Economic Reforms in Colombia
Regulation and Deregulation, 1990-94

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This paper describes the set of economic reforms carried out in Colombia between 1990 and 1994. Given that the main macroeconomic variables were basically in place, the reform's goals were twofold: first, the deregulation of trade, capital, and labor markets; and second, the strengthening and creation of new regulatory institutions, such as public utility regulatory commissions, the Superintendency of Industry and Commerce, and, above all, the Central Bank. The paper takes up the following questions: What was the regulatory situation in the late 1980s? How was an ambitious reform possible in a conservative country that was not suffering a macroeconomic crisis? What were the main elements of this reform? Finally, is this reform going to last?
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Foreword

Private property can be effectively “nationalized” by a suffocating blanket of regulations woven by a paternalistic government that bases its legitimacy and popularity on “protecting” workers and consumers against the “rigors” of the marketplace. At the other extreme, private ownership can be discredited rather than smothered by the type of deregulation that leaves the populace at the mercy of unscrupulous dealers and powerful barons. A well-designed regulatory system has the same basic purpose as private property itself—to decentralize power into the hands of people so that they may actively pursue as well as safely protect their own interests.

The Regulatory Reform Program of the Economic Development Institute (EDI) therefore sees the design of the regulatory system as a fundamental task along side privatization in the development of a market economy. The Program is designed to discover and disseminate best practices in regulatory reform—or better yet, to help clients to uncover and implement these best practices themselves. In light of the educative power of negative examples, the Program also seeks to highlight the pitfalls in other countries’ experiences so that clients might be spared the pain of repeating those lessons of history.

Armando Montenegro’s paper draws many lessons from the remarkable period of regulatory reform under the Gaviria Government in Colombia during the period 1990–94. While pre-reform Colombia was not in a desperate macroeconomic crisis, Montenegro tells of the heavy burden of paternalistic regulations that sapped the entrepreneurial potential of the economy and diverted energies into a wide variety of rent-seeking activities. Some particularly perverse regulations (for example, requiring job tenure after ten years) even led to the opposite of the intended effects (for example, workers being fired just before ten years on the job). Many discussions of regulatory capture and rent-seeking emphasize the demand side of these phenomena but Montenegro highlights the parallel supply side wherein the government uses the design of regulations to garner support and thereby strengthen its political base. While the markets for capital, labor, and tradeables were heavily overregulated, many necessary regulations were left unenforced or ignored (for example, antitrust legislation or the state’s monopoly on the use of force).

From the informed viewpoint of the Director of the National Planning Department of the Gaviria Government (1990–94), Montenegro answers the questions of how the ambitious regulatory reform program was mounted, which institutions were targeted for major changes, and what are the chances for the reforms to be sustained.

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Economic Reform in Colombia: Regulation and Deregulation, 1990–94

The constitutional and legal reforms undertaken from 1990 to 1994 drastically altered the roles of government and the private sector in the Colombian economy. Under these reforms, government was to strengthen its long-neglected obligations to provide security, justice, and services for the poor, while the private sector was to enter into and compete in previously protected markets, and expand its roles in the provision of "public goods" such as public utilities, social services, and infrastructure.

Within this context, two elements of these reforms stand out: a massive effort to deregulate vast areas of the economy, and a simultaneous decision to create new institutions for regulating the expanded private sector activities within a competitive environment.

Deregulating the Colombian economy had become imperative when statistical evidence repeatedly showed that over-regulation and government prohibitions were strangling economic activity, and acting as disincentives to innovation, investment, and growth. For this reason, deregulation was extended to trade, capital, and labor markets, as well as to infrastructure, and social and public services. More precisely, this effort was aimed at eliminating barriers of entry and establishing, when possible, simple and general competitive rules.

Along with this huge effort to deregulate the economy, a strong demand for a new type of state intervention arose: competition had to be protected, monopolistic and oligopolistic abuse had to curtailed, and natural monopolies, public and private, carefully regulated. Therefore, certain institutions had to be wholly restructured in tune with the reforms. Likewise, other regulatory institutions had to be created to set tariffs and market standards, and protect competition.

This paper discusses the deregulatory effort and the institutional transformation accomplished by the Gaviria administration during the 1990–94 period. More specifically, the paper takes up four questions: What was the regulatory landscape before the reform? How was economic reform possible in conservative Colombia? What were its most important elements? And finally, is this reform going to last?

Before proceeding, two points must be noted. First, this paper is confined to regulation associated with capital, trade, labor, public utilities, and protection of competition in various markets. Consequently, issues such as environmental protection, speed limits, security in the workplace, and health standards are not dealt with. Second, the last section, which deals with the sustainability of reform, is based on information gathered as of July 1995.

I. The Previous Situation

What was the Colombian regulatory situation before the 1990–92 reform effort? In this section, I will describe the general institutional conditions that shaped Colombian regulation at the end of the eighties. Second, I will delineate the most relevant features
of the regulatory landscape and, more importantly, their impact on the evolution of
the country’s economy.

**Some General Conditions**

Three basic conditions must be examined with regard to the Colombian situation
before the 1990 reforms: (i) the division of labor and responsibilities between the
government and the private sector; (ii) the position of regulators with regard to other
government officials and private business firms (in this area, it is useful to look at
some conventions, traditions and institutions in which regulators were deeply
immersed); and (iii) the personnel, technical capacity, and, in general, the technology
available to the country, for effectively carrying out the government’s regulatory
responsibilities.

**Private and Public Roles**

At the end of the 1980s, and obviously much earlier, confusion and disorder prevailed
in the roles of the public and the private sectors. Many of the most important
traditional roles of the state were also performed by the private sector amidst a
confused and often violent environment. The most noticeable were security and
justice, where the Colombian state had never been able to impose its monopoly.
Hence, high levels of violence with impunity, the expanding activities of organized
crime, and the persistent challenge of various armed groups proceeding from all kinds
of ideological orientations have dominated the Colombian landscape for many years.

While private groups made incursions into activities usually restricted to the state,
the government also dispersed its energies and resources by undertaking endeavors
within the realm of the private sector. In fact, the government, directly or through its
various enterprises, created, promoted, and invested in public firms in industrial
undertakings, luxury hotel construction, air and river transportation, banking, trade of
agricultural goods, ports, gambling, gas stations, cattle vaccine production, and many
other activities. In its defense, the extent of the Colombian government’s intervention
in these areas was less prevalent than in the worst Latin American examples.

In areas where private and public sector agents coexisted, the rules of the game
were not clear. In general, public or mixed firms usually received a special treatment
by the government, which their private competitors felt hindered fair competition. For
example, public banks controlled over 50 percent of banking business, enjoying
regulatory advantages, especially in mobilizing the substantial volume of government
funds. Likewise, those firms in which Empresa Colombiana de Petróleos (ECOPETROL),
the state oil holding, held equity investments (the gasoline-distributing Terpeles, for
example), were viewed by their occasional competitors as enjoying preferential
treatment with respect to financial and commercial matters.

The state reserved for itself full monopoly in the production of some goods and the
 provision of important services, such as: alcoholic beverages, lotteries,
 telecommunications, electricity, and most public utilities. Certain perfectly public
monopolies had actually been private enterprises some decades back: ports, power
production and distribution, and water supply in several Colombian cities.

From the standpoint of analyzing the regulatory regime, this private-public
division of labor had three consequences:

- Where the government simultaneously played the roles of both competitor
and regulator, distinct conflicts of interest arose. Very often, the private sector justifiably felt that competition from public enterprises was unfair, and that there were no institutions to which they could take their complaints;

- Where government firms were perfect or near-perfect monopolies, there was no consumer protection from their dominant position in the markets. Nor were private agents allowed to provide public services even when state enterprises rendered very poor ones;
- Only in those areas where there was a network of local public monopolies administered by regional firms, was there a weak but growing body of regulatory authority, as for example, in the National Tariff Board.

* Regulators and the Private Sector

In regulating businesses, certain traditional practices fostered intimate relationships between regulators and the regulated. In many instances, the distinction between private and public roles was not clear-cut. On the contrary, traditional government interventions in the private sector were characterized by a complicated network of contacts and exchanges between public officials and the major producer associations. In many instances, public intervention in the economy provided an umbrella for partnerships between the government and influential groups representing the largest productive sectors.

Three crucial aspects of these regulatory arrangements are worth mentioning. First, the system was centered around the executive branch, without the scrutiny of Congress, the press, or any agency in charge of public control. Moreover, fiscal and quasifiscal rents were assigned without being incorporated into public budgets. To this end a multipurpose, and certainly quite heterodox, Central Bank was indispensable to Colombian policymaking. Second, most subsidies and fiscal transfers to private groups were simply income and wealth distributions, and thus were not aimed at fostering investment, innovation, and growth. Finally, regulatory decisions were made, one by one, in a fragmented and arbitrary fashion, without a consistent framework. Thus in many instances, public policies were established simply to compensate for the negative impact of prior decisions made to affect particular previous circumstances. For example, certain export subsidies were deemed necessary to compensate for quantitative restrictions and high tariffs, as well as for labor regulations and regulation-induced infrastructure inefficiencies.

Some academic observers feel that Colombian regulation is predominantly an example of the 'capture' model, which maintains that 'regulation' becomes acquired by the industry it is designed to patrol and consequently operates primarily for its benefit (the quoted text is from Stigler 1971). Others explain Colombian regulation using the 'rent-seeking' approach, which regards policies as the result of lobbies and pressures by powerful groups. Notwithstanding their interesting insights, these 'demand centered' explanations are often too simplistic. They neglect the supply side of the regulatory market, namely the State's own policy goals and administrative motivations, which could certainly be independent from those of the dominant classes (see Skockpol 1994). More specifically, they neglect regulation and economic policymaking as government instruments for obtaining support and securing political control.

To account for these realities, other analysts—mostly foreigners—have pictured Colombian policymaking as a complex system where strong business interests
lobbying for favorable regulation interact within a more or less informal, decentralized setting, with government officials. In this system, vying interests come together and regulation is created on a somewhat ad hoc basis. These analysts have used a variety of models that try to incorporate all the elements of this "real world" activity—such as corporatism, societal corporatism, elitist pluralism and consociational democracy. They suggest that negotiations and accords concerning regulations and policies have only been the economic byproduct of business-supported political pacts (including the well-known National Front). In addition, most observers have noted that a stable technocracy existed that was capable of simultaneously establishing a protected and microeconomically distorted domestic market within a stable and more or less orthodox fiscal and monetary framework.

The most often described examples of this type of policymaking were a) the influence of the agricultural lobbies on the activities of the Ministry of Agriculture and its various public enterprises and b) the system of consultations between the Ministry of Development and industry associations. However, because of its impact on regulatory policymaking, the most important examples of this sort of corporatism were the operation of the Monetary Board, and the network of subsidized credit administered and financed by the Central Bank. Although the private sector was not directly represented on the Monetary Board, it was customary, and very much accepted, for sectoral ministries to devote their time and effort to capturing rents—more often than not coming directly from the main production lobbies for the sectors they represented. By the same token, building from a more or less stable relationship between the bank's bureaucracy and its clientele, the Central Bank's cheap and directed credit was carefully distributed among a group of privileged customers. This arrangement was organized and supported by producer associations and their respective sectoral ministries.

In addition to these relationships, high protection was institutionalized through the enactment of tailor-made trade and foreign investment policies. Although the main decisionmaking bodies in these areas—Instituto de Comercio Exterior, or Foreign Trade Institute (INCOMEX) and the National Planning Department—did not formally incorporate private sector representatives into their organizations. Their regulatory activities were crafted so as to be highly responsive to business petitions. Protection was therefore almost automatically granted to a Colombian firm claiming that some good was domestically produced and, in the same way, prohibition of foreign investment in competing sectors was easily obtained by local producers.

An important characteristic of this form of policymaking was its lack of flexibility, which made it difficult to reform. This rigidity was the result of various entrenched powers—business and political players who were endowed with veto power in the process of formulating policies. This fact, together with the accomplishments in the macroeconomic area, created a conservative environment in which change and innovation were certainly difficult.

Inputs and Resources for Regulation

Given these previous conditions, especially the lack of clear regulatory institutions and the inordinate emphasis on negotiations, it was no surprise to find that the Colombian state lacked sufficient resources to carry out modern regulation. In particular, it needed educated personnel, a framework for action, and accurate data.

The shortage of educated personnel is predominantly the result of two trends:
First, most economists have a legalistic bias—they tend to be prepared to administer the complicated regulations already in place rather than to search for newer, more efficient models on which a new regulatory regime might be based. The most relevant example was the obstructive foreign exchange control system, command of which was much more important for young economists than a sound knowledge of fundamental exchange rate economics. Similar situations existed regarding trade policies and monopoly regulation. Second, most of the economists who had studied abroad were devoted to macroeconomics. Due to insufficient demand, applied microeconomists, and experts on industrial organization and public utility regulation were almost absent in the country (there was one notable exception: there was a growing group of capable, specialized people dealing with power sector regulations, formed with the support of multilateral institutions involved in building institutional capacity in Colombia).

Until the mid-1980s, no public institution in Colombia actively used economic models to analyze the economic impact of different regulatory policies. Even the National Planning Department started using some economic models only in the 1970s and 1980s, mostly in the macroeconomic and trade areas. The technical capacity of the Central Bank was conspicuously low up to the 1980s, and the Monetary Board, whose decisions were generally regarded as being better prepared, worked with a reduced amount of resources. The rest of the public sector agencies engaged in some form of regulation had very inadequate technical capacities, again with the exception of the power sector.

Information and data, crucial inputs for regulation, were also scarce. In this area, it is worth remembering that when the country faced a macroeconomic crisis in the mid-1980s, multilateral institutions found that the country did not have reliable data available for fiscal, foreign debt, and important trade matters. The only reliable statistics were related to the monetary system. Information regarding industries was relatively abundant but entirely provided by the firms themselves. However, the worst situation (which still prevails today) was found in the agricultural sector, where no reliable accounting was exercised at all, and where most of the available data was provided by the farmers and negotiated with bureaucrats from the Ministry of Agriculture. In the public utilities area, again only the power sector had enough reliable information to provide the basis for sound regulatory policies.

II. The Regulatory System and Its Economic Consequences

Naturally, such enormous disorganization, combined with the state's ambition to extend itself in virtually all areas of the economy, greatly weakened the Colombian state and resulted in a failure to attend to its primary functions. Specifically, regarding its regulatory responsibilities:

- The most important markets—capital, labor, and trade of goods and services—were over-regulated.

- At the same time, regulatory actions indispensable to fostering competition were vastly ignored (examples would include antitrust actions and regulations for services provided by the state or by state-fostered monopolies or quasimonopolies).

- Finally, incipient and weak regulatory institutions, such as the National Tariff Board, set tariffs and standards for power distribution, telecommunications, and water and sanitation public enterprises, leading to confused rules,
institutional disorganization, and, ultimately, poor service for consumers.

**Over-Regulation of Private Activities**

For many years, and in a cumulative fashion, excessive and arbitrary regulations were established on markets without a clear, global rationale. Over-regulation was mostly a consequence of the agglomeration of many independent decisions, made under different policy scenarios, at different times, usually with the active intervention of their beneficiaries. Once enacted, and due to those groups' vigilance, reversing a regulatory policy was much more difficult. This helped reinforce the aforementioned lack of flexibility, codifying it into a regime where innovations were at best, difficult to introduce.

These policymaking practices created a fragmented system where compartments, tailor-made market islets, targeted subsidies, and privileges were the rule rather than the exception. In the capital markets, for example, the foreign exchange control system, while granting full monopoly power of foreign exchange and credit markets to the Central Bank, also gave considerable leeway to the Monetary Board to grant exceptions. In the financial sector, the web of regulations created a complex, specialized banking sector where credit was directed to some groups, and competition was effectively restricted. Moreover, Central Bank mechanisms for directing credit reinforced and, to a large extent, coordinated the flow of targeted resources to the various groups involved in concerted policymaking. Finally, a regime that was hostile to foreign investment completed this less-than-perfectly competitive picture.

As for the labor market, complicated congressional laws worked against the stability and growth of jobs. Among these, the most remarkable were the costly, retroactive severance payment system and the various tenure laws (after ten years of service)—especially the one that forced reinstatement of dismissed workers.

Regarding the trade sector, the most important instrument of protection was the widespread use of quantitative restrictions, which were established in a piecemeal fashion following informal consultations and negotiations between government officials and firms seeking protection. At the beginning of the Gaviria government, 43.3 percent of the items on the import list (65 percent in the industrial sector) required prior licenses. At the same time, in 1990 Colombia had the highest average tariff level in the Andean Pact: 36.8 percent (for consumer goods, it was 53 percent; for intermediate goods 35 percent; and for capital goods 34 percent). In addition, importing and exporting were plagued by myriad procedures and a profusion of red tape, which imposed a considerable tariff-equivalent disincentive to trade.

In sum, the state, in concert with some regulated agents, promoted monopoly and oligopolies (see Hommes 1995). Its regulatory apparatus was aimed at avoiding competition in various markets, making them less flexible by blocking the entry of new players, and securing rents for tenured participants. This was defended as necessary public intervention in the economy, in order to correct certain market failures, improve income distribution, mitigate alleged unfair international competition, protect local infant industries, etc.

**No Regulation in Crucial Areas**

In the midst of this very confused definition of public and private roles, alongside some excessively regulated sectors, it is no surprise to find certain activities untouched
by any regulation whatsoever. In these activities, such as air and maritime transportation, consumers and firms were highly vulnerable to the effects of monopolies and oligopolies, some of which were publicly operated.

One of the most striking examples of the absence of effective regulation was the disregard for antitrust public activity. While the government was actively involved in promoting market concentration and restricting competition in important markets, it did not pay any attention to existing antitrust regulation. In fact, the Colombian version of antitrust regulations, Law 155 of 1959 promoted and pushed through Congress by an isolated liberal Minister of Finance, has never been used. Apart from the evident lack of political will, three reasons explain why this law was never implemented in 35 years (see Hommes 1995):

- Within the Colombian tradition of statutory justice, violation of existing regulations must be defined in full detail. As these descriptions were either incomplete or nonexistent, the law was rendered useless (see Orozco 1993 and Hommes 1995).
- In order to prosecute unfair practices, the law required detailed proof as to both ‘cartelization’ (that is, price-fixing agreements) and its damaging effects on the economy. These were difficult to gather (by contrast, U.S. antitrust law defines some conduct as price fixing, and thereby illegal).
- Law 155 had conceptual limitations. It gave government the capacity to fix some prices in order to defend consumers from monopolies, but it did not rely on expanding competition to reduce market power.

Further, not only did the government fail to regulate monopolistic or oligopolistic activities, in some areas it was itself engaged in monopolies (such as train transportation, port services, and most social services, including health and education). Consequently, in these sectors no mechanism protected defenseless consumers from poor services, tariff overcharge, or other monopolistic abuses. Moreover, in some instances, a curious form of de facto privatization took place when strong labor unions, facing weak government administrators, held inordinate influence over the direction or management of public monopolies. Needless to say, this situation worsened the already negative impact of public monopolies over consumers and society as a whole. Good illustrations of this were the monopolies in charge of train transportation, ports, some municipal public utilities, and, to some extent, public education.

Finally, private quasimonopolies in charge of air and maritime transportation, must be included in this list of unregulated sectors. In the airline sector, entry was carefully controlled and most rates were established by the Department for Aeronautics in such a way, that competition was severely restricted so as to protect Aerovías Nacionales de Colombia's (AVIANCA) quasimonopoly. However, the most egregious restriction was in the shipping sector where the flag law reserved, through the so-called cargo reservation mechanism, 50 percent of the market share for the flag carrier domestic shipping line Flota Mercante Grancolombiana.

Incomplete and Distorted Regulation on Public Enterprises

Those services provided by public local monopolies: electricity, telecommunications, and water supply and sanitation, were regulated by an incipient and weak institution: the National Tariff Board. Although imperfect, this entity filled a notorious gap within Colombian institutions. In fact, since the mid 1970s there had been an increasing need
for some form of regulation regarding rates and consumer protection. Public protests on high tariffs, suppliers' frequent financial disorders, and some pressure from multilateral banks were behind the consolidation of the National Tariff Board in the 1980s, under the umbrella of the National Planning Department, in charge of setting tariffs and establishing some norms for consumer protection.\(^7\)

In the power sector, the development of a clear regulatory framework was obstructed by pressure from the largest firms in charge of generation, public entities with strong regional interests. Moreover, the Central Government, represented by the Ministry of Mines and Energy, and nominally responsible for sectoral planning and regulation, was in fact weak, with no capacity to lead or control the powerful regional enterprises. Large investments and operational decisions were made through a system of accords and negotiations by the National Transmission Institute (ISA). These decisions were clearly less than optimal from a national interest point of view and partially responsible for the country's power shortages.\(^8\) While the National Tariff Board was in charge of setting electricity rates, other important areas of regulation were established by the ISA. Thus, once more in this area there was no sharp distinction between the regulators and the regulated.\(^9\)

In telecommunications, \textit{Empresa Nacional de Telecomunicaciones} (TELECOM) held a monopoly as the national and international long distance carrier. This firm was also a major shareholder in many local carriers. Here, the Minister of Communications had a dual and conflicted role: while representing the national interest, he was also TELECOM's Board President, in charge of furthering its interests. TELECOM was very much involved in regulatory matters because of its legal privileges and the extremely weak technical capacity at the Ministry, which forced it to rely on TELECOM to carry out its licensing responsibilities. Therefore, numerous cases of conflict existed, leading to constant complaints of discrimination and unfair practices. Because private carriers were not allowed to function in that market, TELECOM's clashes were limited to Departmental and Municipal public enterprises.

A very similar situation prevailed in the energy sector. Here, ECOPETROL, the state monopoly, was simultaneously regulator and competitor in exploration, oil refining, and distribution of gasoline. This was also the case with \textit{Carbones de Colombia} (CARBOCOL), the Colombian coal enterprise, which, in addition to its coal extracting and exporting activities, also decided on sites and licenses for other firms. The Minister of Mines also presided over the boards of these companies; his conflict of interest often led him to restrict competition and innovation. Finally, a side effect of this regulatory setting was the limited involvement of the private sector in this area. Fearful private firms had to comply promptly with the whims and desires of bureaucrats, which led them to keep their distance from such sectors.

In water supply and sanitation, the regulatory system was also in great disarray. After the decentralization reforms of the 1980s, the very inefficient national monopoly (INSFOPAL) was dismantled, and water supply and sewerage systems were transferred to municipalities. However, regulatory responsibilities remained highly confused. Rates were fixed by the National Tariff Board, health norms and water quality standards were set by the Ministry of Health, and technical matters relating to equipment and construction standards were established by the Ministry of Public works. Needless to say, the private sector was effectively prevented from carrying out these public utility functions even in those cities with poor or no services.
The Economic Impact of the Regulatory System

It comes as no surprise to find that the sectoral and macroeconomic consequences of the described system of regulation was a negative rate of productivity growth and declining economic growth. Actually, the extremely complicated and disorganized Colombian regulatory system at the end of the 1980s provided no incentives or signals whatsoever for dynamic private economic expansion. Excessive regulations in some sectors, an absolute lack of regulations in others, and the prohibition of private activities in essential areas in the midst of a rent-seeking environment all welded intimately together to produce an economy where competition was highly restricted, oligopolistic practices were widespread, innovation was discouraged, and risk-taking investments went unrewarded.

In financial and capital markets, for example, the banking sector was incredibly small, and interest rate margins were among the highest in the world. Simultaneously, the expansion and proliferation of cheap Central Bank credit crowded out what in the 1950s and 1960s had been a dynamic stock market. Instead of raising funds in the markets, firms opted for lobbying high Central Bank officers. A serious side effect of this multipurpose Central Bank, engaged in promoting economic development, was its partial disregard for its main goal of reducing Colombia’s relatively high inflation rate.

Labor regulations, intended to promote employment and protect job stability, did exactly the opposite: two thirds of the labor force were compelled to enter the informal sector. Turnover was extremely high. Thirty-three percent of all legally employed workers lost their jobs every year. In addition, every year about 100,000 workers who were nearing ten years of seniority were fired by employers, thus evading the costly regulations supposedly established to protect workers.

This regulatory system in which the state fostered low competition was fertile terrain for monopolistic and oligopolistic competition. In fact, oligopolistic practices and market concentration grew in the economy. Almost 70 percent of Colombian industrial output was produced under oligopolistic structures in 1988 (see Bonilla and Osorio 1993). In addition, the situation deteriorated in important areas. For example, while in 1968 49 percent of intermediate good industries were highly or moderately concentrated, in 1984 that percentage reached 78 percent. In the capital goods industries, it rose from 24 to 85 percent.

In the air transportation and shipping sectors, tariffs were much higher than in other similar countries. By the same token, delays and unreliability of service were high by international standards (World Bank 1994). Public train and port monopolies also provided very high-cost and deficient services. In addition, they were in the clutches of strong unions, and because of their enormous costs, produced elevated deficits.

Most public utilities, also provided by monopolistic enterprises, were troubled. While electricity coverage in cities was 95 percent, in the countryside it was only 41 percent, and most power enterprises were insolvent, with a seriously limited capacity to undertake the requisite expansion projects. Telephone coverage (eight lines per hundred inhabitants in 1990) was internationally acceptable but its quality, costs, and service reliability were all poor. International long-distance rates were 15 to 50 percent higher than those in more competitive countries. Water supply and sewerage coverage and quality remained very low in important areas. While around 90 percent in the three main cities, coverage was below 60 percent in several intermediate cities, and only 24 percent in rural areas.
Because of the lack of competition, serious distortions and inefficient essential services, productivity and innovation were lagging in the country's economy. In fact, the contribution of total factor productivity (TFP) to economic growth steadily declined from the mid-1970s to the late 1980s.\(^1\) While TFP had grown steadily from 1950 to 1974, it continually declined thereafter. Moreover, TFP was negative (-0.6 percent) in the period 1980–86. From 1980 to 1983, both output and productivity had negative annual growth rates, -1.3 percent and -2.6 percent, respectively. Later, from 1984 to 1987, when industrial output had a healthy growth (7.4 percent per year), TFP continued to decrease at a rate of -0.5 percent per year. Thus, industrial growth was the result of an accumulation of inefficient factors, within a closed and secluded economy. Innovation, technological change, and an efficient use of inputs were not present in the Colombian economy.

The proliferation of regulations and the country's negative productivity growth naturally had a negative impact on economic growth. From 1970 to 1974, annual average growth was 5.3 percent; it declined to 4.3 percent during 1975–80, and to only 3.4 percent in the 1980s. Given that income per capita was only US$1,300, this meant that at least three generations of Colombians were going to live in a very poor country. In fact, with the 1980s' growth rates, it would have taken 25 years to reach a per capita income of only US$3,000.

Despite these figures, Colombia's rate of economic growth was relatively higher than that of many Latin American countries. It has been hypothesized that this was due to Colombia's more orthodox fiscal and monetary management which kept public deficits and inflation rates under control. Another explanation could be Colombia's relatively more relaxed adherence to the model of state intervention, together with economic agents' almost total disregard for growth-retarding regulations and the state's lack of will and capacity to enforce its own rules: as suggested by the entrenched and tolerated foreign exchange "gray market," the extended informal sectors, the very visible and growing "free-trade markets," and other forms of smuggled goods trading.

In conclusion, even though the country's economy was suffering from deep-seated structural deficiencies that stymied economic growth, it was not in macroeconomic crisis. This fact has led to a puzzle: since such crises are often regarded as the catalyst for serious economic reform, some observers wonder how Colombia could carry out an ambitious reform in 1990. The next section will attempt to solve this puzzle.

III. Why Was Economic Reform Possible in Colombia?

Ambitious economic reform seemed to be out of the question in Colombia in the late 1980s. No compelling motivation existed among key political and economic players to change an economic model that was not undergoing an acute macroeconomic crisis (and certainly was not collapsing), and that in many respects was considered one of the best performers in Latin America.\(^2\) Although its economic indicators were mediocre when compared with those of the East Asian tigers, the Colombian economy showed a relatively good performance in the region during the "lost decade": growth was low but never negative, close to 3.4 percent; average inflation was below 30 percent and never got entirely out of hand; international debt was never restructured; and the fiscal situation was relatively good after solving the problems of the first half of the 1980s, the public deficit remained below 2.5 percent of GDP between 1987 and 1990 (see Table 1).
### Table 1: Colombia: Main Macroeconomic Indicators, 1980–95

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP growth (percent)</th>
<th>Inflation rate (percent)</th>
<th>Fiscal deficit (percent GDP)</th>
<th>Foreign debt (percent GDP)</th>
<th>Unemployment (percent)</th>
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* Estimated

Sources: Banco de la República DNP, various years.

At the same time, the Colombian way of economic policymaking exhibited great stability and gathered remarkable consensus among most local economists and business leaders. Colombian economists were self-congratulatory about being relatively independent from international fads and fashions. In the 1970s and 1980s, the resounding failures of left and right-wing economic experiments throughout Latin America reinforced their feelings of mild intellectual chauvinism. Their reading of the economic figures of the 1980s only confirmed their perception that the model did not need revision. Pragmatism and moderation were the adjectives used to describe a Colombian economic policy that stressed fiscal conservatism and heterodox microeconomic allocations amid a set of corporatist, consensual arrangements. An able "musical chair" group of technocrats maintained control of monetary and fiscal policies, regardless of the changing political governments that came and went during the past three decades. In this environment, criticism and challenge were scarce.

Without an economic crisis and amidst intellectual conformity with the status quo, why then was Colombia ready to undergo an ambitious economic reform in 1990? The answer is simple: it was made possible because the new government was equipped with a very clear reform agenda and the determination and political capacity to carry out this reform. After taking office in August of 1990, the new government pushed its platform forward by issuing decrees, sending bills to Congress, and making myriad administrative decisions.

As to the new government's leadership, two factors were decisive. First, President Gaviria was relatively free to follow his own agenda because he was elected without attachments to the powerful interests that usually accompany successful candidates in
Colombia. In fact, candidate Gaviria took the place of the assassinated, extremely popular Luis Carlos Galán, thus winning the presidential election almost exclusively based on his movement’s popularity, without having to make deals with business and electoral leaders in exchange for their financial and political support. Second, the President and his team knew exactly what they wanted to do in office. The candidate and his economic team formulated a coherent and consistent reform plan before his term started. The main elements of this reform were introduced simply because the team members believed in them. Internal and external agents, such as the business community or the multilateral institutions, had little or no influence on the drafting of the new government’s economic platform.

In addition to the new government’s leadership, what other elements helped push the reform effort? First, the country was in a reform mood. The extremely high level of violence, the activity of various guerrilla groups, the unpredictable outcome of the war against drug lords, the assassination of three presidential candidates during the 1990 campaign, as well as frequent street bombings, created the impression that the country was in the midst of a hurricane and that something different ought to be attempted. This feeling was reinforced after various proposals of institutional change and renovation had recently failed (for example, the third failure to modify the 1886 Constitution). In this environment of crisis and frustration, people were prepared for new and unexpected measures. Thus, the need for deep reforms seemed inevitable. That is why the initiative to modify the 105-year-old Constitution without the intervention of Congress proceeded rapidly in 1990. The most important items in this initiative were changing the obsolete judicial system and democratizing old political practices that impeded the political participation of vast segments of the society. In this context, the new government introduced the need to reform the traditional, Colombian way of economic policymaking.

Second, the complex and profound political crisis had put the traditional Colombian business and political leaders in a state of confusion, temporarily depriving them of their sense of direction. Therefore, a new generation of leaders began to enter into the political stream. A whole generation of politicians, in their fifties and sixties, most of them defenders of the status quo, were forced to retire after 1990. This situation also provided a window of political opportunity for the reform initiatives of the new government.

Third, the debate over constitutional reform commanded the attention of the main political and economic forces, thus distracting potential opponents of economic reform, and giving the government more freedom to act in both the congressional and administrative spheres. Congress, where the President’s party held a majority, was justly called ineffectual by political reformists. Although it belatedly tried to prove its ability to renew the country’s institutions by quickly approving more than a dozen reform bills between September and December of 1990, it was dissolved by the Constitutional Assembly in 1991. When the new Congress convened in 1992—after new elections had taken place late in 1991—most of the reform measures had already been enacted. More important, while the constitutional changes took place, many economic reforms had more than a year to be implemented and consolidated without effective opposition.

Fourth, the government found a sizable group of supporters for its regulatory proposals among business leaders. Widespread disregard for some absurdly strict regulations had placed many Colombians in the position of supporting a deregulatory effort that would legalize their actions. This was the case of foreign exchange
regulations that prohibited Colombians from having accounts abroad (in vain). Equally inane labor regulations were routinely violated, and trade permits were circumvented by widespread smuggling. Many influential people viewed their support of the deregulatory bills as necessary to normalize their legal situation.

A final element often mentioned as helping the Colombian reform was the so-called international demonstration effect. Rapid growth in Chile and the Asian countries showed that Colombia was not performing as well as many professional observers had thought. By the same token, the collapse of socialist countries and their search for market mechanisms weakened positions favoring planning and state intervention. But above all, the experience of many countries showed that reform was possible in democratic environments without the enormous social cost predicted by status quo economists. These factors, together with the influence of multilateral institutions and the observations that economic reform seemed to be a sign of the times, finally had an impact on business and political leaders. Thus, it was accepted that economic reform, even in conservative and traditional Colombia, seemed to be inevitable.19

All of these elements allowed the government to get a crucial number of its reform proposals approved in its first year. Once these were consolidated, the reform movement gained momentum and opened the door for the next round of changes that completed the reform agenda described in this paper.

IV. The Reform Effort

The regulatory reform undertaken in the early 1990s can only be understood within the framework of the general institutional transformation put forward by the Constitutional Reform of 1991 and the various laws enacted since the beginning of the Gaviria administration in 1990. One of the objectives of these reforms was to reorganize and rationalize the roles of both the state and the private sector in order to make them responsive and accountable to Colombian society. In particular, an important effort was made to strengthen the state's roles regarding justice, security and essential social services, to fill a long-lasting government vacuum that for many years had been occupied in a chaotic manner by numerous private groups. Simultaneously, the government intended to reduce and eventually relinquish its intervention in those areas where the private sector could better perform or produce some goods and services more efficiently.

A fundamental element in the redefinition of roles between the government and the private sector was the constitutional guarantee of free competition and the limitations over monopolistic and other practices against free entry and economic opportunities that this guarantee necessitated. This was a necessary complement to the political reform aimed at democratizing the country's political life. Under the new order, competition was regarded as a right of both consumers and entrepreneurs, regardless of their size or importance.20 The main consequence of these norms was that many monopolies, public and quasipublic, and also those elitist market compartments created by regulations, lost their juridical foundations. Therefore, after the constitutional reform of 1991, a vigorous process of entry into many previously secluded markets was expected to occur.

The expansion of private activities towards areas previously monopolized by public entities was to be obtained through two instruments: privatization of existing public enterprises, and more importantly, elimination of barriers to entry in many
restricted sectors. Naturally, the latter required a massive deregulatory effort in sectors ranging from social services and public utilities to industry and mining.\footnote{1}

With the lifting of barriers to free entry and the privatization of important public enterprises, some complementary institutional reforms regarding regulation were indispensable. Ministers and public enterprise officials could no longer hold roles plagued by conflicts of interest. They were forced to separate their roles as regulators from their roles as market players. Also, new regulatory institutions had to be created in order to assume independent positions with regard to public and private competitors in setting rates, protecting competition, and establishing market standards. This meant, for example, creating new regulatory commissions for public utilities and a redefined and recreated Central Bank. It would no longer be allowed to allocate credit or to assign favors only to privileged agents.

Before describing the reform initiatives in detail, it must be reiterated that, unlike other countries, Colombia's reform did not start with macroeconomic adjustment, fiscal correction, exchange rate devaluation, and increases in subsidized public prices.\footnote{2} As the macroeconomic situation was basically in place, its reform started directly with institutional changes, most of which had to be adopted in politically contested arenas.

**Deregulation**

As regulations—in the form of licenses, permits, bureaucratic revisions, authorizations, and general 'red tape'—constituted effective barriers to entry, it was absolutely necessary to launch a general effort to deregulate the Colombian economy in order to create a competitive environment. Within a deregulated environment—amid a set of general and stable rules—free and fair competition could be developed. In this way, the market players could be sure that the state was not going to use its regulatory power to restrict competition, foster oligopolies, or create market compartments. The main areas of deregulation included foreign trade, foreign investment, labor markets, financial markets, public utilities, and air and shipping activities. Another area in which private activity was permitted by the new constitution was the provision of social services, such as health and education.

**FOREIGN TRADE.** Some actions to open up foreign trade had been started by the Barco administration in early 1990. During the last months of that government, a gradual five-year liberalization program was initiated. The Barco reform was to have three steps: an immediate liberalization of those goods that did not compete with domestic products, which involved moving some goods from licenses to the free trade list; a two-year program for replacing quantitative restrictions with tariffs for all other goods; and a three-year period of tariff reduction to ensue, once this had been accomplished. During the first two years, the government was to auction import licenses for those items on the restricted list, in order to determine the tariff equivalent level of protection. Ultimately, the program intended to reduce the overall average tariff to 25 percent.

However, an ambitious foreign trade reform did not actually begin until August 1990. During the first months of the Gaviria administration, several simultaneous decisions were made, which would establish a new trade reform program. First, quantitative restrictions, in the form of import quotas, import licenses, and lists of forbidden imports (around which favors and privileges were concerted and
distributed), were eliminated. Second, due to pressures from the more conservative members of government, a gradual four-year reduction program was announced, which was to bring average tariffs down to 12 percent by the end of 1993. This gradualism soon proved to be impractical because both importers and investors took a "wait-and-see" attitude that resulted in a very large current account surplus and an acute reduction of private investment. Consequently, the Colombian private sector generated a forced surplus, international reserves accumulated sharply, and the monetary base grew fast. Finally, forced by this macroeconomic situation, 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 percent in 1990 to less than 12 percent in 1991. More important, the average effective protection was reduced from 75 percent in 1989 to 34 percent in 1991, and 21 percent in 1992.

**FOREIGN INVESTMENT REFORM.** Deregulation of the very obsolete foreign investment regime took place in a rapid fashion. The reform had three main elements. In sharp contrast with the immediate past, all economic sectors were opened to foreign investment, with the exception of security related matters and nuclear waste disposal. All prior administrative decisions on foreign investment were eliminated. This was a crucial step in creating an environment of competition and transparency in what previously was a very closed and protected environment. Only those foreign investments in public utilities were made subject to some prior examination by the central government. Foreign investors were granted the same treatment as the domestic ones. Additionally, foreign investors enjoyed full monetary convertibility and free access to foreign exchange for making all kinds of transfers abroad. Moreover, according to international standards, the very definition of foreign investment was made more inclusive in order to incorporate portfolios and various other forms of investment channeled through the stock exchange.

By the same token, the 1990–94 reforms allowed Colombian investors to enjoy the freedom of investing abroad without any prior approval or interference from the government. Previously, Colombians had been prevented from investing in other countries, which limited their ability to directly commercialize their exports and instead force them to invest in the secluded domestic market, thus increasing the level of market concentration.

On the institutional side, regulatory reform also included the elimination of the Special Unit for Foreign Investment Control in the National Planning Department, and the Committee for Royalties in charge of over-regulating various issues related to intellectual property and technology transfer.

**FOREIGN EXCHANGE REFORM.** This reform simply eliminated the very complicated foreign exchange regime by abolishing the Central Bank monopoly, and creating a free foreign exchange market. This move had a practical consequence: the legalization of thousands of savings and deposit accounts held in other countries that had been illegal under the previous, excessively restricted regime. Among the advantages of the new regime were the reduction of transaction costs for firms involved in foreign trade, and the introduction of a number of previously forbidden practices such as hedging, "forwards," and other similar operations. Simultaneously, the foreign exchange reform allowed the macroeconomic authorities to implement market determined foreign exchange rate policies.
As a necessary complement to this reform, the Superintendency of Foreign Exchange Regulations, an entity with the impossible task of enforcing the concocted foreign exchange controls, was eliminated.

LABOR MARKET. The labor market reform, undertaken by Law 50 of 1990, was one of the cornerstones of the structural reforms of the Gaviria administration. It did away with the very costly retroactive severance system and the onerous regulations hopelessly directed at fostering stability for workers with more than ten years of service. Among the latter we could mention the elimination of forced reinstatement of dismissed workers, and some pecuniary sanctions for firms. In order to avoid unnecessary costs for workers, the Law established a reasonable system of monetary compensation for affected workers.

FINANCIAL REFORMS. Several reforms were introduced to dismantle the existing regulations and develop a more competitive financial environment. These reforms include the elimination of virtually all forced investments by financial institutions; the relaxation of norms that forbade competition among different institutions, especially those that segmented credit and saving markets; the maintenance of market determined interest rates; and the opening of international competition in the financial markets.25 However, one of the most important reforms that followed the transformation of the Central Bank and the elimination of the Monetary Board as the money and credit authority was suppressing the various funds that financed subsidized direct credit. As a consequence, agricultural credit was no longer provided by the Central Bank, but by the Caja Agraria and Financiera Nacional Agropecuaria (FINAGRO), a specialized second-tier institution. By the same token, industrial credit was to be concentrated in the Instituto de Fomento Industrial (IFI) and the commercial financial institutions. A serious effort was made to force these institutions into lending at market interest rates and to stop their risk investments that only masked some transfers and subsidies for private partners.

Finally, to eliminate the public monopoly in pension funds, private pension funds were allowed in the market. Similarly, severance payment funds, which receive individual accounts with these resources started to be created by several private financial firms.

PUBLIC UTILITIES. The public utility reform centered around granting free entry for private agents to provide all kinds of public services.26 Moreover, it established that municipalities must grant permits and facilitate private investments in public utilities. Additionally, in order to encourage competition, the reform created numerous mechanisms for public enterprises to make them more competitive and to strengthen their managerial and financial resources. This reform law also allowed freedom of foreign investment in public utilities and established that, after a transition period, rates would have to reflect economic costs.

Most notably, in telecommunications, the reforms enacted by the Gaviria administration, allowed the entrance of private suppliers of value-added systems: cellular services, and set in motion the private participation of several private operators of domestic and international long distance services.27 After the very troublesome national strike of TELECOM's workers in 1992, the reform did not
necessarily envision its privatization, but rather the entry of many competitors to its previously captive market.

In the power service, private operators were explicitly allowed to operate freely in generation, transmission and distribution.\textsuperscript{28} Only in those poor areas where, due to market size, no private agents were interested in providing services, could the regulatory commissions determine the exclusivity for certain private operators. Those operators would be selected by public auction and supported by public resources.

In this sector, several measures were taken to disintegrate the existing vertical integration in the most important electric enterprises. In particular, \textit{Interconexión Eléctrica, S.A.} (ISA), the powerful public conglomerate, was to be divided into two firms: one in charge of generation, and the other, transmission. Each of these firms could be totally or partially sold to private investors. In addition, ISA was left with no regulatory or policymaking capacity.

\textbf{OTHER SECTORS.} Other important areas where deregulation was established in order to promote competition and eliminate national public or quasipublic monopolies included: \textit{air transportation} (an "open skies" policy was established, and passenger and cargo tariffs were fully deregulated); \textit{shipping} (the cargo reservation policy, by which the government forced traders to use the national flag carrier, was also dismantled and free entry was guaranteed); \textit{ports} (the national monopoly was liquidated and, instead, free competition among independent, privately-run ports was established); \textit{trains} (the national train monopoly was also terminated and private entry was allowed. A public firm was to be in charge of railroad maintenance; this firm was to be financed by fees paid by private operators); and \textit{pension funds} (the new social security law allows workers to freely deposit their savings into private pension funds. This reform, which follows the Chilean example, is expected to mobilize usage volume of resources).

\textbf{Creation of New Regulatory Institutions}

Regulatory reform was complemented by the creation of new institutions to meet the growing demand for new forms of state intervention. Unlike in the past, under the new model intervention had a clear procompetition bias. It assured the various market players that the powerful macroeconomic instruments in the hands of the Central Bank were not going to be used to favor only certain select groups. The institutions created mechanisms to avoid unfair competition and curtail abuses of dominant market positions, and attempted to regulate natural monopolies to produce market-like outcomes in terms of prices and quantities.

In this context, the most important institutional transformations were the establishment of an independent Central Bank; the general overhaul of the Superintendency of Industry and Commerce, making it capable of protecting competition policies; and the creation of three new regulatory commissions for public utilities, and superintendencies for public services, ports, and private security.

\textbf{AN AUTONOMOUS CENTRAL BANK.} A crucial element in reordering economic policymaking and regulation in Colombia was the complete transformation of its multipurpose and highly heterodox Central Bank. Now, freed from its previous microeconomic and sectoral obligations (for example, export promotion and directed
credit), it is responsible only for clearly defined, macroeconomic objectives (including reducing the inflation level and maintaining price stability, administering the country’s international reserves, and being a bank of last resort for financial institutions).

The new Bank was to have a highly technical orientation and its activities were to be under political control. The institution is now led by a full-time, fixed-term, competent board of directors. In addition, its recently gained specialization in macroeconomic and financial issues has forced a progressive upgrading of its technical personnel. Moreover, the Bank net income now belongs to the national government and is included in the national budget. The Superintendency of Banks is in charge of controlling its financial activities, and the Attorney General watches over its personnel performance.

Given its less-than-orthodox history, the new Bank was set up to maintain institutional distance from both the private sector and the government. The Bank’s Board of Directors is explicitly forbidden to lend, issue guarantees, or grant any kind of favor to private entities. Board members are specifically ordered to seek only the national interest. Furthermore, to prevent any wrongdoing, the reform established very demanding conflict of interest standards for Board members regarding their previous jobs, their behavior while serving at the Bank, and, most important, their work activities after they complete their tenure.

Finally, the reform established severe limitations on the Bank’s financial dealings with the government. Loans for the Treasury, one cause of macroeconomic instability in the early 1980s, can now be approved only with the Board members’ unanimous consent. Moreover, the government, represented by the Minister of Finance, while maintaining the token distinction of presiding over the Board, has only limited leverage; it was given only one of the seven votes.

REFORM OF THE SUPERINTENDENCY OF INDUSTRY AND COMMERCE. The reform was intended to strengthen the state’s capacity to limit monopolistic activities, and, more important, to provide incentives to free competition. The state had to play a very active role in protecting the less-powerful market players and consumers from potential abuses of agents capable of fixing prices and taking advantage of their monopolistic or oligopolistic capacity. Therefore, it was necessary to resurrect and revise the thirty-five-year-old, never-used, antitrust statute, Law 155/59.

The reform, carried out by Decree-Law 2153/92, sought to modernize the existing antitrust regime by filling the many gaps that rendered it useless. Consequently, a list of punishable conduct was carefully delineated: including price fixing, restriction on outputs, and geographic distribution of markets. The Superintendency received ample powers to investigate and penalize actions against free competition, on its own initiative or through the request of third parties. The Superintendency was endowed with an array of instruments to achieve its goals: investigatory capacity, the power to impose penalties, and the mandate to force firms to modify transactions.

PUBLIC UTILITY REGULATORY COMMISSIONS. With free entry granted to all public utility markets where natural or local monopolies are frequent, it was necessary to restructure completely the weak existing state regulatory capacity. The National Tariff Board was abolished and three modern regulatory commissions were created for telecommunications, water supply and sanitation, and electricity and gas. Their
general functions were to foster competition and prevent monopolistic practices. More precisely, these commissions were in charge of setting rate formulae, fees, conditions for auctions, and technical and commercial conditions for competitive market development. While promoting competition, commissions could establish general rules, investigate complaints against unfair practices, and order the vertical disintegration and suspension of, for example, output restraints and market segmentation.

The composition of these commissions is mixed consisting of high government officials and fix-term independent experts. The government's initial proposal was to establish fully independent commissions—indeedependent from both the government and the private carriers—somewhat akin to U.S. regulatory commissions. But some ministers and members of Congress insisted on, and eventually propelled, the creation of more public and thus less autonomous entities. Some ministries argued, for example, that tariff-setting could have a strong political impact, and hence, that responsibility should not be left in the hands of technical experts, since the government would be blamed when their decisions turned out poorly. Likewise, some members of Congress feared that regulations crafted solely by experts would be excessively technocratic, without regional and consumer input. Therefore, Congress compromised by approving the above-mentioned three semi-independent regulatory commissions.

In the power sector, the reform carefully sought to avoid the previous leverage of public enterprises on regulatory matters. With this in mind, the Board of Directors of ISA, the public holding in charge of transmission and generation, was left without any regulatory powers, especially in the operation of the electric system. Moreover, gas and oil regulation by the Ministry of Mines, which had been under the notorious influence of ECOPETROL and CARBOCOL, was also eliminated. The Ministry was to be devoted to sectoral planning and policymaking, and ECOPETROL and CARBOCOL to production and commercialization of oil and coal, respectively.

A crucial element to foster private participation in providing public services was the enactment of a clear-cut, full-cost recovery tariff policy. In this regard, the reform established a four-year period to eliminate subsidies to middle-class groups. It further established subsidies for the poorer groups to be paid mainly out of the national budget and, residually, by surcharges on higher status consumers.

SUPERINTENDENCY OF PUBLIC SERVICES. A Superintendency of Public Services was established as a complement to the regulatory commissions. Its main function is to protect consumers, and watch over public utility enterprises in financial and administrative matters. This entity is particularly obliged to ensure full compliance of the decisions of the regulatory commissions, the ministries, and other relevant authorities. This Superintendency is also in charge of designing accounting and finance systems for public service enterprises. When the regulatory commissions find evidence of unfair practices, the Superintendency will intervene by imposing penalties, ordering the suspension of those practices, sanctioning managers and, eventually, even taking control of or eliminating enterprises.

OTHER REGULATORY INSTITUTIONS. The creation of two additional institutions, in charge of regulating ports and security services, and the transformation of the Superintendency of Banks are also worth mentioning:
• **Superintendency of Ports:** When the public monopoly in charge of Colombian ports was abolished and free entry was granted, this regulatory entity was created in charge of setting rates, licensing, and securing competition.

• **Superintendency of Security:** This Superintendency was created under the institutional umbrella of the Ministry of Defense in response to the chaotic provision of security services provided by many private firms such as protecting buildings, farms, and individuals. Its main responsibility is to grant licenses and monitor the activities of private security firms.

• **Superintendency of Banks:** This entity was reformed in order to regulate the newly-created pension and severance payment funds, as well as certain foreign exchange-denominated financial operations.

**V. Challenges and Questions**

This long journey through the many reforms undertaken through 1990-94 has to conclude with a necessary caveat: the deregulatory efforts and the regulatory agencies are still relatively new and hardly constitute an established model of regulation. First, important institutions such as the regulatory commissions and the Superintendency of Public Services, and free entry into many previous monopoly markets are only a few months old, and in many respects still remain dormant in the laws or decrees. Their consolidation and deepening require an enormous effort in terms of government support, financial commitment, and selection of appropriate and effective personnel. Second, many other aspects of Colombian economic life have yet to follow the path of the policies already enacted: numerous licenses, registrations, formalities, and municipal “red tape” remain in place. Third, the past regulatory regime still looms over many people’s minds, and the demand for protection and market compartmentalization is always alive. By the same token, governments always have the temptation to use regulatory powers so as to cultivate loyalties and attain other political goals. Therefore, to maintain a competitive and deregulated environment will certainly require considerable support and commitment by the new government and other important players.

From our description of this important—but still emerging—process of regulatory reform in Colombia, two questions naturally surface: what is the actual state of regulatory reform today? and, more importantly: is this reform going to survive, or will it be set aside like other reforms in the past?

**How Is the New Regime Doing?**

While most of the reform program is taking hold in Colombian economic life, some of the new regulatory institutions, conceived in laws and decrees, have not yet been fully developed. Deregulation of trade, foreign investment, and financial and labor markets are now more than three years old and their economic impact has been remarkably positive, even in the short run. Since 1993, economic growth has been higher than 5 percent per year, unemployment has reached a record low, and private investment, both domestic and foreign, is booming. Though for some sectors transition toward the new model has not been completely smooth nor free of some industry-specific adjustment problems, most of the business complaints have been related to exchange rate appreciation (a continental phenomenon linked to international capital movements) and unfair practices, but not to liberalizing foreign trade. Moreover, the
reforms are widely popular among consumers, as proven by polls, to the extent that no candidate in the 1994 presidential elections ran against them, even those who traditionally had opposed these types of policies.

Unlike most of the deregulatory efforts, however, the creation of the new Central Bank has been very controversial. The Bank has not yet been openly attacked for failing to play its previous role of development agency, perhaps because other institutions are performing those functions (public financial entities provide credit and export subsidies). However, the Central Bank has been criticized for the sectoral impact of exchange rate appreciation and high interest rates. Some congressmen have joined affected business groups in suggesting that more government intervention in these areas is required. Additionally, the new government has criticized what it considers to be the Bank's excessive concentration on reducing inflation and has announced that it is sending a limited counterreform bill to Congress. However, because the autonomous Central Bank enjoys wide support by respected members of the economic establishment and is rooted in the new Constitution, even if some legal limitations are imposed on its exchange rate, it now appears that this new institution is going to last for some time.

The deregulation of public utilities and the organization of the new regulatory commissions are relatively more recent events and, in some instances are only now commencing (Congress approved their creation in 1993). For example, in telecommunications, private carriers of long distance telephone and private television channels will enter the market in the next few years. Similarly, the first private power plants are now being built. Unfortunately, public utility deregulation has happened much faster than the creation and development of the new regulatory institutions. Sectoral ministers—especially those not involved in the reform process—have shown distrust and apprehension over the powers of the commissions because they perceive them as obstacles to their own discretionary power. Therefore, strengthening and consolidating the new regulatory commissions remains a major challenge in order to reassure foreign and domestic investors, avoid abuse of market power, and, most important, maintain a successful privatization policy.

The regulatory commissions are still weak and require strong backing from the new government. The Energy Regulatory Commission, which inherited large resources from the now dissolved National Tariff Board, initially had a strong staff at its disposal, as well as administrative autonomy, financial resources, and the respect of the relevant ministries. Although it has produced important results in terms of gas electricity regulations, it still has to solve many problems related to maintaining the quality of its personnel. The case of other commissions is even more worrisome. For instance, one of them, because it was set up in the last months of the previous government, has not been granted full autonomy and remains completely subordinated to a ministry. Furthermore, its can hardly be said that its personnel have expert qualifications. Without the timely strengthening of the new institutions, the privatization of telecommunication and water supply services could suffer serious delays.

Finally, along with economic dynamism, rapid growth, privatization, and the general internationalization of the Colombian economy, have come the highly visible and controversial operations of conglomerates. Huge transactions not even dreamed of a few years ago are now becoming the standard. As expected, these events have fostered insecurities and criticism among traditional groups, leading to debates over the fairness of the new system. Fortunately, the government has devoted special
attention to social spending, directing more public resources to the poorest sectors of society in an attempt to extend the benefits of the reforms to all economic groups. However, all the events related to rapid wealth creation also suggest that breathing life into antitrust regulation is indispensable. Actually, strengthening the Superintendency of Industry and Commerce is both an economic and a political necessity in Colombia. Unfortunately, the entity has yet to be born that can effectively shoulder the responsibility for protecting consumers and controlling abuse of dominant positions in the market. It lacks essential resources and qualified personnel. In other words, it has not yet found its niche in the Colombian economy.

*Is this Reform Going to Last?*

Apart from the current status of the various elements of regulatory reform, more general and relevant questions are pertinent. Is this model going to survive and take hold in Colombian life? Is this effort only going to be another transitory attempt at trade-opening and modernization, such as the doomed initiatives of the 1970s and early 1980s? Or, will it constitute a definite break with traditional, conservative Colombian style of policymaking? Obviously it is impossible to answer these questions conclusively, and only working hypotheses and general observations are presented below.

First, given the embryonic stage of reform, its survival and growth need to be nurtured by government’s commitment to its fundamental elements, and, accordingly, by a massive effort directed at strengthening and protecting the deregulatory norms and emerging institutions. In this regard, besides resisting pressures to reverse the new regulatory regime, it will be indispensable for the government to guarantee sufficient financial resources, and select and retain capable personnel in the new institutions. The Samper government has announced its general endorsement of the reforms, albeit with certain reservations in some areas. However, during its first year, perhaps because of the problems of transition, the pace of regulatory reform has advanced less rapidly.

Second, although the reform effort has created forces favoring its acceleration, it has also unleashed tremendous threats to its own survival. On the positive side, it definitely enjoys popularity among consumers and vast groups of producers, which serves as a political shield to discourage conservative attempts at reversal. Additionally, many private investors who await the opening of new areas to competition defend the actions and press for the full development of reform. Likewise, they favor strong regulatory institutions designed for securing competition. On the negative side, however, reform has adversely affected several powerful groups that lost their sources of rents, and are now forced to compete, innovate, and rapidly change (which they are naturally reticent to do as long as they have hopes of turning back the clock). These groups demand protection and subsidies, seeking a return to the old way of regulating the Colombian economy.

Third, due to these conflicting forces, the future of regulatory reform will be determined by political realities. The recent economic history of Colombia clearly shows that the weaker the government’s political clout, the less likely liberalizing reforms are to survive. In the past, policy reversals (especially in trade), accompanied by a proliferation of subsidies and targeted benefits were associated with political crises that weakened governments. On those occasions, policymakers were forced to gain or regain the support of important business groups by granting them additional,
targeted protection. Consequently, the reform program's survival will be greatly enhanced by the stability and strength of the present and future governments.

Fourth, international realities will play an important role in cementing the reforms. International treaties, such as the Andean Pact, G-3, World Trade Organization (WTO), and eventually the North American Free Trade Agreement (NAFTA) or the Mercado Común Suramericano (MERCOSUR) establish limitations on important domestic variables, and on protection-oriented regulations. Furthermore, in the long run the increasing overlap of bilateral, regional, and multilateral treaties leans towards the creation of an international set of regulatory standards in areas such as trade, foreign investment, intellectual property, and technology. This will further insure that Colombia's regulatory reforms will be maintained.

Even in the midst of these considerable uncertainties we must conclude with a limited degree of optimism. The deregulatory reforms and the new regulatory institutions, at least in their basic and broadest elements, have a good chance of surviving. Their popularity and positive impact on the Colombian economy are their main assets. By the same token, new, powerful economic agents are demanding a fair and competitive playing field. Additionally, given that the government has announced its will to continue privatizing and expanding private participation in telecommunications, oil and other areas, sooner or later the institutional reform will have to be completed.

The main threat to the reform's future is political instability. Apart from solving the current political difficulties, one of the challenges of the long term Colombian agenda is to develop fully new political and economic institutions. These new bodies should reflect the broad interests of society so that governments can form coalitions and obtain political support without the traditional assignment of targeted rents. Only then will regulation be something other than just another political tool, and the country enjoy a modern incentive system to support its economic development.
Endnotes

1. See, for example, Nichols (1975) and de la Pedraja (1989).

2. According to Hartlyn (1985), "...the consociational agreement initially weakened the political parties and marginalized Congress from many key decisions as factionalism increased and immobilism led to the granting of power to the Executive Branch."


4. For example, Hartlyn (1985) and Dix (1980).

5. Not surprisingly, this system allowed for many microeconomic distortions. On the Colombian technocracy, see Urrutia (1994).

6. The long, enduring stability of the Colombian policymaking style, derived from its consensual mechanisms, has been widely discussed. First, Olson (1982) provides interesting formulations for this type of outcome. Second, good examples are found in Hartlyn (1989) and Dix (1980).

7. The National Tariff Board was created by Decree 3069 of 1986. Initially, however, it did not have the capacity to set tariffs, but only to examine and revise several decisions made by enterprises. The power of tariff setting was given to the Board by Decrees 201/74 and 149/76. However, these new functions were never fully used within the context of regulation. It was not until 1984—when Decree 2545 ordered the unification of electricity rates in the country—that the Board assumed an active role in regulation. Within this context, it was its Resolution 086 of 1986 that set the precedent of establishing a consistent tariff policy for the power sector.

8. For example, the infamous Acuerdo de Cali, in which the main generation projects were distributed according to a remarkably antitechnological procedure, and gave rise to a distorted, inefficient power sector in Colombia.


10. See, for example, Hommes, Montenegro, and Roda (1994)

11. A good summary of these figures can be found in World Bank (1989).

12. Reform analysts point out that a country is ready for reform when it is suffering a profound crisis that convinces everyone of the need to change the status quo. A change of political regime is also often mentioned as a condition of reform. The "crisis" hypothesis is popular among scholars and has been analyzed by Olson (1982) and Williams (1994). The regime change, wrapped as the "honeymoon" hypothesis, was discussed by Williamson (1994). All these elements were introduced in a general analytical framework in World Bank (1995).

13. In 1987, the Colombian Central Bank organized an international seminar to celebrate the twentieth anniversary of the famous foreign exchange statute that embodied most of the alleged advantages of the Colombian model of policymaking. Instead of criticism, abundant praise to the Colombian "muddle-through" practices were voiced on that occasion.
14. The ample discussion that originated when the Barco government initiated the trade reform in February 1990 was an important element in preparing public opinion to carry out an ambitious reform process during the Gaviria administration.

15. Some of the elements explained herein were discussed by Urrutia (1994b).


17. At the beginning of 1990, the prospects of Colombian society were dismal. Most intellectual observers gave little change to the country. As an example, see Restrepo (1992) and Pizarro (1992).

18. When analyzing reform strategies, speed and opportunity have been deemed as crucial elements for success. For example, Huntington (1968) states that the leader should “dispose of each issue as rapidly as possible, removing it from the political agenda before its opponents are ready to mobilize their forces.”

19. Needless to say, the reform process was opposed by most academic Colombian economists. Fedesarrollo and other think tanks supported the process only two or three years later, when it had already shown some progress. See Cepeda (1994).


21. The necessary complement of these instruments was, naturally, the elimination of price controls in all those sectors where sufficient competition was present. Only in those areas where some natural monopoly existed were regulations on tariffs and prices deemed necessary to produce market-like outcomes.

22. When the Gaviria government started, however, some macroeconomic corrections were necessary: fiscal and monetary tightening had to be implemented in order to reduce an inflation rate that had been over 30 percent in 1990. Nevertheless, these limited measures were not the center of attention for the new government.

23. One of the few exceptions that remained was a tax on profit remittances that, however, was set to decline steadily during the following years.

24. This reform was ordered by Law 9 of 1990. Later, it was developed by Resolution 57/92 of the Monetary Board and Resolution 21/93 of the Banco de la República.

25. This goal, however, was temporarily postponed due to a massive inflow of foreign capital that forced monetary authorities to impose different measures aimed at controlling these flows.

26. Public utility reform was enacted by Law 142 of 1994.

27. At the very beginning of the Gaviria government, decrees 1990 and 1901 of 1990 were issued. Later, Law 142/94 completed the new legal framework granting free competition in the telecommunications sector.

28. Both Law 142/94 and the so-called Electric Law established the new competitive framework for the power sector.
References


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