CSIS POLICY PAPERS ON THE AMERICAS

COLOMBIA'S TRADE POLICY OUTLOOK

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Volume 5, Report No. 2
March 25, 1994
CSIS Americas Program

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CSIS gratefully acknowledges Consejo Empresarial Colombia - Estados Unidos (CECEU), of Bogotá, Colombia, whose support helped make this report possible.

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This study was prepared under the aegis of the CSIS Policy Papers on the Americas Series.
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Executive Summary

During the last few years Colombia has experienced impressive changes, particularly in its trade regime. Trade liberalization was put in place in 18 months rather than the five years originally contemplated. As an integral part of this economic opening, Colombia negotiated or is in the process of negotiating free trade agreements with many individual countries and groups of countries in the region.

Colombia's economic performance in 1993 was the best in five years, with a growth rate in excess of 4 percent and inflation down to around 21 percent. Longer-term economic prospects have improved significantly with the expected increase in petroleum production from the new Cusiana field. By later in this decade production should be about 1 million barrels per day, twice the present capacity.

The petroleum sector attracted one-half of the $790 million in new foreign investment in 1992. The government hopes to raise over $3 billion in 1994 by the sale of its share of the world's largest open-pit coal mine, a nickel mine, and other properties. Both capital and consumer imports are up sharply as trade liberalization has taken hold and the government has promised to slow food and textile imports. In 1992 Colombia prepaid almost half a billion dollars on multilateral loans and this year successfully sold a $250 million bond issue in the United States. Trade between Colombia and Venezuela exploded to over $1.8 billion in 1993, making Venezuela Colombia's second largest trading partner behind the United States.

Although Colombia already enjoys many of the benefits of a free trade agreement with the United States, it is eager to join an expanded North American Free Trade Agreement (NAFTA) in order to attract additional U.S. investment and to secure unrestricted access to the U.S. market. Regardless of who is elected president in May 1994, trade liberalization is likely to continue, because there seems to be a consensus in the country that integrating the economy with world markets is necessary for long-term growth.

In 1992 the United States posted a $433 million trade surplus with Colombia, compared to a $787 million trade deficit in 1991. This dramatic $1 billion shift in the balance of trade was due to the rapid growth in exports of U.S. merchandise to Colombia, which grew 69 percent to $3.3 billion in 1992, an increase of $1.3 billion over 1991. Colombia is now the fourth largest market for U.S exports in Latin America, behind Mexico, Brazil, and Venezuela.

The continued power of the drug barons and endemic violence are two non-trade issues that are certain to be raised in any free trade negotiations with the United States. Continued high inflation and a highly skewed distribution of income are other problems facing the new government.

If the new government is able to deal effectively with these problems and continues the basic trade and economic policies of the administrations of Virgilio Barco and César Gaviria, Colombia will be in an excellent position to push an application for NAFTA entry and to compete successfully in world markets in the next century.

Depth of Reforms

Colombia emerged from the 1980s -- generally considered the "lost decade" for many Latin American countries -- in better shape economically than most of its neighbors, and it entered the 1990s with a firm commitment to an essentially capitalistic free market orientation and to open international economic relations.

In view of the continuity of economic policy, the tradition of consensus on major issues, and the lack of enthusiasm for economic experiments, the depth of the liberalizing reforms that began in the second half of the administration of President Virgilio Barco (which ended in May 1990) and expanded and intensified in the first two years of the government of his successor, César Gaviria, is somewhat surprising. The political component of these reforms resulted in a new constitution and decentralization of the state apparatus, which greatly increased regional autonomy. Another aspect of the general reform increased social sector spending in an effort to help eradicate the worst poverty and to lessen the still great disparity in living standards and highly skewed distribution of income.

In addition to trade liberalization, the economic reforms included labor reform, reform of the foreign investment regime, financial sector reform, and the privatization of the ports and railroads. In 1991 and 1992 the tariff reductions were accelerated, exchange controls were further liberalized, the central bank was made independent, and a second tax reform was passed in Congress. A new foreign trade ministry was created to centralize trade policy, and the export promotion agency, PROEXPO, was converted into the Bank of Foreign Trade.

In 1993 Colombia unveiled additional sweeping reforms to slash red tape for business, reduce spending, and boost efficiency. About 50 state agencies will be cut in size or dismantled, and 24,000 jobs will be eliminated over an 18-month period. The savings will be used to upgrade the courts, law enforcement, and social, health and welfare programs. Also, at the end of 1993, after a two-year struggle, the Colombian Congress approved a radical revision of the social security system that will create private pension funds and thereby stimulate the growth of capital markets. The same legislation also revised the health care system to guarantee health care for a majority of Colombians by the year 2000.

The History of Colombia's Trade Policy

Colombia has not always had a protectionist trade regime. Between 1950 and the significant reforms of the Gaviria administration, there were five periods of trade liberalization: 1951/52, 1954/55, 1965/66, 1967/82, and 1985/86 -- almost all of which were tentative and soon completely reversed.

With the brief exceptions noted above, from 1950 to 1967 Colombia implemented a sophisticated system of exchange rate controls, tariffs, quotas, and licensing schemes, all designed to shelter a fledgling industrial sector from foreign competition. It gradually became clear to policymakers -- not as clear, however, to many traditional industrialists -- that import substitution industrialization caused inefficiencies in Colombia's manufacturing sector, inhibited the efficient allocation of resources, employed fewer workers than export industries, further skewed distribution of income, and produced serious balance of payments problems.

Colombia began to change course in the 1960s, tentatively shifting to export promotion. As a result of this experimentation with market oriented policies, the first to last any sustained period of time, export manufacturing became the fastest growing sector, which led to an overall expansion of the economy in the 1970s. As important as it was in setting the stage for the most recent reform, this liberalization was very limited, affecting only sectors that did not create undue competition for national producers. As soon as any difficulties arose, as they did in the late 1970s when the expansion of coffee production devastated manufacturing by reallocating resources to the agricultural sector and led to the overvaluation of the peso, the government once again reinstated import controls. Any enthusiasm for trade liberalization disappeared completely with the worldwide recession of the 1980s, and the tentative trade opening was never fully implemented.

It was not until the last two years of the Barco administration that domestic and international pressure coalesced to bring about the significant trade liberalization that became the centerpiece of the economic opening.

Domestically, by the late 1980s, exporters -- including some industrialists in textiles, leather products, shoes, and cement -- had become a very strong pressure group. This group included an agribusiness that exported bananas and farm-raised shrimp as well as flowers and fruits. The exporters provided much-needed private sector support for the policymakers and technocrats who were convinced that growth of non-traditional exports was necessary for sustained economic growth and that without some liberalization of imports, Colombia could not handle its foreign debt or expand markets -- and the politicians went along. Because of the success of the 1984/86 economic adjustment program, the macroeconomic situation by 1990 was fairly stable, permitting policymakers to risk the adjustment pressures of trade liberalization.

Internationally, too, pressure began to increase. The United States applied additional pressure for trade liberalization through trade discussions prompted by President George Bush's Enterprise for the Americas Initiative. A fast-disbursing trade adjustment loan that Colombia had negotiated through the World Bank also stepped up pressure to liberalize further.

The trade liberalization program undertaken by the Barco administration was preceded by over a year of discussions between the government and the private sector on the need to modernize the Colombian economy and to open it to international competition. During these discussions even the most ardent supporters of trade liberalization did not advocate radical measures. During the 1990 presidential campaign Gaviria's economic advisers all agreed that the process would continue to be a very gradual one. It was continued high inflation that finally convinced the new president that Colombia had to accelerate the trade opening, overruling his politically powerful minister of development, Ernesto Samper, who became the Liberal Party presidential candidate in the 1994 elections.

Clearly the influence of private sector groups in favor of protectionism had declined and the new influential pressure groups, including exporters, were beginning to see that protectionism was incompatible with exports in a world more and more unwilling to allow Colombia to maintain trade policies no longer accepted anywhere else. Traditional protectionist practices also seemed to be less effective, and the national market was no longer a dynamic source of growth.

Trade reform also was not a subject with high visibility or great public interest in a society in the middle of a violent war on drugs and a tough struggle with some guerrilla groups and peace negotiations with others.

Furthermore, the most difficult part of the discussions concerning trade liberalization took place at the end of the Barco government, when the first tentative steps were taken. This made it easier for the Gaviria administration to radically accelerate the process at the height of its popularity in the first year. In 1991 the government advanced the 1984 tariff targets so that trade reform was put in place in 18 months rather than the five years originally envisioned. This acceleration had the added advantage of undercutting the power of the trade bureaucracy to frustrate the liberalization effort, which it could have done had the dismantling of import controls been more gradual.

It has also been suggested that one of the major differences between the liberalization episodes of the 1970s and the 1990s was the changing backgrounds of the executives in the Colombian private sector. In the 1970s Colombian enterprises were in the hands of men who had entered industry and the financial sector prior to the World War II, usually from local law or engineering schools. They were very comfortable with government protection of industry, which had never been questioned by any of their teachers, colleagues, or friends. Most saw a protected national market as a source of strength. In contrast, in the 1990s, private sector enterprises were often controlled by a new generation of economists, engineers, and MBAs who had foreign postgraduate degrees. To them the government economists' arguments in favor of market-oriented reforms were more familiar and fitted with the ideas they had encountered in graduate schools abroad.

The Economic Situation in Mid-1994

Despite some problem areas, notably agriculture, the Colombian economy remains basically sound. Growth in 1993 was expected to be around 4 to 4.5 percent, up from 3.5 percent in 1992, and 2.3 percent in 1991. But imports of cheap textiles, footwear, cigarettes, and paper products have surged as a result of the reduction in import barriers, and the government has promised to slow food and textile imports.

Imports showed a 34.6 percent growth in 1992 as the government's trade liberalization policies began to take hold, with both capital and consumer imports up sharply. Another reason for the large increase was the fact that reduced import duties have transferred to the legal market many products that had been coming in as contraband, with the result that these are now reflected in official import statistics.

Colombia's major exports continue to be coffee, petroleum, coal, ferro-nickel, and non-traditional exports such as cut flowers, textiles, leather goods, wood and paper products, sugar and candy, cocoa, tropical fruits, precious stones, plastics, and seafood.

Coffee exports, which in the 1960s represented 60 percent of export earnings, now account for less than 20 percent, an indication of the success Colombia has had in diversifying its export base. The volume of coffee exports increased by 30 percent in 1992 as sales efforts focused on expanding market share in the face of declining prices. However, the lack of an international coffee agreement, high inventories in consumer countries, and stagnant demand combined to make 1992 another difficult year for the Colombian coffee industry. In 1993, Colombia joined with other coffee-exporting countries seeking to raise coffee prices by withholding 20 percent of coffee production from the market. These efforts are unlikely to succeed unless coffee production is curtailed more than has been possible to date.

The government argues that many of the difficulties the agricultural sector is now experiencing have nothing to do with trade policy. The growth of banana exports, for example, has been slowed because of European Union restrictions and flowers and fruits are facing the entry of new producers into the U.S. and other markets. Nevertheless, the decline of agricultural gross domestic product (GDP) in 1992 and the increase in food imports have increased pressure on the government to reconsider protectionist measures for this sector. Minimum price restrictions have also been introduced to control the entry of 30 categories of textiles, another politically powerful sector that has been hurt by a surge of cheap imports, particularly from China and other countries in Asia.

Total foreign direct investment increased to $790 million in 1992. The petroleum sector attracted about one-half of that, mostly due to the discovery of the massive Cusiana oil field in the eastern plains region. Non-petroleum investment, of which 93 percent consisted of new funds rather than reinvested profits, was concentrated in the pharmaceutical, machinery, steel, cement, and electronics industries. Non-petroleum investment increased another $437 million in 1993, of which about 35 percent was from the United States, a larger percentage than from neighboring Venezuela. Total U.S. investment, not including all recent petroleum sector investment, is about $2.7 billion, roughly 63 percent of all foreign direct investment in Colombia.

Privatization

The government has made some headway with its privatization program, although a court battle instigated by dock workers and the 1992 strike by telecommunications workers have slowed plans for these areas. The government has sold three cellular telephone concessions to private investors for $624 million. U.S. communications giants McCaw Cellular Communications and LCC Inc. are minority shareholders and operators in the two largest concessions in the Bogotá area. Several additional concessions are expected to be sold this year. There are also plans to sell a variety of other state properties including power plants, vacation resorts, gasoline distributorship, a nickel mine, and banks valued at over $2 billion.

In what would be the largest privatization to date, the government has announced plans to sell its share of Carbones de Colombia (CARBOCOL), the world's largest open-pit coal mine. The government hopes to raise more than $1 billion from this sale; the other 50 percent is owned by Exxon, the U.S. energy company.

Regional Integration

For decades Latin American leaders talked about the benefits of economic integration and even formed various organizations to foster it, but for the most part these organizations just talked and debated. In the 1990s, however, action has replaced debate. There are now more than 20 bilateral and multilateral trade agreements in effect in the region, most of them signed since 1990.

As an integral part of the economic opening, President Gaviria has put Colombia at the forefront of this ambitious regional integration effort and the country has signed or is negotiating free trade agreements with many individual countries (for example, Chile and

Venezuela), and several groups of countries, including the G3 (Colombia, Venezuela, and Mexico), the Andean Pact (Colombia, Venezuela, Ecuador, Bolivia, and Peru), and the common markets of Central America and the Caribbean. With both Atlantic and Pacific ports, Colombia's interests go beyond the Western Hemisphere. In February 1994 President Gaviria made an official visit to Japan seeking major infrastructure investment needed to exploit the recent Cusiana petroleum discoveries.

Colombia-Chile Free Trade Agreement

Chile, an original member of the Andean Pact, dropped out in 1973 and has since signed bilateral agreements with both Colombia and Venezuela and initiated negotiations with Bolivia and Ecuador (but not Peru). The value of two-way trade between Colombia and Chile actually decreased in 1991 and 1992 from a high point in 1990. In 1992 Colombian exports to Chile amounted to $116.6 million, while imports were $81.4 million. How much the free trade agreement signed in 1993 will affect these figures remains to be seen. One recent study by the United Nations Economic Commission for Latin America and the Caribbean concluded that there is no clear correlation between the existence of agreements, their coverage, and increased trade between two countries. Factors other than trade preferences, most important among them geographical proximity, may have a stronger influence on the expansion of trade.

Colombia-Venezuela Free Trade Agreement

Colombia and Venezuela signed a free trade pact in 1991, and since then trade between the two countries has increased from $250 million to $1.8 billion in 1993. Today Venezuela ranks second only to the United States as Colombia's largest trading partner and foreign investor. In 1992 roughly 40 percent of Colombia's exports went to the United States, 8.5 percent to Venezuela. In the same year, the United States supplied 38.5 percent of Colombia's imports, Venezuela, 6.7 percent. Another of the positive results of the agreement is that flights between Bogotá and Caracas increased from 4 to 26 a week at the end of 1993, a far cry from the situation of only a few years ago when most such flights went through Miami.

The Colombia-Venezuela free trade agreement has been very popular with international firms, permitting them to rearrange manufacturing or distribution operations in order to service both the Colombian and Venezuelan markets from one location.

Colombia's relations with Venezuela -- because of geography, more extensive than with any other country in the region -- have not always been harmonious. The major issue involves the boundary between the two countries in the Gulf of Venezuela, where several shooting incidents took place in the 1980s. This still unresolved dispute recently became a campaign issue when Andres Pastrana Arango, the leading Conservative candidate running as an independent in Colombia's May 1994 presidential elections, suggested that there should be joint patrols of the disputed waters during the presidential election campaigns in both countries in order to keep the issue out of politics. The suggestion was ignored by Venezuela, where elections took place in December 1993, and have not been taken up by the Gaviria administration.

Another border problem between the two countries revolves around the approximately 1 million illegal and undocumented Colombians who have entered Venezuela since 1950. For the most part these Colombians work as domestics and in other menial positions shunned by the Venezuelans. This immigration has contributed to the large volume of illegal and contraband trade that has flourished in the border regions. Drug trafficking and cross-border guerrilla attacks by Colombian rebel groups have also contributed to occasional tensions between the two countries.

Despite occasional grumbling in both countries regarding which one got the best of the deal in the free trade negotiations, however, the success of the agreement in increasing trade and investment has served to diminish problem areas. This explosion of trade and investment between the two countries has been propelled by the private sector. Venezuelan investors have been most interested in the newly deregulated Colombian financial sector and have purchased over 20 percent of Colombia's Banco Ganadero, a recently privatized conglomerate. Banco Mercantil, one of Venezuela's largest financial corporations, bought a Colombian bank two years ago and has opened a branch office in Bogotá. The Colombian Petrochemical Group invested in Venezuela's petroleum industry when it bought two plants there. In 1993 Venezuela issued $150 million worth of government bonds in Colombian money markets.

Through these increased trade and investment ties the two countries are likely to grow increasingly interdependent, and as they do border disputes and military rivalry could become an anachronism. In August 1993 the presidents of the two countries agreed to establish a commission on integration. They also agreed to help each other with environmental disasters such as oil spills and to build a 230 kw electricity line to link the two countries' grids. Cooperation between the countries' potato and rice sectors was also agreed to, which could be the beginning of genuine cooperation in the agricultural sector or could mean that Colombia wants to block Venezuelan rice while Venezuela tries to keep out Colombian potatoes. The two countries and Ecuador have also signed an agreement to harmonize automotive policy by setting a common external tariff on fully assembled vehicles as well as on kits imported by assemblers in all three countries.

The Group of Three -- Colombia, Venezuela, and Mexico

Colombia, Venezuela, and Mexico have several times postponed the signing of the so-called G3 free trade agreement, first because Mexico did not want any possible complications prior to U.S. congressional action on the NAFTA accord and later because of the political situation in Venezuela. Indications now are that the Venezuelan government that took office in early February 1994, unhappy over the textile as well as other provisions, has approached Mexico (but not Colombia) about reopening negotiations. In response, Colombia, which has always considered any G3 agreement as a stepping stone to entry into NAFTA, reportedly sounded out Mexico about the possibility of a bilateral agreement. Mexico has been cool to the approaches from both Venezuela and Colombia, and it will obviously take several additional rounds of high-level negotiations to work out these new problems, which Colombian officials have described as minor.

The Andean Pact

Colombia and Venezuela, the two largest members of the Andean Pact (signed in 1969 in Cartagena), account for two-thirds of the combined Andean GDP and three-fourths of its total trade. In August 1993 Colombia reached free trade agreements with Bolivia and Ecuador similar in scope to the one with Venezuela, leaving only Peru outside the smaller club. Both Colombia and Venezuela suspended negotiations with Peru following President Alberto Fujimori's so-called autocoup in April 1992. Peru had been insisting on special concessions reserved for the pact's less developed members, Bolivia and Ecuador.

After enjoying considerable success during its early days, which coincided with the popularity of import substitution, the Andean Pact stagnated in the 1980s. It has survived only because it has completely redefined its goals and methods, today concentrating on promoting free movement of capital, goods, services, and individuals within the region rather than attempting to keep others out, which was its unstated early goal. Only time will tell how successful the pact will be in resolving remaining problems (one of the most important of which is the Common External Tariff) to meet its goal of forming a common market by 1995. In 1989 total trade within the pact amounted to $1.8 billion. The trade-expanding possibilities within the group are far from exhausted and Colombia should be able to increase trade with all of them. The pact has also proved useful to Colombia as a cover for changes in laws regarding intellectual property and other areas where changes in domestic law might not have been possible.

Central American Common Market and CARICOM

Colombia's present trade with both the Central American Common Market and the Caribbean Community and Common Market (CARICOM) is quite small, and given the size of these markets is likely to remain so. Only 0.3 percent of Colombia's exports, for example, are destined for CARICOM countries, and 1.5 percent are directed to Central America.

Interest in a Free Trade Agreement with the United States

From all indications Colombia eagerly wants to join the United States in an expanded version of NAFTA. Colombian trade minister Juan Manuel Santos Calderon, during an extended official visit to the United States in early March 1994, specifically requested negotiations to join NAFTA. According to Colombian Embassy sources, he received a very warm but noncommittal reply from U.S. Trade Representative (USTR) Mickey Kantor, who stressed both that such a move would be a major commitment for Colombia, which required careful study, and that the United States was still in the early stages of formulating its trade policy toward Latin America. Colombian officials were also pleased with Santos' conversations with members of Congress, including Lee Hamilton (D-Ind.), Chairman of the House Foreign Affairs Committee.

Just prior to the congressional vote on NAFTA the Colombian president wrote an op-ed piece in the Washington Post arguing that approval of the treaty would "resonate beyond the borders" of Canada, Mexico, and the United States. "We view NAFTA as a stepping stone toward a greater objective: a hemispheric free trade zone of democratic nations," he wrote. Obviously trying to convince his readers in the United States that Colombia was worthy of consideration as an early entrant into this free trade club, Gaviria cited increases in U.S. exports to Colombia that he said had created 45,000 new jobs in the United States.[1]

Colombia enjoys many of the benefits of a free trade agreement because most Colombian products already enter the United States duty free as a result of the Andean Trade Preference Act (ATPA) passed by Congress in an effort to assist Colombian and other Andean countries in their struggles against drug trafficking. As with the Caribbean Basin Initiative on which it was patterned, ATPA excludes sensitive products from duty-free treatment -- notably textiles, clothing, canned tuna, sugar, footwear, and petroleum and its derivatives. Nevertheless, the act, signed in July 1992, has stimulated non-traditional exports to the United States. The ATPA contains no special provisions regarding non-tariff barriers or the application of U.S. trade remedies. Because it is a unilateral program, the United States can change countries or products at will or cancel the agreement. An important reason for Colombia to seek a free trade arrangement with the United States is, therefore, defensive -- to secure unrestricted access to the U.S. market in the future.

With few tariff barriers to the entry of Colombian products into the U.S. market, Colombia's interest in a free trade agreement would obviously be in negotiating non-tariff barriers -- among them quotas, voluntary export restraints, anti-dumping, and countervailing

1. César Gaviria, "Free Trade Success Story: The Colombian Example", Washington Post, November 14, 1993.

duties. The prospect of an increase in investment is also high on Colombia's list of expectations from any free trade agreement with the United States. In addition, it would be a sign that Colombia had moved to the ranks of the "developed" world.

Expanding NAFTA

The Clinton administration and its NAFTA partners, Mexico and Canada, have not made any basic decisions regarding the expansion of the free trade pact. The issue was discussed at the meeting of the trade ministers from the three countries in January 1994 but no agreement was reached.

The issue of U.S. trade policy toward Latin America has also been discussed at the various interagency meetings dealing with U.S. implementation of the NAFTA accord, but even though the USTR must submit a report to Congress by May 1, many details remain up in the air. According to preliminary administration plans, the free trade zone would be expanded over the next 10 to 15 years, beginning with Chile by late 1995. Reportedly, some officials would like President Bill Clinton to unveil plans for the expanded pact at the meeting of the hemisphere's chiefs of state to be scheduled in late 1994. Others argue that there are already too many trade issues on the table -- getting NAFTA up and running, ratification of the General Agreement on Tariffs and Trade (GATT) accords, and serious trade disputes with Japan and China -- and that possible expansion of NAFTA should therefore wait.

One of the decisions to be made is whether NAFTA members should negotiate with individual countries or with groups of countries, for example, the Andean Pact of Bolivia, Colombia, Ecuador, Peru, and Venezuela. In either case, there is general agreement that Chile, which has progressed the furthest on market reforms, will be the next country to be permitted to join NAFTA, with formal negotiations scheduled for as early as spring 1994. Officials acknowledge that it would probably be more difficult to negotiate with groups such as the Andean Pact or Mercosur (Argentina, Brazil, Paraguay, and Uruguay): within these groupings some countries are much more advanced in economic restructuring than others, and as a result these subregional trade pacts have a long way to go before they are ready to take coordinated steps to be able to negotiate as a group.

The need for the U.S. administration to produce two reports in the next several months (as required by the Danforth amendment to the NAFTA implementing legislation) will speed up some of these decisions. First, by May 1, the USTR is required to submit a report to the Senate Finance Committee, the House Ways and Means Committee, and to the president that lists those foreign countries (1) that currently provide fair and equitable market access to U.S. exports beyond that required by GATT or have made significant progress in opening their markets to U.S. exports; and (2) where the further opening of markets has the greatest potential to increase U.S. exports, either directly or through the establishment of a beneficial precedence.

Then, using this report as a basis, by July 1 the president must report to the Congress naming those countries (if any) with which the United States should seek to negotiate free trade agreements in order to increase U.S. exports. The report must also include specific negotiating objectives for each named country (based on a general set of objectives spelled out in the amendment) and must contain a legislative proposal to ensure adequate consultations with the Congress and the private sector during the negotiations, advance congressional approval of the negotiations recommended by the president and subsequent congressional approval of any trade agreements entered into by the president as a result of the negotiations.

Colombia, Argentina, and Venezuela have been specifically mentioned by President Clinton and other administration officials as examples of countries that might be considered for admission, after Chile, to the expanded NAFTA group. It remains to be seen whether the administration will choose to be exclusive or inclusive in its report to the Congress. The criteria spelled out in the Danforth amendment are quite strict. Nevertheless, at this point it seems likely that the USTR report will be as general and all-inclusive as the amendment permits.

The Debt Situation

Unlike some other countries in Latin America, Colombia's debt situation is manageable, even though its total external debt more than doubled between 1980 and 1986 and its debt service obligation more than tripled over the same period. Colombia's credit standing is among the best of the major debtor nations of Latin America. It was the only nation to be offered loans from private banks voluntarily in the 1980s and was able to draw down accounts from the World Bank and the Inter-American Development Bank without major interference from the International Monetary Fund.

The external debt situation has continued to improve in recent years. In 1992 Colombia was a net capital exporter (about $140 million). At the end of that year total external debt was $16.8 billion, of which $14 billion was public sector debt. Because of its high level of international reserves, Colombia was able to institute a new debt management policy of substituting domestic for external debt through the issuance of dollar-denominated bonds in the local capital markets. In 1992 Colombia prepaid $438.8 million on multilateral loans through this mechanism. In that year, total external debt was reduced by about $464 million. Total payments in 1992 through the external debt account totaled $505.5 million. The debt/GDP ratio has been reduced from 34 percent in 1987 to 27 percent in 1992.

In early February 1994, Colombia had no trouble selling 10-year bonds worth $250 million in the corporate bond market in the United States, the proceeds of which will be used to pay off additional outstanding debt. Marketed with a higher yield than similarly rated U.S.

corporate bonds, the 10-year so-called Yankee bonds were priced with a much narrower yield spread than Argentina's $1 billion bond offering in December 1993. The major credit rating agencies rated the Colombian issue higher than Argentina's, indicating that Wall Street considers Colombia to be more stable than Argentina. The Colombian bonds also received a favorable rating from the National Association of Insurance Commissioners, which permitted institutional investors to make their first foray into the world of developing nation debt.

"What separates Colombia from other Latin American countries is the relative stability of its fiscal policies under economic and political pressure," a spokesman for one of the rating agencies told the press at the time. Another credit rating company was quoted as saying, "Colombia's record as virtually the only Latin American country to meet all of its scheduled debt payments through the 1980s provides evidence of Colombia's commitment to maintain an unblemished payments record." According to the rating agencies, guerrilla and drug-related violence raised some concerns, but these were incorporated into the ratings. In other words, the ratings might have been even higher in the absence of the violence problem.

The Petroleum Industry

The discovery of the Cusiana oil field in Casanare Department by a private sector consortium led by British Petroleum boosted Colombia's oil reserves from 1.8 billion barrels to over 3 billion barrels. Preliminary indications are that Cusiana could contain more than 2 billion barrels of low sulphur light crude petroleum. This new discovery, which placed Colombia in the select circle of Latin America's oil powers behind Venezuela and Mexico, attracted over $400 million in new foreign investment in the petroleum sector in 1993. Petroleum now contributes about 5 percent to Colombia's GDP and is the source of over 20 percent of central government revenues. In 1992 crude oil exports fell in value to $1.1 billion, again falling to second place after surpassing coffee in the two previous years.

It is estimated that foreign companies will spend $5 billion through the end of the decade to develop Cusiana. By the year 2000 Colombia could be exporting half a million barrels of crude a day, almost triple its current exports of about 200,000 barrels a day. Earnings from Cusiana could be in the $2.5 billion to $3 billion a year range by the late 1990s.

This prospect has already sparked debate over how Colombia should spend these funds, expected to total more than $14 billion over the years. Shortly after the announcement of the discovery in 1993, President Gaviria warned that the windfall could deform the national economy. "If we give in to the temptation to spend the money immediately, we will do irreparable harm to the nation's productive apparatus," he said. Colombian government officials are determined to use the oil income more wisely than its neighbors to the north, Mexico and Venezuela, where petrodollars were spent haphazardly, causing inflation, currency revaluation, a bloated public sector, and weak non-oil exports.

One possibility being discussed is to set up a stabilization fund with the income generated by Ecopetrol's (the state-owned oil company) 50 percent share, in effect soaking up excess money so that a sharp rise in the supply of money does not fuel inflation, which is already high. There seems to be some consensus that these funds would be used gradually to further reduce external debt and to develop the transportation and communications systems.

Guerrilla Violence

Another concern highlighted by the Cusiana discovery is the ongoing battle between the government and leftist guerrilla forces. During 1992 and the first half of 1993, insurgents blew up sections of Colombia's main pipeline more than 90 times. Ecopetrol has estimated that attacks on oil installations have cost the economy about $700 million since 1986. In 1993 Colombia was forced to suspend petroleum exports for three days following attacks on the pipeline by guerrilla groups trying to force the government to nationalize the oil industry and expel foreign investors. Other sectors hard hit by the guerrillas included electric transmission facilities, land transportation, and the agricultural sector.

Statistics seem to support the government's claim that it is making progress in its war on violence. For example, in 1993 homicides dropped to about 5,000 from over 7,500 a year earlier. In early February 1994, an agreement of principles was signed by representatives of about 400 urban rebels in Medellín and the government, which both sides say may lead to a peace accord. As the March congressional elections and May presidential elections approach, however, Marxist rebels stepped up their attacks, kidnapping candidates and blowing up police stations and politicians' offices, killing 13 people over one weekend in February.

The threat of guerrilla violence was one of the reasons cited by the French oil giant Elf-Aquitaine in deciding to pull out of Colombia in 1993. High taxation, frequently changing investment regulations, and a crackdown on oil companies by local environmental officials in the eastern plains regions were other reasons listed by the French. Texaco has also reportedly expressed concern that heavy taxation could restrict further investment.

Outlook

The trade liberalization process in Colombia is likely to continue. Neither of the two major presidential contenders is likely to make significant changes in economic policy, even though Ernesto Samper has been trying to put some distance between himself and President Gaviria. A more populist leader than Gaviria, he may well want to slow the process and would probably be more willing to make concessions to domestic industries that claim they have been damaged by the apertura policy. The leading Conservative candidate, Andres Pastrana Arango, has supported the current government's economic policy while at the same time trying to avoid any policy commitments.

One of the primary challenges facing whoever is elected in May will be to attempt to achieve substantial reductions in inflation without compromising the successful trade policy. The new government, whichever party wins, can count on the support of the private sector, which is now firmly convinced that integration of the economy with the world markets is necessary for long-term growth. The continued cooperation of the private sector to identify remaining barriers and to recommend appropriate adjustments to policies is essential.

Continued high -- if declining -- inflation (the consumer price index has fallen for four straight years, to 21.4 percent at the end of September 1993) is but one of several dark clouds on the horizon. Despite the government's success in hunting down Medellín drug lord Pablo Escobar and its determination to crack down on both political and drug-related violence, the political and economic power of the drug barons and the endemic violence in the country are both issues that are bound to be raised in any free trade discussions with the United States.

Some analysts have argued that much of Colombia's economic success during the 1980s, which permitted it to continue to service its foreign debt while other Latin American countries had to reschedule theirs, was due to the vast sums of drug money -- estimated at between $5 billion and $7 billion annually -- that entered the country. On the other hand it can be argued, perhaps even more convincingly, that by reducing confidence in the country's future, this inward flow of drug money actually led to an increase in capital flight. There seems little doubt that the drug problem -- both perception and reality -- has caused a net deterioration in Colombia's general international position in recent years.

With U.S. assistance, Colombia has made significant progress in the war against drug trafficking. The Medellín cartel has been broken and several key leaders of the rival and now more powerful Cali group have been arrested. Nevertheless, frustration has reached the point where some Colombians in the public eye, including Nobel laureate Gabriel Garcia Marquez, Prosecutor General Gustavo de Greiff, and the leading left-wing presidential candidate and former guerrilla leader Antonio Navarro Wolff, have called for legalization. Calling the drug war "a failed fight," de Greiff recently commented to the press that "a kilo of cocaine costs $50 in the trafficking countries and is sold in the consuming countries for $5,000 to $10,000, and so there always will be someone ready to run the risk of the illegitimate business." These arguments have been rejected by President Gaviria and the two leading presidential candidates, a view backed up by majorities in public opinion polls.

Until further progress against the drug traffickers is made, Colombian leaders are likely to continue to be frustrated in their efforts to focus international opinion on Colombia's record of economic development and social improvement over the last 30 years rather than on narcotics and violence. The new government has to be prepared for criticism and vigorous debate about drug trafficking in any free trade negotiations with the United States. New tensions between Colombia and the United States over drug policy had already arisen early in 1994 because U.S. drug agents feared that de Greiff was negotiating very lenient terms of surrender with the Cali cartel.

Conclusion

Colombia has experienced impressive change during the last few years. Although far from complete, by most standards the reforms to date can be considered successful and a dramatic break from the past. The factors cited by a recent World Bank analysis to explain the country's record of economic development and social improvement during the past 30 years -- rich physical resources, a literate and dependable work force, a robust private sector, competent macroeconomic management, and political stability -- will also serve the country well in the future.

If the new government continues the basic policies of the last five years and moves effectively to deal with persistent problems such as inflation and violence, Colombia will be in an excellent position to demonstrate its readiness for early consideration for membership in an expanded NAFTA. Even with an economy that is relatively small by world standards, Colombia will also be able to hold its own in the competitive environment of the last years of the decade.

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