of the foreign enterprises are only available for the manufacturing subsidiaries of US firms in the years 1957 and 1966. While in 1957 the domestic market accounted for nearly all sales (\$ 107 mn), exports in 1966 absorbed 10 p.c. of the total sales of \$ 358 mn (including \$ 24 mn of intra-group exports to combine companies outside Colombia)¹⁰.

The relatively low export intensity – the US manufacturing subsidiaries in Canada and Western Europe achieved export quotas of 19.4 and 23.7 p.c., respectively, in 1965 – is in the first place due to the motivation of foreign investors in Colombia: their main interest is to supply the local market¹¹. From this follows that the investment projects are internationally not fully competitive: owing to the small size of the market the operating units are often too small to be profitable. Besides, high tariff protection and consequent absence of competitive pressure by similar imported products is not exactly conducive to raising productivity¹².

It would however be wrong to deduce from the figures of foreign trade and financial transactions by the foreign enterprises that the foreign capital has a negative effect on the balance of payments.

⁹ Cf. Exportaciones de empresas con inversion extranjera directa (Exports by enterprises with foreign direct investment), in: Banco de la República: Revista, January 1974, p. 28 ff.

¹⁰ Cf. M. Wionczek, Hacia el establecimiento de un trato comun para la inversion extranjera en el Mercado Comun Andino (Towards the establishment of common treatment for foreign investments in the Andean Common Market), in: El Trimestre Económico, Vol. 38, No. 150, April-June 1971, p. 667 f.

¹¹ Cf. A. Kapoor, Private Foreign Investment in Colombia, in: The Oriental Economist, No. 712, February 1970 (page not indicated); and J. Kummerer, Deutsche Investitionen in Kolumbien (German investments in Colombia), in: Deutsch-Kolumbianische Handelskammer: Vierteljahresschrift, No. 46/1971, p. 17 ff.

¹² Cf. J. Kummerer, *ibid.*, p. 21.

The results as regards the balance of payments could be exactly determined only if it were possible to ascertain whether and to what extent the foreign enterprises are replacing imports by local products, to what degree indigenous firms could have effected the investments by themselves, what export performance alternative would have been offered by domestic investment projects, etc.

Fiscal Losses on Account of Foreign Enterprises

The second complaint – that the foreign enterprises have been paying too little in taxes – is based on the observed fact that the profits recorded by foreign subsidiaries are often astonishingly low. The annual profit rate of US firms in Colombia between 1960 und 1972 for instance averaged 5.9 p.c. – a distinctly lower rate than shown by US companies in industrial countries¹³. The profits of the foreign companies are also low in comparison with those of indigenous firms. Whereas the latter in 1967 and 1968 recorded profit rates of 9.2 and 9.3 p.c. in manufacturing industry and in the service sector, the corresponding figures for the foreign firms were 5.5 and 6.1 p.c., respectively¹⁴.

That the recorded profits understate the actual profits seems to be borne out by the fact that 14 foreign automobile firms applied for production permits in 1969 although the existing company – Chrysler Corp. – had for years been operating at a loss¹⁵.

Constantine Vaitos has made an attempt to calculate a rate of effective profitability for foreign enterprises in Colombia. Starting from a definition of direct investment as a package of capital investment, technology transfer and trade ramification, he identified the effective profitability of an investment project as the sum total of recorded profits, intra-group payments of royalties and fees and the amount by which intra-group trade flows are over- or underinvoiced. In the case of 17 foreign enterprises in the pharmaceutical industry which represented 40 p.c. of the pharmaceutical market in Colombia in 1968 he found the recorded profits to be no more than 3.4 p.c. of effective earnings: royalties accounted for 14 p.c. and over-invoiced imports of intermediates for 82.6 p.c. The declared profit rate of 6.7 p.c. thus compared with an effective rate of 136.3 p.c.¹⁶. This calculation however calls for some comments:

- To lump the full amount of the royalties with the profits without allowing for the expenditure

¹³ Calculated from: Department of Commerce, Survey of Current Business, various volumes.

¹⁴ Cf. C. Vaitos, Intercountry Income Distribution and Transnational Enterprises, Oxford 1974, p. 68.

¹⁵ Cf. C. Vaitos, *ibid.*, p. 50.

¹⁶ Cf. C. Vaitos, *ibid.*, p. 62.

incurred by the provider of the technology seems to be unjustifiable.

□ Payment of royalties is the worst conceivable means of manipulating profits in Colombia because royalties are not only liable to 24 p.c. tax at source but are not deductible as a business expense and are therefore de facto treated as profits.

□ Finally, it is virtually impossible to make a correct estimate of the overpricing because it would have to be ascertained for this purpose whether and to what extent use is being made of intra-group imports as an instrument of internal cost allocation.

Besides, the pharmaceutical industry cannot be regarded as representative for industry generally: the considerable differences between national patent laws have a major bearing on its price policy. Nevertheless these objections cannot refute the argument that foreign enterprises caused a fiscal loss by keeping recorded profits too low.

The third complaint is that the foreign enterprises are not contributing significantly to the reduction of *unemployment* in the country. Data relating to manufacturing industry in 1960–1967 have been quoted in evidence. These show the sectors in which the foreign investments were concentrated to have a relatively high and indeed steadily rising capital intensity¹⁷.

Furthermore, an unpublished investigation by the Departamento Nacional de Planeación showed that between 1957 and 1966 employment temporarily declined in 8 of altogether 18 industries employing domestic and foreign capital which were the subject of the investigation whereas the investment volume increased over the same period¹⁸.

Different findings however were reached in a study concerned with employment by foreign firms by the Banco de la República which covered 76 p.c. of the enterprises with foreign capital participation operating in Colombia¹⁹. This study showed employment to have risen at an average growth rate of 6.2 p.c. annually in 1969–1971. In assessing the contribution to employment of foreign enterprises it must also be borne in mind that there is often a trade-off between labour-intensive production methods on the one hand and productivity and international competitiveness on the other.

One last complaint made about the foreign capital is that powerful multinational enterprises displace indigenous firms in the market. The extensive industrial integration and concentration of capital ownership which attended the policy of import substitution and the role which foreign investors

have been playing in this process are mentioned in support of this argument. In 1968 42.8 p.c. of the gross production value of the whole industrial sector was recorded in industries in which the four largest enterprises accounted for more than 50 p.c. of the total output. Foreign interests owned the majority of the capital of 19 out of 31 dominant firms in the 12 industries which between 1958 and 1968 achieved the highest growth rates²⁰. Foreign enterprises dominate 80 p.c. of the pharmaceutical and rubber industries: in the rubber industry 3 firms are sharing the market. In the pharmaceutical sector there is a high concentration on some individual products: 45 p.c. of the hormone market for instance is controlled by one foreign enterprise²¹.

Foreign investors often enter a market by taking over existing enterprises. This has been the case in 55 of altogether 137 investment projects undertaken by the 396 largest multinational enterprises in Colombia up to 1970²². The ratio of take-overs to newly established firms has markedly increased in the course of time²³. This does not mean that indigenous firms have been supplanted in all instances. On the contrary, there are indications of a clear tendency – fostered by official directives – of foreign capital cooperating with local capital.

Moreover, foreign capital participation in local enterprises often results in considerable improvements in cost efficiency and productivity. It is the task of the political authorities to evaluate trade-offs which occur in this connection – e.g. between the number of the suppliers, the relationship between foreign and domestic firms, productivity and employment – and to take decisions in the light of this evaluation. The necessary instruments have been put in their hands, especially bearing in mind that the harmonization of the investment policies of the Andes pact countries – towards which at least a beginning has been made – is strengthening their negotiating position vis-à-vis the foreign enterprises quite appreciably.

¹⁷ Cf. D. A b a d, *Ausländische Investitionen – Interessenkonflikt und Möglichkeiten des Interessenausgleichs* (Foreign investments – Conflict of interests and possibilities of a reconciliation of interests), in: A. v. G l e i c h (ed.), *Private Auslandsinvestitionen in Lateinamerika* (Private foreign investments in Latin America), Hamburg 1971, p. 44.

¹⁸ Cf. C. V a i t s o s, *ibid.*, p. 70.

¹⁹ Cf. *Empleo en empresas con inversión extranjera directa* (Employment in enterprises with foreign direct investment), in: Banco de la República; *Revista*, March 1974, p. 387 ff.

²⁰ Cf. H. M e l o, *Posición del capital multinacional en la economía Colombiana y algunas limitaciones que impone al desarrollo Andino* (The position of the multinational capital in the Colombian economy and some limitations which it imposes on Andean development), in: *Fundación Friedrich Naumann* (ed.), *Problemas y oportunidades de empresas multinacionales Andinas*, Bogotá 1974 (page not indicated).

²¹ Cf. C. V a i t s o s, *ibid.*, p. 37 ff.

²² Including 187 US firms (on Jan. 1, 1968) and 209 non-US enterprises (on Jan. 1, 1971). Cf. J. V a u p e l, J. C u r r a n, *The World's Multinational Enterprises*, Geneva 1974.

²³ Cf. M. W i o n c z e k, *op. cit.*, p. 665.