Inter-American Development Bank

Office of the Chief Economist

Working Paper #316

REGULATION, DEREGULATION AND MODERNIZATION IN COLOMBIA

by Rudolf Hommes [1]

A Historical Perspective of Regulation

In Colombia, the role of the state in regulating monopolistic or oligopolistic activity has been of benign neglect. The governments have been traditionally more active in regulating the financial markets and in controlling the activities of managers and large shareholders of publicly-held stock corporations than in regulating economic or market power by the private or state-owned companies. Moreover, the goal of state intervention traditionally has been to foster economic activity through tariff protection of the private sector, or through the distribution of subsidies to the productive sector, and not to check its development through regulation of monopolies or oligopolies.

The Colombian constitution of 1886, which was revoked in 1991, authorized the state intervention in the production, utilization and consumption of public and private goods to rationalize and plan the economy, in order to reach "integral development". This wide constitutional authorization had to be regulated by a law before it could be applicable. The legal development was very slow: In 1936, President Alfonso Lopez "capped off his reform program with a series of amendments to the constitution (....) which specifically increased the

[1]. This chapter was sponsored by the Office of the Chief Economist of the Inter-American Development Bank. The author worked as a consultant for this office when the chapter was prepared. Ulpiano Ayala, Armando Montenegro and Luis Alvaro Sanchez reviewed the first draft and offered very helpful comments and suggestions. Moises Naim and Joseph Tulchin revised the second draft and made valuable suggestions to improve substance and editing.

powers of the state in economic matters, spelling out -in terms that inevitable brought to mind the Mexican Constitution of 1917- the doctrine that property rights must be limited by social rights and obligations."[2]

In this reformist environment, a 1936 law was approved that prohibited the participation of bank directors in the boards of directors of other, non-financial corporations (Ley 16/1936). In 1959, taking advantage of the democratic mood that followed the fall of the Rojas Pinilla dictatorship, reformist minister Hernando Agudelo Villa sponsored and obtained a more comprehensive law (Ley 55/1959). It was inspired in the philosophy of the existing anti-trust legislation of the United States which, working under the assumption of an economy based on free enterprise and economic freedom, attempted to regulate monopoly, oligopoly and market power for the first time in Colombia.

This law defined and regulated unfair competition, restrictions to trade, collusion to interfere with trade, price fixing and other practices that hinder competition. The law also attempted to control firms that have a dominant position in their markets and to regulate mergers and acquisitions, requiring a previous government authorization for the such actions; it also prohibited the ownership of distributors by members of the management of corporations or by their families. This rule was a reaction to the textile manufacturers practice to grant regional dealerships to family members or favored associates of management, which increased its economic and political power and extended it through regional networks. It is not clear whether it was intended to prohibit monopolies or the dominant market position of firms or simply to regulate them. At any rate it gives considerable freedom of action to government because it states that firms that have a sizable proportion of the production, distribution or consumption of a good or service, which allows them to influence the conditions of the market, will be subject to government control. The nature of the control is not specified, but it clearly allows for extensive regulation.

---

2 David Bushnell, The Making of Modern Colombia (Berkeley: University of California Press, 1993). 189

This law also empowered the government to investigate violations to the regime through various superintendencies and the Ministry of Industry. In theory, consumer-citizens or competitors can take legal action against monopolies under the law, because it authorizes the same agencies to accept denunciations of violations of the law. But in practical terms, consumers or citizens have a very low likelihood of succeeding because the authorities are required to act only when these denunciations come with sufficient evidence of the violation, which would limit considerably the capacity of the public to take effective actions.[3]

While the government of Colombia has had legal capacity to regulate monopolies or dominant firms and to prevent practices leading to the obstruction of competition it has done very little in the decades since the law was issued. In 1993, it reinforced the legal capacity of the Superintendency of Industry and trade to act on behalf of the consumers but even after these changes no known action has taken place. Clearly, this indicates that there is lack of interest of the Colombian authorities to control and regulate monopolistic and oligopolistic activity. This indifference with the regulation of economic power stems from the nature of the political coalition that rules Colombia. The constituency of government in economic matters traditionally have been the different business interests that are represented by pressure groups and associations and not the public at large. There is no strong consumer lobby in Colombia, nor an important populist party. The left is splintered and has not pursued activist goals --such as the promotion of anti-monopoly regulation -- and same business interests for their electoral survival. As a result of this, any initiative that is taken in favor of a greater control of economic groups carries the risk of affecting the source of campaign contributions of the politicians of political conditions prevail that give government an opportunity to act more the Gaviria administration the opportunity to carry out reforms that would have been

---

3 Suescún Melo, Jorge, Monopolios y Concentración Económica, Asociación Bancaria, Bogotá, 1977.

very unlikely under normal political conditions.[4]

Something similar, although with a greater degree of government involvement has occurred with respect to the regulation of securities and corporate practices, particularly in the fields of disclosure, stockholder protection, insider trading, utilizing the corporation for the private benefit of large stockholders, the management or directors. Although the existing legislation permitted government regulation and intervention in these areas, not all administrations have been eager to strengthen or, even, develop the institutions responsible for developing regulation and for the enforcement of existing rules. During a brief period (1982-86), the Comisión de Valores was very active and played a role in preventing abuses against minority stockholders and mutual fund investors. These have been the exceptions rather than the rule. The entities responsible for supervision and enforcement have largely formal functions and enforce compliance to bureaucratic norms, but do not have the power to effectively control; and unless they obtain presidential support, they rarely have the power to stand up to the influential economic groups they are suposed to supervise.[5]

The origin of the Colombian legislation dealing with the regulation of monopolistic or oligopolistic activities or with the regulation of security markets and corporate practices is probably closer to the tradition of the United States and England than to the Spanish tradition, which leans in favor of concessions, monopolies and licences to the privileged. The formal organization

---

4 For a brief description of the alignment of political power in Colombia, as related to economic policy-making see Urrutia, Miguel "On the Absence of Economic Populism in Colombia", in Dornbusch, Rudiger and Sebastian Edwards, The Macroeconomic of Populism in Latin America (Chicago, The University of Chicago Press, 1991) 369-386. A description of the political barriers to change in Colombia may be found in Hommes, Rudolf, "Social Security Reforms. A Case Study of Political and Financial Viability." Paper presented at the Second Hemispheric Conference on Social Security, Pension Reforms and Capital Markets Development, Inter-American Development Bank, Institute of the Americas. Washington, June 1995.

5 Rudolf Hommes, Gabriel Silva, "La Sociedad Anónima en Colombia: Un Análisis Histórico,"Estrategia, No. 44, Bogotá, May 1981, pp.13-19.

of the laws and the judicial system in which they are imbedded operates formally according to the continental tradition - Spanish, French and Italian. These legal traditions do not mix very well with the Anglo-saxon concepts and instruments of anti-trust legislation because many of the concepts--specially those that require review by a judge or a supervisor-- and are conceived to operate in a common law environment do not travel smoothly to a statutory system. Under this judiciary system and legal environment, it is usually necessary that violations of the existing regulation be described in full detail for it to be enforceable. But these descriptions are often incomplete or leave large loopholes. On the other hand, if too much discretion is granted to the supervisor or to the judge, their decisions can be easily challenged, or they themselves can be challenged politically --through the media or in Congress-- by the business interest they have affected. The result is either inaction or a political and legal quagmire that requires a very strong political will of the executive or of the judiciary to confront the economic power of would be transgressors.

Governments, even when they have the ideological commitment to promote this type of control on monopolistic or oligopolistic activities, may not have the power to do it. In the case of Colombia, it is likely, though, that the main reason why regulation of this sort has not progressed is that governments have been interested in something else - the promotion of industrial activity - which stands at cross purposes with the objectives of regulation of oligopolies and monopolies. After all, it does not make much sense to try to promote competition through the enforcement of anti-trust legislation, when in the office next door, in the same ministry, they are trying to keep competitors out of the country and to protect domestic production with high tariffs and quantitative barriers.

The scarce interest of the Colombian authorities in anti-trust activities must also be analyzed from the perspective of the historical development of industry. In Colombia, following the rapid growth of coffee production in the late nineteenth century and early twentieth century, industry also developed, mainly as a result of domestic or immigrant entrepreneurship and

local capital. **Bavaria,** today's large beer dominant firm was founded by German immigrants in the late nineteenth century. As early as 1905, the Colombian government was using the concept of infant-industry protection to foster the development of modern textile manufacturing and flour milling through high tariffs for the final product and very low tariffs for its inputs. With this inducement and that of the growing market fostered by expanding coffee exports, Colombian factories that performed only the last stages of the production processes sprung up in many cities, especially in Antioquia where gold mining had created an entrepreneurial class with capital to invest.[6] Other industries followed the lead of textiles and were organized either through joint stock ownership or through the merger of existing, smaller firms. Industry leaders such as **Nacional de Chocolates** or **Colombiana de Tabacos** got started this way.[7]

Perhaps the most illustrative example of Colombian enterprises is the case of **Cementos Argos** (Colombia's largest conglomerate in the cement industry). It was started during the twenties through the entrepreneurship of two engineers who had been educated abroad. They came back from their studies with the idea and raised capital in Antioquia, mostly through family connections to create a joint stock corporation. This corporation grew quickly with the surge of public works and the urbanization of the country in the twenties, thirties and forties. Its savings was invested as seed capital to start other joint stock cement producing corporations, with different partners in different regions, or to acquire stock of other Antioquia based corporations that would, in turn, invest in the stock of Argos. The result is one of Colombia's largest, most diversified, profitable and better managed conglomerates- the Suramericana Group.[8] It was started and grew through domestic capital market financing and with local management and ownership.

---

6 Bushnell, David. op.cit. 174-80

7 Rudolf Hommes, G. Silva, op. Cit., pp. 13-18.

8 E.M. Velez y M.F. Velasquez, "Estructura y Funcionamiento del Grupo Suramericana," Temas Económicos (1981).

During the thirties and forties, Colombian industry got a series of big pushes that helped and accelerated its development: There was the wave of fresh foreign entrepreneurship pushed out of Europe by the Spanish Civil War and by fascism. Jewish immigrants came from Europe and the Mediterranean countries. They and other immigrants settled in the country, started small consumer goods industries, capital goods producers and new modes of trade and finance - both supermarkets and consumer credit can be traced to these european immigrants. Industry also flourished during those years because, as a reaction to the world economic depression and to its own domestic economic and financial crisis, the Colombian government devalued the currency, imposed capital and import controls and increased tariffs.[9]

Later, during World War II, not only entrepreneurship was called for, but also resourcefulness and indigenous technological development, because many of the inputs and intermediate goods that came from abroad had to be substituted by local goods. Finally, during the fifties and sixties and well into the seventies, the country embraced enthusiastically an import substitution strategy, forcefully complemented with subsidized credit and government intervention in favor of industry. Foreign investment in consumer goods industries may be seen as an immediate consequence of the import substitution strategy. In other sectors, such as oil or mining, the foreign investment followed natural resources and has had very little bearing in the industrial development of Colombia.

In banking, the foreign investors were very active and were very important for the development of financial practices and institutions. However, of the large banks that have played a role in the recent history of the financial sector, only one - the Banco Comercial Antioqueno- stems from a foreign-owned bank. All other major banks, with the exception of CITIBANK, that joined the country once again in 1990, have domestic owners.

In agriculture, the infamous history of United Fruit

---

9 Bushnell, op. cit., p. 184.

notwithstanding,[10] there has not been traditionally large foreign investment in Colombia. The same can be said for the transportation sector which developed primarily with local entrepreneurs and capital, with the exception of AVIANCA, the largest air carrier that was started by a group of discharged young Luftwaffe pilots, with some foreign capital. During World War II, these stocks were acquired by PanAm and sold in the early seventies to the present Colombian owners.

In the area of public services, there was initially some foreign and local private investment. All the major ports were started by private investors, the electricity and telephone services in large cities were private at first, as well as the water supply. Most of these private companies were locally owned and run, but there were exceptions: The Barranquilla public services company was originally owned by American capital and continued to be managed by an American many years after it had been nationalized. Similarly, the original Bogota phone company was owned by Americans.

During the thirties and forties, when Colombian firms did not continue to have access to international sources of credit, their investment capacity was severely curtailed. This, together with the growth of cities and their inability to supply services to the urban poor created the conditions for the gradual take-over by the public sector. This process culminated in the fifties and sixties when the multilateral financial institutions --unable to lend to the private sector for infrastructure investment-- collaborated with the governments in nationalizing the public service firms and organizing the centralized public monopolies that subsist today. Curiously, they now promote their privatization.

To finish this introductory section, it is worth keeping in mind the

10 The bad reputation of United Fruit stems from the 1928 banana strike. After a three-month strike, "matters came to a head on December 6, when in the town of Cienega soldiers fires into a mass of strikers, killing..."about sixty people (Bushnell.1993. p. 179). This incident was elevated to literature in one chapter of Gabriel Garcia Maquez's One Hundred Years of Solitude.

early steps of Colombian industry and the way it grew, through conglomeratization, fusions and acquisitions, mostly under conditions of protection of the domestic market and government intervention in favor of industrial development. This environment was not conducive to the application of legislation that attempted to regulate monopoly or oligopoly, much less to regulate economic power. But the strategy paid off handsomely during the initial stages: Colombian industry grew 830% during the period between 1929 and 1957. Thereafter, it continued to grow at very rapid rates, until it started to slow down in the seventies and the eighties because the import-substitution model ran out of steam.

The Modern Private Sector

The origins of the modern private sector development can be traced to the expansion of coffee production and coffee exports during the first decades of this century. In 1924, coffee represented already eighty percent of Colombian exports, which were six times the value of exports at the turn of the century. By 1930, Colombia was the second world exporter of coffee, a position that it has maintained until the present time.[11]

Public and Private Spheres of Influence. In general, the industrial development was a private affair. Nevertheless, the government intervened directly in its development. In the early forties, following a Latin American fad that also had an expression in fascist Italy and falangist Spain, it created the Instituto de Fomento Industrial (IFI), a public sector development bank and holding company with the purpose of investing in strategic industries that would be a key for the industrial development and would not be developed independently by the private sector; and to channel credit, mostly subsidized, to the industrial sector. IFI created the caustic soda production plant of Alcalis de Colombia, took over the salt production monopoly of the state and started a number of ambitious and mostly ill conceived investments that have either failed

11 Bushnell, op.cit., p.169

or produced substantial losses. The financial support for most of these projects came during the sixties and until the late eighties, from the reserves of the social security system that were lost and had to be replenished by the central government intervention was introduced: Paz del Río, the Colombian integrated steel firm, was created with capital forcefully collected from Colombian tax-payers in lieu of taxes. A portion of their income tax that had to be subscribed in stock of Paz del Río, which became this way a privately-owned, publicly run monopoly. For a number of years, the market value of these shares was negligible and was acquired by astute investors that gained control of the company. This scheme was utilized later to capitalize Banco Ganadero, with the same results.

Oil and Mining. In sharp contrast with the industrial sector, mining has been predominantly a joint public and private sector endeavor. Except for artisan coal mining and gold panhandling, all other mining activities are either licensed by the government, that has control of natural resources, or jointly owned by public and private enterprises. In the early fifties, under a very conservative regime, the oil industry was nationalized and ECOPETROL was created as a state monopoly to explore and develop this resource. As a result of this, investment in exploration and oil production fell sharply, and Colombia, in the early seventies, ceased to be an oil-exporting country. As a result of this, it was necessary to liberalize the regime and allow private firms to explore and produce oil under a much celebrated, successful but already obsolete joint-production contract (contrato de asociación), the private firm is given the right to explore in a given field, bearing all the costs and risks of exploration. If oil is found, ECOPETROL reimburses the private associate for fifty percent of the exploration costs and enters an association to produce oil on a fifty-fifty basis. Following the early success of the joint-production contract, it was agreement between EXXON Coal and CARBOCOL, a public Colombian company created ad hoc for this purpose. A similar contract was used to develop the nickel Cerro Matoso project with the participation of IFI as the Colombian counterpart.

In these two projects, the joint-production contract has failed

because the public sector has had to invest very large sums in projects that have been less investments is that international prices did not turn out as high as they had been expected in the early seventies or early eighties but rather they were about half the expected level. Additionally, due to the high forecasts , the project designers and constructors incurred in costs that probably could have been avoided if expectations would have been less rosy. The combination of rock-bottom prices and conspicuous investment did away with profits. This led to a reassessment of the joint-production strategy in non-oil mining projects . Starting in the late eighties, new mining investment by the private sector was allowed and encouraged under the old concession or licensing scheme which places all costs and risks on the private investors and limits the government role to collect royalties and taxes. This also is applicable to emeralds and precious metals.

Coffee. The development of commercial agriculture was also in the private realm, although with some peculiar Colombian twists. The most interesting is the National Federation of Coffee Growers (FEDECAFE), a private non-profit organization that was created in the early twenties as a lobbying and support organization for coffee producers.

In the early forties, the government created the National Coffee Fund as a public price stabilization fund and established a coffee board (Comité Nacional de Cafeteros) with equal representation of government and private members but endowing the Minister of Finance with veto power for the key decisions to determine coffee support prices, to regulate the marketing of the product domestically and abroad, to dictate policies leading to changes in production or accumulation of stocks and to decide how to spend the usually vast resources of the Fund. These resources came from three sources until 1991: from an export tax, from the "retention"in money or stocks of a proportion of the yearly crop, and from the profits of the direct exports of FEDECAFE. This arrangement has worked fairly well despite some financial setbacks and the nagging question of whether the control of such vast resources does or does not

give too much power to the management of FEDECAFE; and whether or not the resources have been spend and invested wisely.

In macroeconomic terms, the Fund and the coffee board have been successful because Colombia has managed to de-link the real exchange rate largely has been de-linked from fluctuations of the international coffee prices, sheltering exporters of other sectors from the effect of these fluctuations. This was achieved by regulating domestic coffee prices and collecting the difference between them and international prices during the boom years and by smoothing the down-fall with resources collected for the coffee fund during the upturn. Thus, the income of producers was stabilized and the real exchange rate was prevented from appreciating to the full extend that it would have appreciated in the absence of regulation and the stabilizing mechanism.

The management of the Fund was entrusted to FEDECAFE which also became an exporter of coffee, with a de-facto monopoly of 50 percent of the exports. The remaining fifty percent is allocated to exporters selected and approved by this same organization, with the ensuing risks of croyism and concentration of economic and political power among a few individuals or firms.

This scheme continues almost intact to this day. The management of public funds has rendered the federation, the leaders of the coffee producers political institutions and the chosen exporters a very powerful pressure group that also has a high degree of control over the assets of the Fund. These have been invested partially in coffee stocks, but also in a number of organizations that have economic and political clout: the **Flota Mercante Grancolombiana**, the Colombian merchant marine flag carrier; **Banco cafetero**, one of the largest Colombian banks; **CONCASA**, a large savings and loan corporation; **Agrícola de Seguros**, an insurance company; ACES, an airline; and several other minor companies, plus investments in most of the regional private development banks.

Agriculture. Other agricultural sub-sectors have not become as intertwined with the public sector as coffee but are constantly seeking arrangements to secure subsidies and rents from the government. This has come

invariably under the guise of support prices for commercial agricultural goods by the state marketing institute IDEMA, in the form of subsidized credit or high protection from imports. The non-commercial, peasant agriculture has lacked political representation, has no effective lobby capacity and has not obtained any significant benefits from the state despite the fact that most subsidy programs and "agricultural development"schemes are supposed to be directed to the peasants and small farmers.

Finance. Another area that has been the object of heavy intervention by the public sector has been the financial sector. Until the enactment of the new constitution, in 1991, the government, through the President, was authorized to intervene in the financial sector on matters related to the protection of private financial savings. This enabled the government to regulate all financial activities through presidential decrees. Additionally, the market was regulated by the Monetary Board, the Banco de la República (central bank), and the bank superintendent. The constitution of 1991 concentrated all regulatory power on the government and on the central bank --an autonomous authority in matters related to credit, monetary policy and foreign exchange policy and management. The institutional regulatory power was retained by the government as well as all precautionary regulation of the financial system.

In addition to its regulatory role, the government has been a banker since the nineteen thirties and forties. It created and still owns the Banco Central Hipotecario (BHC) -a mortgage bank; the Caja Agraria -a commercial bank specializing in agricultural credit and an agricultural insurance company; IFI, and the Banco Popular - a commercial bank run by the government that was originally created as a popular consumer bank that would increase access of the public to durable consumer goods but is simply a mediocre publicly-owned commercial bank.

Furthermore, in the early eighties, Colombia suffered a major banking crisis caused by a combination of fraudulent management of some institutions and the effects of the international credit crunch for Latin America in the aftermath

of a coffee boom during which credit had expanded significantly and banking standards had been loosened. The crisis forced the nationalization of Banco de Colombia and the intervention of Banco de Bogotá, the largest private banks; and the acquisition by the Fondo de Garantías de Instituciones Financieras (FOGAFIN) of a number of other medium-sized and small financial institutions that were run by FOGAFIN as private institutions under public trust until they were sold or liquidated.

Industrial Development. Although protectionism played a role as an initial inducement for the creation of industry, it only generated a precarious industrial development until the big pull came from the expansion of the domestic market. This expansion was due almost entirely to the successful development of the coffee sector which was facilitated posible by large public investment in railroads and by private transportation development. After 1930, industrialization took off. The share of manufacturing sector as a proportion of GDP grew from less than 8% in the first half of the thirties to 10% in the second half and to 15% by the end of the 40s. It continued growing vigorously during the fifties and less rapidly through the sixties and seventies when it reached a share of 22% of GDP, but it lost dynamism thereafter. In fact, the share of manufacturing in GDP has been constant since 1980 (Figure 1).

Production in the manufacturing sector was initially concentrated in food processing, tobacco and wooden products which accounted for 77% of manufacturing value added in the late twenties. With time, other sectors such as beverage production, textiles, clothing, other light manufacturing and cement gained a greater share in the composition of manufacturing value added as well as more sophisticated subsectors such as paper products, chemicals, rubber, metal manufactures and machinery. In the late seventies, the three groups of products reached even shares of the manufacturing value added, which they have maintained until today (figure 2). Clearly, technological development and rapid growth of high value-added industries is absent in the history of industrialized development in Colombia.

The development of the manufacturing sector in Colombia had special characteristics: In contrast to other countries in the region it maintained a relatively conservative structure --low risk, low technology and moderate investment-- concentrating in light manufacturing and consumer products, without making an all out effort to produce intermediate or capital goods. This is due in part to the relatively less important role that the public sector played as a direct investor in manufacturing production, and to the strategy of import substitution in a small economy.

The expansion of industry did not take place at the expense of agriculture. It is remarkable that during the years of rapid industrial growth, the commercial agriculture developed also very rapidly as a private sector activity. According to Ocampo, the agricultural sector has maintained a relatively high share of GDP when compared with countries of similar size and development.[12] However, the share of agriculture is much lower than that of other comparable and more dynamic countries such as Indonesia and Thailand.

Industrialization, fostered by an import substitution scheme, did not contribute to a dynamic development of export industries. Exports were 24 percent of GDP in the last half of the twenties and this share was gradually reduced to 16 percent in the mid and late sixties and to 14 percent in the early eighties. The mixed strategy of import substitution cum export promotion of GDP and exports did not begin to gain ground again until the trade regime began to be liberalized in the late eighties (Figure 3). The well known story of the Asian tigers points to a different path in which exports gain an increasing share of GDP. However, exports have diversified substantially, making the economy much more resilient to external shocks (Figure 4).

Patterns of Concentration.

The concentration of the industrial sector has been substantial since

12 Ocampo, José Antonio, "La Internacionalización de la Economía Colombiana," in J.A. Ocampo, Colombia ante la Economía Mundial, (Bogotá, Tercer Mundo Editores, 1993), pp. 19-65.

its beginnings and has increased over time. In a very thorough analysis of the Colombian industrial sector, Kristin Hallberg shows that the proportion of industries at a four-digit level "with highly and moderately concentrated market structures has increased over time, with a corresponding decrease in the proportion of industries with less concentrated market structure."[13] In 1968, the share of total manufacturing production corresponding to moderately and highly concentrated industries was 47.2%; in 1984, the share of these same industries had grown to 65.3% (Table 1). Moreover, a greater degree of concentration is shown in capital goods industries (Table 2) --where the moderately and highly concentrated industries have a share of 85.1% of production, and in intermediate goods where the share amounts to 78%, --than in consumer goods where the share of subsectors subject to moderate competition and strong competition is 53.5% and has grown since 1968. The intermediate and capital goods industries have enjoyed a significantly lower degree of protection from external competition than the consumer goods sectors. This would suggest that there may be a positive relationship between industry concentration and degree of openness to the foreign competition and the tendency of sectors facing international competition to require larger firms to compete. However, Hallberg did not find any pattern or clear association between the degrees of internal and external competition. For example, she found that some highly concentrated sectors such as beer and non-alcoholic beverages and non concentrated --competitive-- sectors such as paper containers, knitting mills or bakery products were equally subject to very little external competition.[14]

TABLE 1

Concentration of Production, 1968 and 1984

---

13 Colombia: Industrial Competition and Performance, a World Bank Country Study, (Washington, D.C., World Bank, 1990), p. 45. Notice that in this study the concentration scale goes from highly concentrated to competitive. This may create semantic confusion since competitive subsectors in this context are those that are less concentrated, not necessarily the more efficient.

14 Ibid., pp. 56-62.

	1968 **No.industries**	%	**1984** **No.industries**	%
Highly Concentrated	16	18.0	19	26.4
Moderately Concentrated	26	29.2	28	38.9
Moderately Competitive	28	31.5	22	30.6
Competitive	19	21.4	3	4.2
TOTAL	89	100.0	72	100.0

Source: Misas (1988). The total number of four-digit industries refers to the number analyzed in each of the two years. The definitions of the concentration categories are:

Highly concentrated: 75 < CR4 # 100
Moderately concentrated: 50 < CR4 # 75
Moderately competitive: 25 < CR4 # 50
Competitive: 0 < CR4 # 25

Note: Taken from Colombia. Industrial Competition and Performance.

TABLE 2

Concentration by Type of Industry, 1968 and 1984
(as % of industries analyzed)

	Consumer Goods		Intermediate Goods		Capital Goods	
	1968	1984	1968	1984	1968	1984
Highly Concentrated	15.1	20.6	35.3	39.0	10.9	8.9
Moderately Concentrated	20.9	26.0	13.6	39.0	13.4	76.2
Moderately Competitive	46.8	31.7	36.4	22.0	41.8	14.9
Competitive	17.2	21.8	14.7	0.0	33.9	0.0
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0

Source: Misas (1988).
Note: Taken from Colombia. Industrial Competition and Performance.

Another very interesting finding of the same study is the relationship between the price cost margins and the growth of productivity with the degrees of internal and external competition. It was found that

industries in markets facing greater competition, be it domestic or international, showed lower price cost margins than firms in less competitive markets. In the same way, subsectors with more competition showed higher rates of total factor productivity growth than sectors facing less competition.[15] Clearly, all these findings are arguments in favor of opening up the economy and they were in fact the main arguments for doing so in 1990-1991.

Ownership and Conglomerates. The patterns of ownership of Colombian firms are also very concentrated, and have become more concentrated over time. Gini coefficients calculated for the distribution of ownership of firms listed in the stock exchange show that concentration increased substantially between 1973 and the early eighties,[16] when several of the principal firms in the stock exchange were taken over by conglomerates.

In many developing countries, "a significant part of the domestic and privately owned industrial sector, and particularly the activities which use relatively modern and capital-intensive techniques is organized in a special institutional pattern. Following the Latin American term, we may call this structure the 'group', although this pattern of economic organization is also common, with different names, in Asia and Africa."[17] Likewise, in Colombia, the feature that dominates is the group or conglomerate. Since the early thirties, firms have attempted to integrate horizontally to corner specific markets and establish monopolies - like the beer monopoly or the cement oligopoly, for example-and, at the same time, they have integrated vertically to establish barriers to entry for prospective new competitors.

During the decades of import-substitution growth strategies and

---

15 Ibid., pp. 65-67.

16 Ibid., p. 55.

17 Leff, Nathaniel, "Industrial Organization and Entrepreneurship in the Developing Countries: The Economic Groups", *Economic Development and Cultural Change; 26(4), July 1978, pp. 661-75*

intervention of the government in the economy to protect specific industries and to promote others, it became profitable for conglomerates to extend into the financial sector to capture the rents provided by government through subsidized credit and into the media to acquire political control. In this way, the modern Colombian conglomerate typically owns a "cash-cow"in a low competition sector, not subject to external competition, and protects entry into this market by vertical integration up- and down-stream. Furthermore, it owns a bank or a large financial institution and has access to the media through direct ownership of a media channel or through heavy advertising in independent media. The clearest examples of this pattern are the Santodomingo, Suramericana and Ardila conglomerates and the FEDECAFE group, which are among the four or five dominant economic organizations in Colombia.[18] Typically, these conglomerates generated liquid resources far in excess of their cash requirements for the expansion of their core activities, which produce for a small protected domestic market and not for exportation. **Bavaria** and **Postobon** are the examples of cash cows generating the liquidity that the group utilized to finance other acquisitions in the age of import substitution and capital controls.[19] The limited extent of the market and the practical prohibition of expansion abroad that remained the rule for several decades facilitated or forced the channeling of funds initially to vertical and horizontal integration through mergers and acquisitions, and later into diversification of the conglomerate.

The management strategies vary from one conglomerate to the others. For example, the Santodomingo and Ardila conglomerates management directly involved in the management of the different firms. Although both

---

18 Colombia: Private Sector Assessment, Draft Report No. 13113-CO, (Washington, World Bank, August 1994), Annex II.

19 During the late eighties **Bavaria** maintained very large idle cash deposits in the Colombian central bank, while **AVIANCA** was obtaining subsidized credit from the same bank. **Postobon** boasted not to need any credit to finance its acquisitions of other soft-drink bottlers. This changes after the opening of the economy when both groups started to expand into other activities.

groups are managed as if they were wholly-owned, the core firm of the Santodomingo conglomerate is an open stock corporation with thousands of small stockholders, while the Postobón equivalent of the Ardila group is a family-owned corporation. Suramericana firms are all open stock corporations and are run more independently by professional managers that collectively comprise the management committee of the conglomerate. Although it also has a centralized management that sets the objectives for the whole group and establishes constraints for the individual firms, the managers have independence and are accountable for results to the stockholders in a traditional way.

It is possible that conglomerates in Colombia have been economically inefficient since they did not always seek economies of scale or scope and some of their investments would probably not be able to subsist in a more competitive environment or if government enforced the existing regulations for protection of minority shareholders. This is so because some of the groups that manage the conglomerates can and may use the financial power of the core companies to enlarge their own empires at the expense of the smaller shareholders. For example, it is not clear whether the group of stockholders that have the controlling interest in a stock corporation can legally use its cash flow or its credit-worthiness to finance the acquisition of other companies by the controlling stockholders; or if they can sell goods or services to the company in less-than-competitive conditions. These practices have been common in the formation of the conglomerates and are still used as levers for their expansion. More stringent application of existing laws and regulations would prevent their utilization and probably slow this process. [20] Given the present character of Colombian politics and the public opinion

---

20 The Superintendencia de Valores and the Superintendencia de Sociedades are responsible for the protection of small stockholders. However, they are fairly ineffective in pursuing this goal. For example, the Santodomingo group has used **Bavaria** as collateral for loans to other group companies that do not have the same shareholders and has sold stock of other group companies to **Bavaria** without eliciting any intervention by these agencies in defense of the interest of third-party stockholders.

influence of conglomerates, it is not very likely that in the near future, governments would introduce more effective anti-trust legislation, preventing the creation of barriers to entry through vertical integration and the rent-seeking and augmentation of political power through accumulation of economic power.

Recent Reforms and their Impact on Competition

Although conglomerates cast a large shadow over Colombian politics, there are times when the political atmosphere is more favorable to reforms because the attention of the country is focused in different problems, or because the political forces are re-aligning and the popular constituency has a chance to express its desire for change. This happened during the 1990-1994 Gaviria administration, particularly during its first two years. The country had experienced a political shock after the confrontation of the Medellin drug organization with the authorities, that launched an unprecedented period of terrorism, and the assassination of several presidential candidates, including the leading liberal candidate Luis Carlos Galan who had opposed the Mafia barons many years before other politicians deemed it necessary to follow suit. This crisis, like most crises opened avenues for reform that were cleverly used by Gaviria and his team. Their reforms spanned a wide range of activities: The constitution was changed for the first time after hundred and five years; trade was liberalize; price controls were removed; a financial sector reform was approved by Congress; the exchange control system was liberalized and revamped; obstacles to foreign investment were completely removed; the regulatory framework was modernized and some of the supervisory agencies were given more teeth. The government initiated a reform of the state, opening up investment in public services to the private sector, as well as in telecommunications and ports, and a modest privatization program was initiated. A summary of the principal reforms will be provided in the following sections. A more extensive description of the main legal changes is contained in the Annex, at the end of this chapter.

Apertura.

In 1990, Colombia had the highest tariffs in the region and, together with Ecuador, it had the least open economy of the Andean countries. Accordingly, from the point of view of fostering competition, the most important reform undertaken by the Colombian government is what is called the "apertura"or opening of the economy to foreign trade and foreign investment. These reforms were implemented by the Gaviria administration between 1990 and 1991, although a very timid action in the same direction had been started by the preceding Barco administration.

The foreign trade reform started in 1990 was much more ambitious and straight-forward. During the first four months of the Gaviria administration, quantitative restrictions were practically eliminated. This involved moving from an environment of quantitative input restrictions such as import quotas, import licenses and lists of products of forbidden importation, to free trade. At the same time, the reduction of import tariffs was accelerated. After a hesitant start, they were cut from an average of 36.8 percent in 1990 to 12 percent in 1991. The average effective protection was reduced from 75% in 1989 to 34% in 1991 and to 21% in 1992. Although some tariffs have been increased due to political pressures or in response to price fluctuations in international markets, the tariff structure has remained largely unaltered since 1991.[21]

The reaction of private sector to "apertura" as well as to the trade integration with Venezuela and Ecuador was generally favorable among industrialists who rose to the challenge of investing in new plant and equipment, changed their production structures and have generally increased labor productivity year after year following the 1991 changes. In the

---

21 Luis Alfonso Torres, "La Reforma del Régimen de Comercio y la Apertura Económica," in Olga Lucía Acosta and Israel Fainboim, eds., Las Reformas Económicas del Gobierno del Presidente Gaviria: Una Visión desde Adentro, (Bogotá, Ministerio de Hacienda, 1994), pp. 61-76.

agricultural sector the response was largely negative and the government had to back-pedal some of the changes in 1993, when the low international prices of agricultural goods such as rice and cotton increased the competition of foreign products in these markets.

As time elapses, policies such as the use of reference international prices for some products, or the intensification of anti-dumping suits and the use of safeguard clauses in international trade agreements are beginning to undermine the initial opening of the economy that was achieved in 1991. This drift to higher protectionism is a natural process because there are no strong consumer lobbies in Colombia and all the pressure is in the direction of more protection. However, this is not exclusively a Colombian trait, it occurs everywhere, even in countries where consumers are organized. Unfortunately the rules of collective choice are biased in favor of protectionism since few benefit from it substantially while most pay a small amount for it. The disproportionate difference between individual benefits and collective costs works in favor of active and powerful associations of producers, not of consumers.

The consequences of the “apertura” on the market structure of the productive sectors is not yet clear. As a result of the “apertura”, there were no immediate business failures or significant plant closing. What has been noticeable is a shift from the use of domestic raw materials to imported intermediate goods and much higher private investment. Additionally, labor productivity in the manufacturing sector has increased and consequently, employment in this sector is growing well below output.

The conglomerates have been expanding inside the country and abroad, branching out to other industries and seeking economies of scale and scope. Although their core industries have not been affected by foreign competition, internal competition has become more intensive in the beer and soft-drink markets, for example. In those areas where conglomerate interests were affected – foreign competition through different means. Overall,

“apertura” has been a shot in the arm of the industrial sector, introducing much needed dynamism and increasing the potential of foreign competition and thus the need to invest and update technology and trading patterns. If anything, the apertura will probably force consolidation -mergers, strategic associations- and more concentration internally, but it will also render more competitive firms.

Constitutional Reform and Derived Legislation. The constitutional reform of 1991 laid new ground rules for the relationship between the state and the private sector and between firms. It established that the economic activity is limited by the public interest, that free competition is a universal right and that the state is responsible for impeding restrictions to economic freedom.

Additionally, the new constitution, following the 1936 tradition, authorized the state to intervene in the general direction of the economy and in all sectors to "promote productivity and competitiveness" --which may be a contradictory mandate in some cases--, to foster rationality in the use of resources and to protect the environment and the quality of life. Furthermore, it prohibited the creation of legal monopolies but kept alive state monopolies such as liquor production or gambling.

The constitution defined banking, insurance and all other financial services, including the exchanges, as activities of public interest that cannot be entered without express authorization of the state and directed the government to regulate these activities.

No initiative has been presented to Congress leading to the legal development of the articles of the constitution that deal with the regulation of monopolies or oligopolies, and there is a very high probability that such a legislation would be effectively blocked by the lobbies of the conglomerates that operate in highly concentrated markets. In fact, the constitutional Assembly attempted to draft articles dealing with the concentration of economic power and its political consequences; this was blocked successfully

by the conglomerate lobbies. Nevertheless, the constitution left a small door open for reform that would lead to increase the capacity of the state to regulate oligopolies and monopolies because it authorized the government to restructure the government agencies to make them consistent with the new constitution.[22] The government used this authorization to restructure the Superintendency of Industry and Commerce, giving it new powers to increase the applicability of the existing legislation to regulate monopoly and oligopoly and to intervene in cases of abuse of dominant position or obstruction of competition (Decreto 2153/1992). Additionally, the norms defined when and how the Superintendency can act in cases of mergers and acquisitions.

With its new charter, the Superintendency could act very forcefully to promote competition and to check violations of existing norms, with a wide field of action in the industrial and commercial sectors and following up complaints in the public services sectors. However, during the first two years of operation under the new charter, the Superintendency did not act on any case dealing with restriction of competition, free trade or abuse of the dominant position and it would be a wonder if it did. The firms that operate under extreme monopolistic conditions, or even those that operate in oligopolistic markets in Colombia, either operate very large communication networks spanning radio and TV stations throughout Colombia, or have strong influence in the media through their advertising expenditure. Under these conditions, aspiring civil servants will very rarely risk, without the support of higher echelons in the government, the social and political costs of confronting the economic power of their would-be **victim**. As a result; even with an enhanced charter, the Superintendency is as pertaining to the control of monopolies or oligopolies. This will remain without change until the higher government decides to act. When this will take place, it will be equipped with sufficient legal tools for the task.

---

[22] Artículo 20 Transitorio, Ibid., p.152

Price Controls. Traditionally, the Colombian government actually helped the leading firms in various markets to set non-competitive prices or to obtain above normal profits through the mechanisms of price control that were in operation before the Gaviria administration and were largely abolished by 1994. In the past, the government set the prices of beer, soft drinks, tires, transportation equipment, paper, medicines and numerous other articles. This was done in coordination with the private sector through elaborate negotiations that included revisions that often surpassed inflation; and prices were set above the costs of the most inefficient producer. The result was that prices of "controlled"products often increased more than those of "free" products, that the prices set by the government generated large rents for the more efficient producers, and that in combination with external protection, severely taxed the Colombian consumer.

The Gaviria administration liberated most of these prices and opened the markets to foreign competition as an instrument of price control. Very rapidly, the prices of tradeable goods such as tires and paper began to decrease in real and relative terms. Others, such as beer or soft drinks continued to grow with inflation, but not above.

Financial Sector Reform the government sought to liberalize the financial sector in 1990 but met with fierce opposition by the management of the central bank that used all its considerable prestige and political power to prevent a full liberalization. A compromise solution was drafted into a new statute for the financial sector that allowed greater competition in the sector, permitted foreign ownership of banks and brought down many of the pre-existing barriers to entrance. The new regulation also helped to increase transparency and created more effective rules to promote disclosure of the real financial situation of banks and financial institutions. Despite this progress, the new system continues to induce market segmentation and to prevent competition, although to a lesser degree.

After the 1991 constitution was approved, the government had to go

to Congress for a new law that regulated the intervention of the government in the financial markets. It created new opportunities for competition in the sector and brought down even more the barriers to entry, just stopping shy of authorizing universal banking.

Although these laws introduced more freedom and potentially more competition in the financial markets, and although the quality of government intervention and supervision has improved substantially as a result of the reforms, the sector remains over-regulated and segmented. Financial institutions still show very large margins and only two new banks has been created since 1990, although a number of financial institutions including financial cooperatives have transformed into commercial banks.

The Regulation of Public Services. According to the constitution, the state is responsible for the efficient provision of public services. Following the prescriptions of the new constitution, all basic services were re-regulated (Law 142/1994). Special commissions were created for energy, telecommunications, water supply and sewage that are responsible to foster competition in their sectors, inhibit practices that are restrictive to competition, set guidelines for tariffs, including caps or maximum rates of return, regulate licenses, and oversee costs.[23]

The reform of the public services regulation -including the deregulation of transportation and the privatization of ports[24] and the authorization of private investors to participate in the provision of public services- was aimed at increasing competition, eliminating the pre-existing public sector monopolies and increasing the capacity of the government to

---

23 Acosta and Feinboim, op. cit., 127-132.

24 The Colombian Departamento Nacional de Planeación estimated that Colombian firms paid an over-cost of about 10 percent of the border price of imports and exports due to port, transportation and infraestructure deficiencies. The deregulation of transportation has brought tariffs down considerably and something similar has happened to port tariffs. This will promote competition not only in those services, but also by removing implicit trade barriers imbedded in the inefficiencies of ports and transportation.

control and monitor practices by the dominant firms in each sub-sector. The most significant innovation of this legislation is that anybody can organize and operate firms to supply public services, within the existing legal constraints. In the past, this had been reserved exclusively for public enterprises.

The new regulatory framework for the provision and distribution of public services authorizes government intervention to promote free competition and to suppress the "abuse of a dominant position in the market" by private and public enterprises. It covers the whole realm of public services ranging from water supply, local garbage disposal to street cleaning and telecommunications.

Central and local governments are forced to grant operating licenses and to allow private firms to build and operate the networks that are required for their business. Governments cannot grant monopolies or special privileges to any supplier of public services that are not available to others under the same conditions. These firms, public or private, must avoid privileges or unjustified discrimination and must abstain from any practice that would restrict competition or constitute "disloyal competition." These practices consist of setting tariffs below operating costs, collusion agreements and abuses of a dominant position is also defined as imposing conditions on the buyers that would affect their freedom to operate a business or unduly limit the liability of the supplier.

This law also obligates the owners of networks to give access to all suppliers, at the same prices, to deliver the services to consumers. The enforcement of these laws is the responsibility of the Superintendency of Public Services. This agency is empowered to supervise public service suppliers and distributors and to ascertain that their operations comply with the new regulations. It can impose fines, suspend the operation of a supplier or directly intervene the management of the firms when violations occur. The regulatory commissions have the responsibility for regulating the supply of

public services and to promote competition between suppliers when it is economically desirable in terms of efficiency and quality of the services provided. They are authorized to regulate tariffs, issue quality norms, provide standards pertaining to the supply and distribution contracts of public services and encourage systems that increase the efficiency or quality of services or lower the supply costs. They have been empowered to order mergers of suppliers, or to divide the firms into independent components when these actions contribute to promote competition or to increase efficiency. They regulate the access of suppliers to networks and the conditions of utilization of networks. They can also regulate the nature and size of the subsidies that have to be provided by the government to low-income families; and they can adopt policies to promote the diversification of ownership of public service companies and can regulate the equity composition of those firms to avoid excessive concentration of ownership. The commissions may also act as arbiters in conflicts between suppliers or between them and the users. They must define the rules for the participation of the private sector and for the relationships between firms in the sectors that are regulated by them.

Having been issued at the end of the Gaviria administration, most of these laws have not been exposed to the test of time. And it will probably take a long time before there is real competition in the public services because private investment is still timid and the authorities not quite sure how to deal with it. But, at any rate, it is now possible to develop most public services without having to wait for the state to gather enough resources to do it; and in the future it will be possible that the local public utilities can be privately run. This was impossible even in the late eighties.

Privatization. The opening of the public services sector to private companies is the most important step undertaken by the government in favor of privatization. This will increase the participation of the private sector in activities that had been monopolized by the state, it will increase

competition and hopefully it will increase the quality of public services. However, private foreign and domestic investment will not flow freely to these sectors until the majority of the supply and distribution facilities will be privatized.

The government took very serious steps to privatize the banking sector that had been substantially nationalized during the first half of the eighties. It sold initially two small banks and a medium bank to private investors, began to privatize Banco Cafetero and sold Banco de Colombia and the public share of Banco Ganadero and CORPAVI to private Colombian and foreign investors. This changed significantly the structure of ownership of the Colombian financial sector because the private sector now owns more than 50% of the combined equity of financial institutions, while in 1990, the public sector owned the majority. The government also plans to privatize Banco Popular and Banco Central Hipotecario so that 60% of the sector would be in private hands. IFI, the largest development finance company has not been scheduled for privatization and continues to invest in dubious projects while it offers for sale, simultaneously, its shares of equally dubious companies that it acquired in the past.

Other privatizations have been numerous but not important, partly because the Colombian government had not followed the lead of other countries in the continent where governments owned an important share of the industrial and mining sector; and partly because the important holdings --TELECOM and ECOPETROL--are not for sale. Apart from these two companies, the list of public firms and assets that would be sold is not very large: IFI and its investments, CARBOCOL (coal), important assets in the electrical sector that include a hydroelectric generation facility, a thermoelectric plant and the governments shares in ISA (electric generation and national grid).

CARBOCOL and two of the electrical generation plants have been restructured and can be sold when the decision is taken. ISA is being reorganized into two companies - the national distribution grid and the

generation plants. The government plans to sell stock of the generation company to the private sector. Other assets to be privatized include IFI's portfolio of investments - basically shares in PROPAL and Monomeros Colombo-Venezolanos, stocks owned by ECOPETROL in companies that are also owned by the private sector (TERPEL and PROMIGAS) and the Flota Mercante Grancolombiana. [25] Given the financial needs of the Colombian government, the poor state of infrastructure in the country and the existing plans to substantially increase the public spending in education, health and social services, this assets will be privatized if the private sector want them. The privatization of TELECOM probably will never take place and Colombians have not even started discussing whether or not they want to privatize ECOPETROL.

Telecommunications. Telecommunications in Colombia had not developed at the pace required by private sector development. In part, this was due to the state monopoly of telephone services and to the constraints imposed on investment by this type of ownership, since the public companies were prevented from increasing their investment either because they did not have access to capital or because the adjustment programs of the public sector precluded such investment. During the first two years of the Gaviria administration, a plan was developed to privatize the state monopoly -TELECOM- maintaining the monopoly it enjoys in domestic and international long-distance services for a period of 10 years. The government did not wish to grant a permanent monopoly license to the private sector but it was thought at that time that a temporary monopoly concession would bring up the price paid by the private sector.

Any form of privatization of TELECOM was opposed by the firm's union. When it was announced that the government would seek Congressional authorization to sell the company the union went on strike and interrupted communications isolating Colombia from the rest of the world and creating

---

25 Ibid., p. 72.

havoc in internal communications. Not being able to stop the strike or to operate an alternative communications system, the government had to withdraw this proposal and change strategy. The new strategy entailed opening the value added, long distance and cellular phone services to private investment and allow a gradual fade-out of TELECOM. This strategy has begun to show results. The cellular phone service was licensed to six companies for fees exceeding one billion dollars and is operating in the main cities. The private sector has been able to develop private communication services that have upgraded the quality of services available and would undermine the strength of TELECOM's union in the case of an eventual future confrontation. Domestic long-distance operation can be licensed to private operators at any time, if the government gives the go-ahead, and international long-distance services can also be granted in the new legal environment created by the public services law. Moreover, the opposition of the unions is not as strong as in the past, nor their power. In fact, they were although they opposed it, they did not use their technical capacity to obstruct communications and to prevent in this manner the passing of the law.

The Political Environment of Regulation

so far, this chapter has provided an overview of what has happened in Colombia in terms of regulation and control of monopolies and oligopolies and of what is happening after the 1990 - 1994 reform period. The bottom line is that there is enough legislation to deal with monopolies and oligopolies and insufficient action on the part of the government, the political parties, the leftist intellectuals or even the populist factions of the ruling parties; nor are there relevant civil organizations such as consumer advocacy groups that have taken the defense of consumers, nor groups of consumers that have taken class actions against monopolists for any violation of their consumer rights. This generalized indifference can be attributed to a number of reasons: Insufficient political development in the sense that the individuals do not regard the state as a vehicle for safeguarding their interests and do

not sue or appeal to the supervisory agencies in defense of their rights. Insufficient independence of the bureaucracy from the political process and, more importantly, from the economic interests and power centers. Governments had not perceived that by not promoting competition, they were fostering technical stagnation and facilitating the laziness of private investors. Moreover, the political parties, drawing resources from the private sector to finance their electoral campaigns, have surrendered much of the political power to the financiers and are unable to promote or even back actions that would not receive full endorsement by the large private economic groups.

For these reasons, if one were to single out the policy or set of related policies that have contributed most to promote competition and the modernization and international competitiveness of the Colombian productive sectors, that policy, without doubt, would be the liberalization of trade. It had immediate and profound consequences over private investment, market organization and productivity. It shook up the economic groups and awakened them from the inaction induced by protected markets and private non-aggression agreements that were possible in a closed economy. It set them to compete to position themselves in the new markets opened up by deregulation and privatization. There is also renewed competition in the markets that had been protected by the pre-existing gentlemen agreements, as has been the case in the beer and soft-drink markets in Colombia. All the other reform efforts of the Barco and Gaviria administrations will probably induce changes in the organization of several sectors that would result in a more competitive business environment in the future, but their effects are not as swift as those of the "apertura." However, the other legal reforms have cut very deep and the charges can be labeled almost revolutionary, at least on paper. The legal framework is now adequate for the application of pro-competition policies.

Additionally, the country showed that it has the political will to change - which was an element that was in doubt until the Gaviria years - and

that the economic groups, although very powerful, can be effectively outmaneuvered if the government displays good politics and good ideas. Further reform will need less legislative action and more, much more, administrative and real action.

What happened at the beginning of the Gaviria administration that made it possible for the government to obtain far-reaching reform legislation so swiftly? Gaviria came to power fortuitously --a dark horse that appeared in the presidential race after Galan's assassination-- and did not owe his candidacy or the presidency to the backing of economic groups, nor to the traditional factions in the liberal party who had endorsed other candidates in the primary elections. When he prepared his economic and political platforms for the final election he already was virtually president and was the undisputed leader of the liberal party--the traditionalists jockeying for positions, particularly those who had not supported him in the primary election. In these conditions, the candidate's team of advisors had time to prepare a wide-raging government program and draft reform proposals which were discussed and cleared with Gaviria well in advance of his election. After he was elected he sought consensus in the technocratic establishment ad built bridges with the politicians.

In his inaugural speech he announced and outlined his main policies, which already had been developed and very rapidly went to Congress as part of an ambitious package of reforms. Traditionally, the first months of a presidential term enjoy what is called a "honeymoon" with Congress; this time it was heightened by the fact that the leading liberal political barons had opposed Gaviria and wanted to mend fences. Congress also was pressured because the electorate had overwhelmingly voted for the convocation of a constitutional assembly--a competing legislative body-- to change the Constitution. Congress decided then to show that it could work efficiently and set out to work on the reform program with unprecedented enthusiasm and discipline.

Meanwhile, the rest of the country had its attention focused on the "apertura" program and the dispute going on within government about the speed at which this program should be applied, on the election of the constitutional assembly and on the twin wars against the Medellin cartel that was bombing the cities and the guerrillas that were bombing the oil pipelines. The tax reform that was being processed along with the reform package concentrated the attention of lobbyists and the press and the labor reform obtained all the backing of the private sector and distracted the attention of the labor movements. The rest of the legislative agenda was not in the main stream of consciousness of the public nor did it figure in the priority list of the private sector. For example, the Federation of Coffee Growers became aware that the National Coffee Fund regime that had been practically unaltered for fifty years was being changed in Congress, only the morning after it had been voted in the Senate commission of economic affairs. After that day, they had two of their more skilled senior vice-presidents sitting in the discussions full time to monitor the progress of the law and steer its contents. But the main objective had already been accomplished: Congress had dared to change a Colombian totem --the foreign exchange regime and the chapters dealing with the mechanisms of the coffee board and stabilization fund-- without a previous nod by the coffee growers organization. Despite the announcements made by Gaviria during his inaugural speech in which he outlined all the reforms he intended to pursue, the private sector and the public did not expect that all of them would be presented at once and much less that Congress would attempt to pass them all in one session. This explains why the pressure groups were ill-prepared for the legislative "blietzkrieg" engineered by government and why their intervention was delayed and largely ineffective.

Some Ethical Considerations Around Economic Liberalization

The tax reform of 1990 contained a tax jubileum for returning capital flight and the reform of the exchange regime legalized the tenure of foreign assets by Colombian residents, which had been outlawed by the 1967 foreign

exchange regime of the Carlos Lleras administration. The fact was that most Colombians who could afford it had assets abroad and that violations of the foreign exchange regime did not carry any social sanction. Moreover, a very active parallel exchange market was openly operated and tolerated. The parallel exchange rate carried a small premium or a small discount over the official rate.[26] These were normally of the order of one to five percent, except for the 1983-1984 when the official exchange rate was fourteen percent lower than the black market rate. At some point during this period, the differential was as high as thirty percent. That year was characterized by a confidence crisis, a financial crisis and a massive change of land property between the old landed proprietors and the new rich, some of them presumably connected to drug organizations.[27]

The legislation of a free exchange and allowing Colombians to bring back their foreign assets without being penalized cleared the way for introducing new measures to control money laundering which had been impossible to implement in the old regime. Under the pre-existing foreign exchange regime, it was impossible to ascertain who was violating the law just for their own portfolio precautionary reasons and who was a money launderer. Under the new system it could be assumed that if the assets were not registered for tax purposes, taking advantage of the tax jubileum, they could be investigated. To make this more effective, an agreement was negotiated between the Colombian and U.S. tax authorities regarding the exchange of information about Colombian and U.S. taxpayers and Congress authorized government to sign this agreement in exchange for the tax jubileum. Before the legal change of regime, the Colombian authorities had been reluctant to pursue an agreement of this nature because many prominent Colombian names would come out, linked to a socially accepted and condoned but illegal behavior --dodging the exchange controls.

---

26 Urrutia, Miguel. op.cit. Table 11.1 p.371

27 Hommes, Rudolf. "Capital Flight: Colombia" in Capital Flight: The Problem and Policy Responses. Institute for International Economics, Washington D.C. 1986

The liberalization also made it possible to apply the standard international controls of money laundering and to hold banks operating in Colombia legally responsible for reporting any unusual or suspicious movements of funds. In this way, deregulation of capital flows enhanced the opportunities to implement more strict controls to money laundering.

Conclusion

This brings into account the question of what kind of policies are the best suited for a small democratic small country like Colombia. As in the case of Denmark, Sweden or the Netherlands, local firms must develop into large enterprises to be able to compete in the world markets. At the same time, the preservation of democracy requires that the political involvement of big business be checked because it may lead to the excessive concentration of political power.

In this context, the "apertura" has shown already some positive results. Maintaining an open economy will ensure that domestic monopolies invest in their core business and expand it to capture economies of scale and scope. This will probably induce direct foreign investment of Colombian firms abroad and an expansion of exports in the medium to long run, because the firms will have to acquire "world size" to compete in an open market. This requires a fairly open capital account that permits this type of reverse foreign investment without the interference of government, or a bureaucratic mentality that would allow these flows even with a restrictive foreign exchange regime. In the past, the capital account was closed and the bureaucratic mentality was opposed to Colombian direct investment abroad. This brought about three undesirable consequences: Foreign investment by Colombian firms was limited to those that had the political clout to obtain the licenses; and even in those cases, it was severely restricted. All other firms had to do it illegally or could not do it at all. As a consequence, many Colombian business could not compete advantageously in foreign markets unless they broke the law. This was

exemplified by the flower exporters whose investment in warehouses and distribution channels was impeded by the central bank bureaucracy.

In the case of large enterprises like those in the beverage and bee sector that generate autonomously large cash surpluses, or the cement sector that also generates large cash flows as a consequence of growth of housing and construction, the firms were prevented from investing the resources abroad in the same core business and this contributed to speeding up the concentration and the strengthening of conglomerates of the private sector, since it had to find outlets for the cash flow, greatly augmented by the preferential subsidized credit that flowed from the central bank through the financial sector to the firms that could offer the best collateral.

In an open economy, the firms will do what comes most naturally which is to expand the core business internationally or to increase the scope of the core production. Both phenomena are taking place in Colombia at the present time, but conglomerates continue to grow and will continue as long as the largest firms or groups have privileged access to financial resources and the stock market prices remain fairly depressed and not competitive. In this respect, the role of the government beyond fostering competition in the goods markets, should focus on promoting competition in the financial and capital markets and leaves firms alone in their decisions regarding size and vertical or horizontal integration.

In the public services sectors, the problem is that the monopoly is of the state. Take for example the electrical sector: One public firm owns the national grid and the largest capacity of hydroelectric generating power. The same firm has a regulatory role and sets the rules for dispatching energy and for acquiring it from hydroelectric or other sources. If one compares this with a more liberal environment in which the generating capacity is diversified in private hands, the grid is a highly regulated private firm that acquires energy at market prices, dispatching according to legally set rules, and the regulation is by an independent government commission. Undoubtedly

more private investment (and more competition) are expected to flow into the second model than into the first. This example was selected to make a point: the regulations are in place to permit private investment in the public sector services, and there is already some investment, but true competition and dynamic investment will follow only when the government reduces its participation and dominance by selling existing assets and effectively privatizing the electrical sector. The same holds true for banking, gas distribution and production, transportation, telecommunications and all other public services. In other words, greater privatization of public services in Colombia is a necessary condition to promote private investment and competition.

The agenda for a would-be promoter of competitiveness in the Colombian markets if fairly clear-cut: there is a first stage of competition enhancement that does not require excessive political courage and will not encounter unsustainable opposition. This encompasses maintaining an open trade policy, privatization of public services, allowing Colombian foreign direct investment to grow abroad and encouraging foreign direct investment into the country. This, in turn, is achieved maintaining stable rules, giving foreign investors the same treatment given to domestic investors, and deregulating foreign investment --which has already been done-- and offering stable macroeconomic and political conditions. Furthermore, legislation is required to bring down barriers to entry into different sectors and to permit private investment in sectors where public investment dominates. A lot of progress has already been done in Colombia on all these fronts. Additionally, a workable set of rules has been devised and has been in place for many years that permit regulation of monopoly and oligopoly by the central government superintendencies and by the regulatory commissions. These powers, in the case of anti-trust actions have been greatly augmented for the Superintendency of Industry and Commerce and for the Superintendency of Banks.

The second stage of the process, which requires great political skills

and power to implement, is to control the behavior of oligopolies in the domestic market. The objective of such a policy cannot be to prevent or hinder the growth of firms, because size will be required to face international competition abroad and domestically, but rather, to regulate the activities of leading firms in the domestic markets so that they do not hinder the growth and development of competitor corporations in terms of services and size, do not conspire to fix prices or to segment markets, and do not erect insurmountable barriers to the entry of new firms into their markets. This would require a government decision to go ahead with the policy and the maintenance of a consistent course during several administrations. A policy of this nature would necessarily have a constituency that has been absent in Colombia in the twentieth century. This would be akin to the grass-roots movement that led to the anti-trust legislation of the late nineteenth century in the United States or to the political coalition that made possible in the same country the strengthening of the Clayton Act, or the functioning of the Federal Trade Commission and the Securities and Exchange Commission in the thirties. Until political conditions arise, the existing legislation will probably lie dormant as a testimony to the countervailing power of Colombian economic conglomerates. Roughly the same can be observed in the case of security and exchange regulations for a stock market that does not really exist, while failure of disclosure is widespread and management and dominant stockholder groups have been fairly free to use corporate power, credit and cash flows for their in the commercial code, waiting for a government that has the will and the political power to bring them to life. This would undoubtedly require also a reform of the rules that regulate the financing of political campaigns and public officials.

A third, and much higher stage of reformism dealing with the control of economic power would respond to the question of how much economic power is too much. One is reminded that Standard Oil was broken into several companies, not only because it was too big, but because it had so much political power

that it threatened the public interest. This is very pertinent in the case of Colombia where the public interest lies precisely in preserving some form of democracy and promoting a pluralist society. The domination of politics by conglomerates weaken democracy and creates the conditions for the development of capitalism under more authoritarian modes of government which would have business as their sole constituency and could lead to latter- day mutations of fascism or to militarism. One does not have to go to far back in Latin American history to observe the consequences of these type of governments and of their corporatist economic structure.

In Colombia, one group, very often a single person, controls banks and communications media, in addition to the productive and commercial activities. This concentration of power is not well suited to a democratic society, however, under the present political and economic conditions of Colombia, given the state of awareness of the middle-class it is hard to envision a government that would be willing to tackle this problem.

Probably, it would be wiser to start with more modest goals such as developing the bureaucracies that would be responsible for the application of the anti-trust legislation, the rules of securities and exchange and the commercial code. Strengthening these bureaucracies and backing their activities in a setting of moderate reform goals, directed at stemming the misuse of the market power of monopolies, oligopolies and conglomerates will probably achieve much more than over-reaching. The problem is more political than economic, and therefore it is difficult to predict the future course of events. A good cause for hope is to observe that these problems have been solved in some other countries with economic and political development, but not always and not everywhere.

ANNEX

The Regulatory and Structural Reforms of The Gaviria Administration

1990 - 1994

Apertura. In 1990, Colombia had the highest tariffs in the region and, one of the least open economies of the Andean countries, despite a trade reform effort that had been undertaken by the Barco administration. During the last year of that administration, a gradualist five-year trade liberalization program was initiated. The Barco reform was to have three steps: (a) the liberalization of trade for goods that did not compete with domestic products, which involved moving those tariff items from the restricted import to the free trade list; (b) a two-year sub-program involving the gradual substitution of quantitative restrictions would be completely eliminated, a three-year period of tariff reduction would ensue. During the first two years of the program, the government would have auctioned import licenses for the items that were on the restricted list, to determine an initial level of protection. The goal of the program was to reduce tariffs to an average level of 25%. Additionally, in order to prevent a huge initial current account deficit, nominal devaluation was accelerated to record levels during 1990, achieving a real devaluation of nearly 17% for the whole year. This policy was embraced by the Gaviria administration and contributed to a record inflation rate of 32.4 percent in 1990 and to also a record jump in the value of non-traditional exports which increased more than 30 percent, in dollar terms in 1991.

The foreign trade reform started in 1990 was much more ambitious and straight-forward than the Barco experiment. During the first four months of the Gaviria administration, quantitative restrictions were practically eliminated. This involved moving from an environment of quantitative input restrictions such as import quotas, import licenses and lists of products of forbidden importation, to free trade. At the same time, the reduction of import tariffs was accelerated.

Initially, due to the pressures of the more conservative members of government that represented the point of view of several business sectors, a four year reduction program was initiated and announced, which would have

brought average tariffs down to 12% by the end of 1993. This gradualism proved to be impractical because importers and investors took a "wait-and-see" attitude that resulted in a very large current account surplus and a corresponding increase in the level of international reserves and the money base. The liberalization program was accelerated during the first seven months of 1991. As a result, tariffs were drastically reduced from an average of 38.6% in 1990 to less than 12% in 1991 where they have remained.

Constitutional Reform and Derived Legislation. The constitutional reform of 1991 established (a) that economic activities and private initiatives are free, limited only by the "common" good; (b) that nobody can impose licensing or other requirements without legal authorization; © that free competition is a universal right that presupposes responsibilities and obligations for enterprises; and (d) that the state, mandated by the law, is constitutionally responsible for impeding restrictions to economic freedom and controlling abuses of the dominant position of firms or individuals in the domestic market.[28]

Additionally, the new constitution directly authorized the state to intervene in the general direction of the economy and to "promote productivity and competitiveness." It also established that the law can mandate the government to intervene "in the exploitation of natural resources, the use of the soil, the production, distribution, utilization and consumption of goods and in the public and private services, to rationalize the economy with the purpose of obtaining an improvement in the quality of life of the population, the equitable distribution of opportunities and the benefits of development and the conservation of the environment."[29] Furthermore, it prohibits the creation of legal monopolies, excepting the old Spanish revenue raising monopolies such as liquor production or gambling; but it limits these to those

---

28 Article 333, Constitución Política de Colombia, (Bogotá, Presidencia de la República, 1991), p. 129.

29 Article 334, Ibid., p. 130

established with purposes of public interest, and according to the law.[30]

Financial Sector Reform. The deregulation of the Colombian financial sector was started in 1990 with a new law that encompassed the regulatory environment for financial institutions in Colombia (Ley 45/1990). This law permitted complete ownership of Colombian banks by foreign stockholders including banks, which has been forbidden since 1975, and removed the existing barriers to foreign investment in the financial sector. It also reformed the system of specialized banking that was the norm in Colombia since 1923 and moved towards universal banking by allowing finance corporations to offer savings accounts and by permitting financial institutions to own specialized financial service institutions - like brokerage, leasing or factoring. They themselves had been prevented from supplying these same services under the previously existing system and are not allowed to provide them directly under the new law. Although, this law sought to reduce the segmentation of the market induced by the specialized banking system and by over-regulation of the financial sector, it fell short of instituting universal banking because of the strong opposition to liberalization from the Colombian central bank and the more conservative elements of the political sector. As a consequence, the new system continues to induce market segmentation and to prevent competition but it helped to increase transparency by regulating the disclosure of information by financial institutions, albeit at a lower level.

Additionally, it established clearly the requirements for licensing new institutions and the minimum capital requirements for each type of new financial institution. These innovations lowered considerably the barriers of entrance in the financial sector because the bank superintendent had previously had the autonomy to grant or deny licenses, choosing often to deny them without explanation.

After the new constitution was approved, this legislation was

---

30 Article 336, Ibid., p. 130.

complemented by another law (Ley 35/1993) that established the rules for the intervention of government in the financial sector. This law develops the constitutional authorization to the government to intervene in the financial markets or financial institutions to protect the investors and users of the system, to seek adequate levels of capitalization of the financial institutions, to promote competition and to foster transparency. It also rules that government should specify maximum levels of credit or of risk exposure per borrower and provide lending guidelines that would help prevent credit discrimination.

The law also contributed to bring down the barriers to competition by allowing the mortgage corporations (corporaciones de ahorro y vivienda) to create or acquire financial service companies and by authorizing these institutions and the commercial finance companies to participate in the foreign exchange market. This market had been reserved previously for the commercial banks and the finance corporations which were the only institutions allowed to buy, hold and sell foreign exchange on a commercial basis.

Reform of the Superintendency of Industry and Commerce. Under the new charter, the Superintendency was given the following functions: (a) To watch for the observance of the laws and regulations that deal with the promotion of competition and with restrictive commercial practices; (b) to follow-up complaints dealing with market competition and to process those cases in which the action of the Superintendency would increase the efficiency of production; those that would insure that consumers have freedom of choice or better access to markets; those that would increase the participation of firms in the markets; and those fostering variety in prices and quality of goods and services. It was empowered to give fines and other penalties to firms that restrict trade or did not comply with guidelines issued by the agency; and to act at the request of the public service regulatory commissions when public or private firms obstruct free competition or when they violate the regulations pertaining to tariffs, collections, trade or client relations. It was also

required to watch the observance of regulations dealing with consumer protection and to accept complaints in those matters when they are not of the jurisdiction of other agencies. In those cases, the Superintendency can establish responsibilities and issue instructions that must be obeyed. To achieve this mandate, the Superintendency was authorized to visit firms, to obtain all the relevant information and to interrogate under oath anybody whose testimony may "result useful" in the exercise of its functions. In addition to the functions of the agency, the same decree defined very specifically what acts, conducts, or agreements affected free competition, singled out which ones are contrary to free trade and competition, and specified what is the "abuse of dominant position" in a market. It also delimited the power of the Superintendency to intervene in the case of mergers and acquisitions (it cannot act when the parties can demonstrate that efficiency gains can be derived from the transaction or a reduction of cost would ensue that could not be achieved by other means).

It was also determined that the Superintendency could act in all cases on its own accord or when a complaint is filed. In this case, it is authorized to conduct a preliminary inquiry to determine if there is cause to proceed. When a process is concluded, the investigators would inform the Superintendent who, in turn, would inform the subject of the investigation. He or it can inhibit the process by altering the behavior that would otherwise be punishable by fines amounting to 300 times the monthly minimum salary. These provisions were designed to fill some of the gaps that were left open in the 1959 law that rendered it inapplicable. The objective was only partially accomplished due to the restrictions imposed by the legal and constitutional authorizations. For example, the Superintendency cannot act in the communications and media sector on its own accord, and it is confined to follow up complaints that are filed with it. Consequently, even though it is widely known that there are violations to the existing rules of competition in television, it cannot act until there is an independent complaint.

The Regulation of Public Services. The regulatory law for the electrical sector (Law 143/1994) determines that the state is responsible, in relation to the provision of electricity services, to promote free competition in the activities of the sector; to prevent unfair competition or abuse of the dominant position in the sector; to protect the users; and to regulate the circumstances in which natural monopolies arise and free competition is unable to guarantee the efficient provision of services at the lowest possible economic cost. The law guarantees that private or mixed ownership -public and private- enterprises are free to develop their activities in the context of free competition, regulated by the government.

The law created a commission for energy and gas regulation composed by eight members, three of which represent the ministries of Mines and Energy, Finance and Planning, and five members appointed by the President for a four-year period. This commission has the responsibility to regulate the energy sector with the basic objective of supplying electricity and gas at the lowest cost possible, utilizing the available resources and providing opportune and quality service to the users. All this is to be achieved in the context of free competition and the commission has a mandate to promote and create the conditions for freer competition. The law also rules that electricity generation is allowed for all economic agents and that they can sell this electricity freely at market rates. The owners of the national networks are required to interconnect suppliers and users at pre-established and regulated tariffs. The abuse of dominant position or the violation of the norms of free competition in the energy markets are clearly defined and the penalties for these violations are defined as well, ranging from warning by the authorities to fines and administrative actions such as ordering the dismissal of management or temporary takeover of the management by the government. The law contains also provisions to foster competition and to punish unlawful conducts interfering with this purpose and to impose strict penalties in those instances.

Transportation. In air transportation, deregulation was also implemented. Increased competition in the airline sector has changed significantly the market structure of the service. The leading company -AVIANCA- decreased its share of augmented international flights from 56% in 1990 to 35% in 1993 and the share of the domestic market from 49% to 38%. As a consequence, the company had to invest in fleet renewal and upgrading of services what it had not invested in many years. It has also drastically reduced its personnel from 7000 in 1990 to just over 4000 in 1993.[31]

Land transportation has also benefited from the apertura. Before 1990, the government allotted import licenses of transportation equipment with the idea of protecting the existing shipping companies from excessive competition. After 1990, trucks and all transportation equipment can be freely imported. As a result, shipping tariffs decreased 50% in real terms between 1990 and 1993.

The railway sector was one of the first sectors to be deregulated in Colombia, in the last year of the Barco presidency. The almost extinct monopoly -Ferrocarriles Nacionales- was dissolved and two new companies were created: a public company that is responsible for the upgrading, expansion, maintenance of the rail network and regulation of tariffs, and a private company that would run the trains. So far, the reform has failed to produce results.

The deregulation of the shipping sector has been very drastic. The Flota Mercante Grancolombiana, a public shipping firm jointly owned by the National Coffee Fund of Colombia and the government of Ecuador had virtual monopoly based on the “flag reserve” which reserved 50% of the foreign shipping to domestic carriers. Since other domestic shipping lines were very small, this firm practically dominated the market, offering poor service at high non-competitive tariffs. Beginning in 1989, the government started a

---

31 Colombia. Private Sector Assessment. (Washington, World Bank Draft, August 1994), p. 62.

gradual deregulation program that was accelerated in 1991 when it abolished the quota and allowed free entrance of foreign ships to Colombian ports, excepting those from countries that do not grant reciprocal treatment to Colombian carriers. The share of the market of the Colombian line was drastically reduced and it was forced to restructure. This brought down prices significantly and increased the supply and quality of services.[32]

Port Regulation. The ports had been strictly a public sector activity until 1991. In that year a law was issued that permitted the liquidation of the national port company and allowed private sector investment and management in the operation of the Colombian ports; it created also a new Superintendency of Transportation and Public Works that oversees the port activities, regulates tariffs and intervenes to secure land where new facilities have to be build and the private negotiations are stalled (Ley 1/1991). This legislation was complemented in 1992 by a decree (Decreto 2171/1992), which restructured the Ministry of Transportation and its agencies. These norms authorized the government to lease or sell the existing facilities to independent port companies that can be partially or wholly owned by the private sector. As a result of the new regulations, Colombian ports are now managed with private sector participation, new private ports have been constructed and tariffs have decreased substantially.

32 Ibid., pp. 69-70.