Investing in COLOMBIA

FINANCIAL TIMES **SPECIAL REPORT** | Tuesday May 8 2012

Inside

A realignment of criminal and terrorist groups is creating a new dynamic. The government has struck back, writes **Naomi Mapstone** **Page 3**

www.ft.com/colombia-2012 | twitter.com/ftreports

Nation shakes off 'nearly failed' status

John Paul Rathbone reports on an emerging power that has come a long way but remains full of contradictions

Power broker: US President Barack Obama greets Colombia's President Juan Manuel Santos at the Summit of the Americas in Cartagena Getty

It is a sign of how far perceptions of Colombia have changed that 33 years ago Time Magazine ran a cover with the scurrilous title, "The Colombian connection: billions in pot & coke" stencilled over the psychedelic image of a cannabis leaf.

Today, South America's third-biggest economy is again in the public eye, albeit for less controversial reasons. Last month, Time ran a full face photograph of president Juan Manuel Santos on its cover with the title: "The Colombian comeback: from nearly failed state to emerging global player."

In Washington and on Wall Street, the world's second most populous Spanish speaking country (after Mexico, but before Spain) is even sometimes referred to as "the new Brazil".

Few would disagree with Colombia's description as an emerging power broker. During April's Summit of the Americas in Cartagena, which gathered more than 30 leaders from around the region, Mr Santos displayed the near-frictionless but nonetheless purposeful diplomatic style he has become known for.

"It is the country that we most see eye-to-eye with on most issues," is a common refrain heard among western policy makers. Colombia is also the oldest democracy in the hemisphere and, unlike its Latin peers, has never defaulted on a loan.

Nonetheless, many hold a stereotypical view of a country of drug lords and unbridled violence, in the same way England is sometimes stuck in popular perception as a land of drunken lords, cups of tea and bowler hats.

So, to get a sense of how the country has changed from battle ground to bustling investor destination, you can do worse than go to Medellín. An industrial city of 3m people set amid rolling hills with a permanent spring-like climate, Colombia's second city was once known as the world's murder capital. Drug cartel leaders such as Pablo Escobar held sway, and Medellín's traditionally can-do but financially conservative business class was hidden by a fog of violence. At its worst in 1990, there were 6,349 homicides, equivalent to 380 deaths per 100,000 people.

Now, multinationals such as Hewlett-Packard have made Medellín their regional base. Local *multilatinas* such as Grupo Sura are meanwhile expanding aggressively abroad: last year, the financial services group bought Dutch insurer ING's Latin American pension assets in a $3.7bn deal.

"Medellín is living through its best times since the violence began," says Carlos Piedrahíta, president of Nutresa, a food company, which also has operations in Mexico, Central America and the US via its Lil' Dutch Maid brand.

As for violence, while still high, it has dropped to a fifth of what it once was and Pablo Escobar's grave – he was shot in 1993, fleeing across a rooftop – has become a macabre tourist attraction.

Much of Colombia is enjoying something of a natural high. The shame many felt about their country's former status as a "nearly failed" state has been replaced by pride.

With leftwing guerrilla groups on the back foot and drug gangs no longer a systemic security threat, there has been a step-change in the country's situation, similar to that enjoyed in Peru which similarly quashed leftwing guerrilla groups.

Crucially, relative peace has allowed the centrist Mr Santos to address development, especially long-overlooked social issues. At his inauguration in August 2010, the 62-year-old president promised to govern "for those who have nothing, and are tired of waiting" – although success has been mixed so far.

The country's $370bn economy is booming, with output growing at 6 per cent a year. A free trade deal has been closed with the US and foreign investment is rolling in, especially into mining and energy. When Mariano Rajoy, the Spanish prime minister, visited in April with a group of leading Madrid businessmen, he was still smarting from Argentina's recent nationalisation of oil company YPF. "We don't expropriate," Mr Santos said pointedly, laying out Colombia's difference.

Inflation, at 3.4 per cent, remains within the central bank's target. With interest rates at 5.25 per cent, the peso has appreciated significantly, partly due to "quantitative easing" in the US. Yet, in contrast to Brazil, there is little talk of "currency wars".

"Yes, US monetary policy makes life difficult for us, but I'd be more concerned if the US was pursuing contractionary policies," says Dario Uribe, head of the traditionally orthodox central bank.

Rapid consumer credit growth in a country with historically little financial depth has raised concerns about a credit bubble and over-leverage among the fast growing middle class. But although there is some deterioration of loan portfolios, analysts say there is little chance of blow-up.

"Provisions are very high, banks are well capitalised, and overdue debt is less than in other Latin American countries," says José Fernando Restrepo, head of research at Interbolsa, a local brokerage.

Mr Santos has also launched a series of modernising initiatives. These include a $100bn infrastructure programme, an ambitious restitution law that seeks to return land confiscated by guerrillas or paramilitary groups, and other reforms designed to improve the tax code, the education system, the judiciary and more besides.

It is a full agenda, which, to some observers, recalls the old saying that the one way to change nothing is to try to change everything.

Indeed, while his government is widely praised for its technocratic professionalism and energy, critics say Mr Santos, who comes from a wealthy newspaper publishing family, has spent the past two years governing "via headlines rather than with the articles".

"Such criticisms are all about implementation," says Mr Santos, who says he remains intensely focused on governance and contests the view that his government lacks follow-through.

One sign of that grip is a near 50 per cent rise in tax revenues over the past two years. But such nitty-gritty hardly gets the average Colombian's pulse racing. A midterm drop in the polls points to three main difficulties Mr Santos faces before presidential elections in 2014.

The first is security. There is a widespread perception it is deteriorating, as guerrillas and disbanded paramilitaries morph into smaller but harder-to-hit criminal gangs that engage not just in drug-running but also extortion and other rackets.

"The old vertical structures are broken," says Jeremy McDermott of Insight Crime, a Medellín-based consultancy. "Crime has become more democratised. It has also become more clandestine and underground."

The second is execution. Although Mr Santos's coalition has virtual control of Congress, initiatives often get bogged down in highly legalistic processes.

The third issue is to ensure in one of the world's most unequal countries that the poor enjoy the fruits of rapid economic growth. To that end, Mr Santos recently announced fully-funded plans to build 200,000 houses for those most in need. To criticisms it was a populist move, the well-bred Mr Santos shot back: "If helping the poor means being a populist or a traitor to my class, then I am both."

Colombia may well be an "emerging power", but it will remain a complex country of contradictions and surprises for a good while yet.

Inside this issue

Economy José Antonio Ocampo on the mixed blessing of high energy and mining prices **Page 2**

Banking New entrants are queueing up to capture returns in one of Latin America's most vibrant economies **Page 2**

Infrastructure The rules have been redrawn in the wake of a construction sector scandal **Page 3**

Legislation Hunter T. Carter looks at two bills – a new regime to replace a creaky bidding process and anti-corruption measures aimed at public officials **Page 3**

The view from Caracas The dismal investment climate in Venezuela has driven wealthy people across the border **Page 4**

Oil The industry is close to hitting its 1m barrel-a-day target, in spite of disruption **Page 4**

Mining Pent-up investor demand is about to have an outlet **Page 4**

Transformed second city excites envy

Medellín

The former crime capital is a hotbed of entrepreneurs, says **John Paul Rathbone**

In the 1990s, inhabitants of the capital used to wince at the thought of Medellín. Crime rates were sky-high and Colombia's second city was almost written off as a lost cause.

Now, when they think of Medellín it is often with envy. Its municipal transport system actually works, unlike the capital's traffic-clogged streets. Its business elite is often the country's corporate face abroad. Violence has diminished, and the city is known for its innovative architecture.

"Frankly, Bogotá needs a bit of Medellín. We don't have anything like its civic sense," says a Bogotá-based banker.

There are three reasons for this status.

First, a public administration that works well: its publicly owned electricity companies hand over $450m each year.

Second, the so-called Sindicato Antioqueño, three leading companies that hold controlling shares in each other and are sometimes referred to as Colombia's *keiretsu* in a reference to Japan's series of conglomerates with interlocking business relationships.

Grupo Sura, the country's second biggest financial group, Grupo Argos, the leading cement producer, and Grupo Nutresa, a food processing company, are also prime examples of so-called "multilatinas" – dominant local companies that are budding multinationals.

They are also emblematic of Medellín's traditional entrepreneurialism.

Rupert Stebbings, managing director of broker BTG Pactual-Celfin, says: "If you are interested in fixed income or oil, go to Bogotá. But if you are interested in equities more generally, there is more here.

"It's also easier to see: less traffic," he adds.

The third reason was Sergio Fajardo, an innovative mayor with a PhD in mathematics, now governor of surrounding Antioquia state who, laid the groundwork for the city's large public works under a programme he calls "social urbanism".

He explains: "If you build a beautiful library in a poor neighbourhood, it gives people a sense of importance. It raises their dignity and gives them access to goods such as education.

"It also brings visitors from other parts of the city. That encourages social integration."

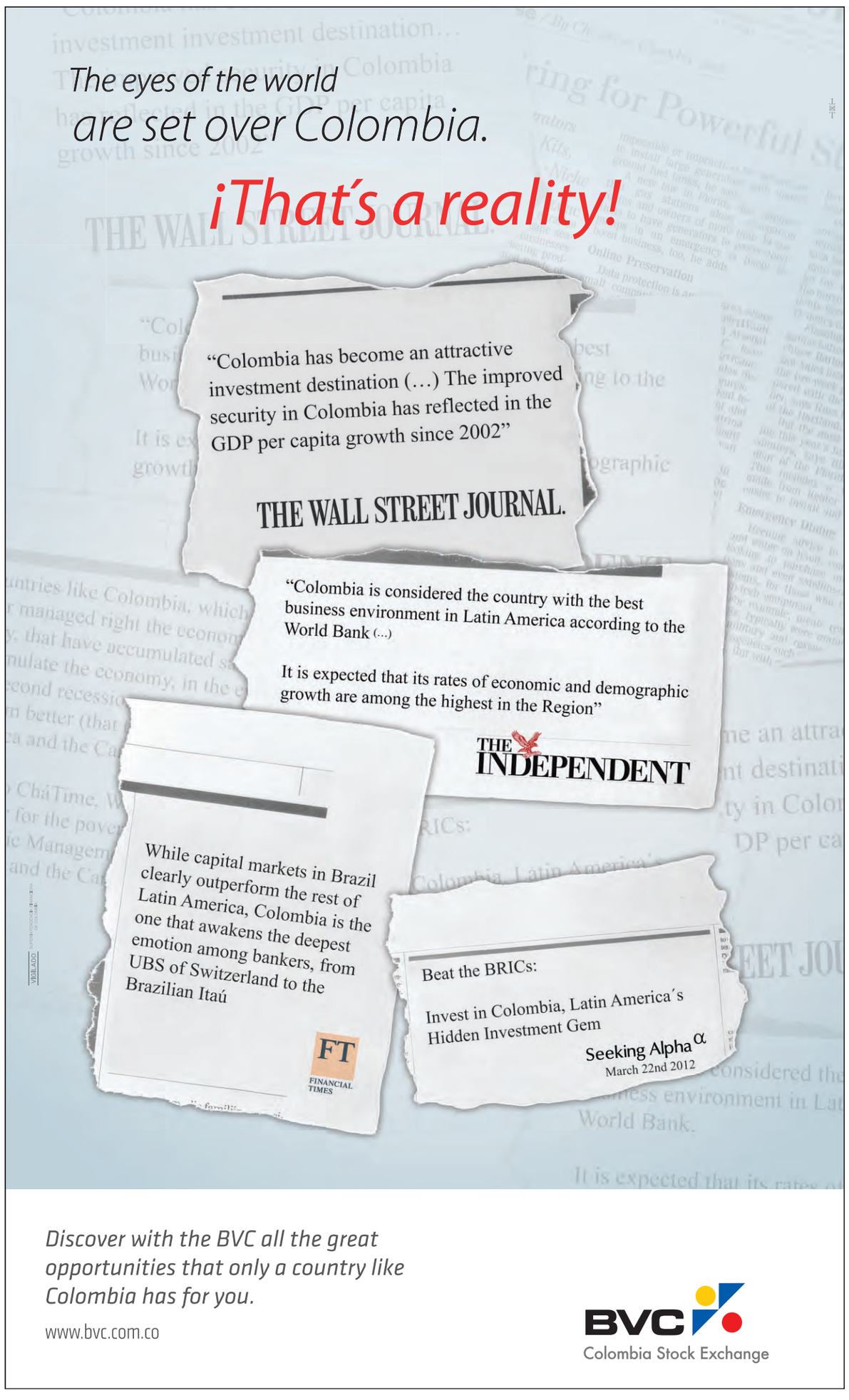
It can also inspire more generally.

Alfredo Gómez Cerdá, a Spanish novelist, wrote a prize-winning children's book after visiting Medellín's "Spanish library", which in turn inspired a West Side Story-style musical, *Barro de Medellín*, where the cast was drawn from different neighbourhoods.

Still, it is premature to call Medellín fully arrived. For one, bizarre Egyptian or Greco-themed restaurants speak of a persistent underlying narco-culture.

"It's a bit like Northern Ireland," explains Mr Stebbing. "There is peace, but problems remain."

In rehearsal: a musical inspired by the 'Spanish library'



Boom times a threat to traditional diversification

Guest Column
JOSÉ ANTONIO OCAMPO

Rapid economic growth returned to Colombia in 2004, accompanied by low inflation and high investment. At 27 per cent of gross domestic product the investment rate is among Latin America's highest. Foreign direct investment has also soared.

The average annual growth rate since 2004 has been 4.7 per cent. Growth slowed during the global financial crisis of 2008/9 but there was no recession. This is in sharp contrast to the Asian and Russian crises in the late 1990s when Colombia experienced its worst recession of the 20th century. The improvement was in part thanks to the country's ability to adopt a counter-cyclical monetary policy, a big advance over the policies adopted in previous crises.

A better security environment is part of the story; so too is the high price of commodities. Together they have encouraged a resources boom, particularly in oil, coal and gold.

Mining and oil exports have grown sevenfold since 2003. At $37bn in 2011, they accounted for two-thirds of exports. Traditional exports, such as agriculture and manufacturing, have also grown – but only by three times. Coffee, the traditional staple, represents only about 5 per cent of exports.

High energy and mining prices are a mixed blessing, however, as they threaten to undermine diversification of the economy, traditionally one of its strongest characteristics. As a capital-intensive activity, mining also generates limited employment, a big concern in a country that, despite significant improvements, has struggled to shrink unemployment. At an average rate of 10.8 per cent in 2011, it remains one of Latin America's highest.

The administration of President Juan Manuel Santos has put a strong emphasis on competitiveness that is crucial if the country is to benefit from opportunities created by the new US trade agreement and manage its potentially adverse effects on the less competitive agricultural and manufacturing sectors

Follow through is essential as similar competitiveness policies were abandoned during the first administration of former president Alvaro Uribe. Technology policies put in place by the Samper administration (1994-1998) were also abandoned during the crisis of the late 1990s. Improving physical infrastructure remains an overriding concern.

Competitiveness is particularly important today as Colombia – sometimes referred to on Wall Street as "the new Brazil" – shares one of the Brazilian economy's more unfortunate features: rapid exchange rate appreciation. Colombia's trade-weighted real exchange rate is 39 per cent stronger than its 20-year average.

José Antonio Ocampo: 'Further reform of the tax regime remains a priority'

Brazil, however, has tried hard to limit exchange rate overvaluation. Its central bank has been active in the foreign exchange market and myriad regulations on capital inflows have been adopted. Colombia has used similar policies in the past but recent action has been limited.

Taxation of mining rents and profits are another source of concern. In oil, the tax and contracting regime allows the state to appropriate a large share of rents from productive fields and high international prices. Yet nothing similar is in place in other mining activities. As a result the state captures only a small proportion of booming international mining revenues. Adapting the oil regime to the mining sector should be a priority.

Still, there have been some improvements. Tax subsidies designed to encourage foreign mining investment have been eliminated. Following a 2011 law, mining royalties also have the potential to be better deployed by the central government into regional development projects, and for general research and development.

Further reform of the tax regime remains a priority, especially those benefits granted to specific sectors or activities without clear criteria during the two previous administrations of Mr Uribe. Many of these subsidies are protected by tax stability guarantees and were designed to reassure and encourage foreign companies to invest in the country in the early 2000s. Nonetheless, the tax regime had previously enjoyed a long-term process of simplification, with tax loopholes progressively closed since 1974. Mr Uribe broke that trend. Simplifying the tax regime and closing loopholes are critical.

In doing so, the redistributive possibilities of fiscal policy also need to be enhanced. This is particularly important in a country that, over the past decade, has largely missed the improvements in income distribution enjoyed by the rest of Latin America. Colombia now has one of the worst income distributions in a region famed for its inequality. At 0.578 the Gini coefficient is Latin America's worst after Guatemala. Bettering that is essential to sustained and prolonged growth.

José Antonio Ocampo is a professor at Columbia University in New York. He is a former Colombian finance minister, former executive secretary of the UN Economic Commission for Latin America and the Caribbean, and former under-secretary-general of the UN Department for Economic and Social Affairs

Jammed: life in Bogotá is not without its difficulties, The traffic is terrible and the cost of living is rising Getty

Expatriates return Life starts to look better back home for Colombians on Wall Street

After 15 years on Wall Street, Gustavo Serpa decided last summer that it was time to go home to Colombia.

It was not an easy decision. Having arrived in New York in 1996 as a 29-year-old to pursue a MA at Columbia University, Mr Serpa has built a comfortable life for himself in the US.

First, he was a banker at Merrill Lynch's private wealth management business, then a managing director at Pali Capital, a boutique firm specialising in derivatives and fixed-income trading that went under. Later, he was a managing director at Forefront Advisory, an asset management group.

Along the way, he also got married and had two children.

"The global financial crisis changed everything," he says. "When I first left to go abroad, things in Colombia were very complicated. It was the peak of the violence. The feeling was that the guerrillas were close to taking over the country.

"But today, it is in much better shape, while Wall Street is struggling.

"I realised that with my experience on Wall Street and my network of contacts in Colombia, there were more attractive opportunities for me back home."

Mr Serpa, who now heads the Colombia operations of Amber Capital, the private equity group, is not alone in feeling this way.

Across Wall Street, anecdotal evidence suggests that an increasing number of Colombians are upping sticks and heading home.

The country attracted close to $15bn in foreign direct investment last year.

Growth in gross domestic product in 2011 is likely to have been above 5.5 per cent, according to the central bank, and the forecast for this year is a 5 to 6 per cent expansion.

Andres Garcia-Amaya, global market strategist at JPMorgan's asset management division and a Colombian native, says several of his friends, tired perhaps of the sluggish deal making climate on Wall Street, have gone home to work in private equity groups.

Opportunities for deals abound, in mining, energy, consumer, infrastructure and financials.

"I am definitely coming across a lot of returnees," comments Mr Serpa.

His partner at Amber Capital Colombia for example, moved back after 16 years in London and he says he knows at least 10 other people – mostly ex-Wall Street/City of London types – who have recently moved back after a stint abroad.

Life in Bogotá is not without its difficulties, however. Traffic is an issue and the capital, while not quite on a par with New York, is nonetheless becoming an expensive place to live, says Mr Serpa.

Still he feels he has made the right move. "Our quality of life is much better here than in New York," he says. "And it's good to be back home."

Pan Kwan Yuk

www.globalcdb.com

INVESTMENT BANKING • SALES & TRADING
ASSET MANAGEMENT • PRIVATE EQUITY

GSC bringing capital, ideas and execution together in Colombia.

In GSC we thrive in becoming Colombia´s preferred Investment Bank and Asset Manager. The GSC team provides global insight with experienced local advice, in a wide range of financial services to a substantial and diversified client base that includes corporations, financial institutions and high- net-worth individuals.

VIGILADO SUPERINTENDENCIA FINANCIERA DE COLOMBIA

GSC
Global Securities Colombia
Afiliado a Global Securities Group
MIEMBRO DE LA BOLSA DE VALORES DE COLOMBIA S.A.

BOGOTÁ • MEDELLÍN • CALI

Liquidity generated locally drives flurry of overseas deals

Banking

New entrants are out to capture big returns, says **John Paul Rathbone**

Bogotá's hotels are filled with visiting bankers. The economy is taking off, credit is growing at 20 per cent, and new entrants want to capture the returns in one of Latin America's most vibrant economies.

Brazilian giant Itaú is setting up shop, Canada's Scotiabank just bought a local presence in a $1bn deal, as has Chile's Corpbanca. Others are moving in as well.

Above all the excitement stands the measured confidence of Grupa Aval, Colombia's largest financial services group, and Luis Carlos Sarmiento Jnr, its straight-talking chief executive.

"We welcome the competition," says the son of self-made billionaire Luis Carlo Sarmiento Snr, who turned a 10,000 peso bonus 50 years ago into a fortune that Forbes estimates today stands at $12.4bn, the 64th largest in the world.

Mr Sarmiento Snr has just crowned his career with the purchase of Colombia's most venerable newspaper, El Tiempo.

But media is not part of Mr Sarmineto Jnr's remit. Instead he manages the group's largest part, banking, including the $2bn purchase of central American credit card issuer BAC-Credomatic in 2010, one of a flurry of overseas Colombian banking deals.

"We generate so much liquidity at home, we have to use it somehow," he says.

Credomatic last year earned $200m in profit, giving the deal a respectable – if not stellar – 10 per cent return on investment, versus the 20 per cent plus return on equity Grupo Aval enjoys at home.

"Once you take into account leverage, though, the return is more like 18 per cent," says Mr Sarmiento.

Still, the difference illustrates just what a tempting market Grupo Aval sits on.

Indeed, in midtown Bogotá, Itaú, Latin America's biggest bank by assets, has just opened a gleaming corporate and investment banking office.

"Colombia offers all the right financial conditions," says Ramiro González-Prandi, country manager.

"Moreover, a lot of our clients are coming here, and we can help Colombian companies go abroad. It's all part of Latin America's growing internationalisation."

Mr Sarmiento appears unruffled at the prospect of entrants competing away his returns.

"That kind of talk has often been heard before: when American banks came here, and then Spaniards," he says. "But with Colombian banks selling for three times book value, the new entrants will want to earn their money back."

Such talk might sound complacent were it not for the long-held conservatism of Colombian bankers, plus the Sarmiento family's record.

"As my father says: aim for the sky but always prepare for what the worst outcome might be. That is the secret of his Midas touch."

Luis Carlo Sarmiento Jnr: straight-talker

Unlikely owner saves national airline

Profile
German Efromovich

Joe Leahy talks to the man who pitched for Avianca as a joke and was accepted

A Bolivian-born, Brazilian businessman might seem an unlikely person to own one of Colombia's trademark companies, but German Efromovich is not one to worry about such things.

Mr Efromovich, who has a background in oil and telecommunications, bought Avianca, Colombia's national airline, for $64m plus the assumption of $220m in debt and leasing liabilities in 2004.

Avianca was then in Chapter 11 administration, but he was betting that the company's proud history – it claims to be the world's second-oldest airline – would help him turn it round. It worked. "The demand is there – people love this airline in the country," Mr Efromovich says.

Avianca hit trouble in the early 2000s after a series of regional crises undermined commodity prices and Latin American currencies. The airline was then owned by Valorem, a holding company controlled by the family of Julio Mario Santo Domingo, the late billionaire Colombian businessman. Valorem was bleeding money and half of its debt belonged to Avianca, so it decided to put the airline into Chapter 11.

"I went to Colombia and somebody said: 'Why don't you buy Avianca, nobody wants it'," says Mr Eframovich. He jokes that, to stop people asking him to buy the airline, he made an offer he thought the creditors would refuse. To his surprise, they accepted it.

By 2005, he had doubled the fleet to 70 aircraft and the same year received citizenship from Colombia's then president, Álvaro Uribe, for his investment in the airline industry and in oil.

Today, the airline has a fleet of more than 100 larger aircraft. The holding company, Avianca-Taca, made a profit last year of 202bn pesos ($114m), up 221 per cent on the previous year.

It also has operations in Brazil, Peru and Ecuador. Its Brazil division is planning to buy 50 aircraft for use in Latin America's largest economy at a reported cost of $4.1bn.

There has been some turbulence along the way. Avianca-Taca listed on the Bogotá stock market a year ago, raising $260m.

But its shares suffered when investors turned bearish on the overall market and an arbitration claim from former owner Valorem weighed on the stock.

Helped by Latin America's strong economies, the airline is expanding. It transported nearly 21m passengers in 2011, 18 per cent up on 2010.

With a free-trade agreement between the US and Colombia due to take effect this year, Bogotá's El Dorado airport is doubling its cargo capacity. Avianca is matching it, beefing up its cargo operations through the purchase of four Airbus SAS freighters last year.

Gang rivals reinvent themselves as partners in crime

Security

Naomi Mapstone on a new dynamic between criminals and insurgents

When Colombia's armed forces killed organised crime don Juan de Dios Uzuga this year, retribution was swift. The dead man's gang, the Urabeños, called a "strike" in the north-west of the country, threatening businesses that refused to comply, and putting a $1,000 bounty on the heads of police officers.

Oscar Naranjo, Colombia's police chief, had already warned that organised crime gangs – known as Bacrim, the Spanish acronym – presented a greater threat to security than the Marxist Revolutionary Armed Forces of Colombia (Farc), which has waged a 48-year war against the state. But the empty streets of the coastal city of Santa Marta and the burnt-out shells of 11 vehicles that failed to observe the gang's strike provided stark evidence of a realignment of criminal and terrorist groups in the country.

Juan Carlos Pinzon, the defence minister, says: "The success of the past eight years has created a new dynamic between all of the criminal organisations – Farc, ELN [National Liberation Army], criminal bands. They are not fighting among themselves any more – they are partners in business, whether that's drug trafficking or illegal mining or other activities."

The rise of the Urabeños gang, which controls much of the drug trafficking on the north Caribbean coast in conjunction with Mexico's Sinaloa cartel and Familia Michoacana, came after the 2006 demobilisation of right-wing paramilitaries. A rival gang, the Rastrojos, now dominates the drugs trade along the border with Venezuela, a traditional stronghold for both the Farc and the ELN, according to Nuevo Arco Iris, a Bogotá-based non-government organisation.

Other gangs, such as the Black Eagles, the Paisas and the Revolutionary Anti-Subversive People's Army of Colombia, have also staked out lucrative territories, even as the Farc has increased its attacks on security forces and infrastructure.

In February, after an extensive review of security strategy, the government struck back with "Sword of Honour", a policy whose hallmark is much closer co-operation between military and police forces. In two big offensives, the army captured several mid-ranking Farc leaders and killed 69 guerrillas.

Juan Carlos Pinzon: criminal gangs 'are not fighting among themselves any more – they're in business'

Mr Pinzon says the number of arrests of Bacrim and Farc leaders is up 44 per cent in the year to April. "More and more the Farc, ELN and criminal gangs are not always presenting themselves as militarily organised structures. Instead, they are merging as civilians into the population and trying to create social control," he says. "This is why the strategy includes not only offensive task forces but having policing capabilities merged with the military."

Military and police forces are focusing on 10 hot zones, bringing in local prosecutors to speed the granting of search and arrest warrants. In the next two years, the police will add 20,000 recruits and the army 5,000.

Like his predecessor, Álvaro Uribe, President Juan Manuel Santos is travelling the country widely, but Mr Pinzon says the president's visits to the hot zones are geared towards holding cabinet ministers responsible for responding to infrastructure, security or other needs. "For the first time it's not just a presidential speech," he says.

While previously, the military had focused – with great success – on eliminating the top leadership of the Farc, "Sword of Honour" has widened the focus to dismantling entire fronts of the Farc, systematically attacking their financial interests.

Mr Santos's landmark victim compensation and restitution of land legislation, which seeks to redress decades of land seizures by guerrillas and criminal groups, is an important factor in security strategy.

The Farc and Bacrim are heavily invested in illegal mining and logging, dairy cattle, agriculture and coca cultivation, and army troops have reclaimed several ranches this year with the aim of turning them over to the original owners.

Last month, the Farc relinquished its last military and police hostages – 10 men held for up to 14 years – as an overture for peace talks.

But peace talks are "very unlikely" in the short term, says James Lockhart-Smith, Latin America analyst at Maplecroft, despite the tabling of a bill by the Santos administration to provide the framework for transitional justice legislation.

"Since the peak of its capabilities between 1995 and 2001, the Farc has lost more than half its operatives, who currently number about 8,000," a Maplecroft report says. "It can no longer successfully take and hold territory through large-scale assaults on fixed government positions … nevertheless the group has not yet been sufficiently weakened so as to acquiesce to government demands for negotiation on official terms."

Pressing need for better transport

Infrastructure

Naomi Mapstone on re-engineering the bidding process

Gustavo Petro has big plans for Bogotá. The new mayor of Colombia's capital city was elected in the wake of a construction sector scandal that sent both the previous mayor Samuel Moreno and his bagman brother Iván, a senator, to jail.

Bogotános are not happy with the tangle of broken streets the Moreno brothers left behind, nor with long-unfulfilled promises of a metro system or that mythical beast, an "integrated mass public transport system".

"Bogotá is far behind what a city of its size should have for its infrastructure," says Daniel García Penã, Mr Petro's director of international relations. He says the Petro administration is committed to several transport initiatives in the next four years.

The first is an electric train to run down the Septima, the main road connecting Bogotá's presidential palace and government buildings in the old centre to the business district with affluent suburbs in the north.

The second is finishing extensions to the existing TransMilenio rapid transit bus system and converting it from diesel to cleaner energy, such as electricity. The TransMilenio model has been widely copied across Latin America and beyond but, after 12 years, it is running at capacity. "The ruling class tends to exaggerate the value of the TransMilenio. They see it as a magic solution and not as part of what modern cities throughout the world discovered decades ago – the need to integrate different types of transport in one system," says Mr García Penã.

To that end, Mayor Petro also wants to get the first two above-ground tranches of a metro system under way and build a light rail link near the Bogotá River to form an outer loop round the city. Two cable cars up the mountains that serve as a backdrop to the city centre would round out the mayor's transport commitments, says Mr García Penã.

> Bogotános are not happy with the tangle of broken streets, nor with unfulfilled promises

It is an ambitious agenda for Mr Petro, a former leftist guerrilla with the M-19 movement and an anti-corruption campaigner.

Bogotá is not alone in the scale of its transport ambitions or woes. All across Colombia, poor links between regional centres such as Cali, Medellín, Barranquilla and the port of Buenaventura are driving up the cost of doing business and adding hours to transport times.

"There's plenty of opportunity in terms of investment," says Bernardo Gamboa, president of Conciviles, one of Colombia's oldest construction companies. "We have more than seven cities with 1m-plus inhabitants and connectivity is one of the main issues."

The catch for investors is that new road concessions have been on hold since President Juan Manuel Santos, who came to power in August 2010, ordered a restructuring of the bidding process and regulatory authority to correct a system that had become a tangle of political patronage, corruption, weak engineering design and poor oversight.

"Things really got out of hand in the past 10 years," says one investor. "The new administration found that most of the major concessionary works were already awarded for the next few years and all of them had problems – very few requirements for builders, contracts that opened the door to successive renegotiations, increases in prices and delays in construction."

The revamp will eventually lead to "a much better and cleaner way of doing business", he adds.

Mr Gamboa agrees the restructuring has been necessary, but emphasises the clock is ticking. "If we don't do this [restructure] well, countries in Europe and elsewhere will start to recover and the investment focus will have moved to a better place."

Bus stop: the TransMilenio model has been widely copied but, after 12 years, it is running at capacity Getty

The man charged with heading the new National Infrastructure Agency (ANI) is Luis Fernando Andrade, the respected former head of McKinsey in Colombia.

Mr Andrade will oversee a tripling in transport infrastructure investment by 2014 via public private partnerships for big roads, such as a $700m section of the route from Bogotá to the port of Buenaventura.

Big road concessions are expected to flow again in the second quarter of 2013.

Mr Andrade has also floated the possibility of issuing up to $22.7bn in 25-year investment-grade bonds from mid-2013 to build new roads, increase lane capacity and improve existing routes. Most of the new concessions would be public private partnerships with 20-year contracts.

This would help address another obstacle for Colombian construction companies which still look to banks as the best form of financing.

"Unfortunately for us, the primary source of finance is going to be standard corporate loans or project finance with a financial entity," Mr Gamboa explains. That's really the only option for Colombian companies at present." Conciviles has recently structured some alternative funding via private equity for several bids, he says, but private equity is still in its infancy in Colombia.

Contributors

John Paul Rathbone
Latin America Editor

Naomi Mapstone
Andes Correspondent

Pan Kwan Yuk
Emerging Markets Reporter

Joe Leahy
Brazil Bureau Chief

Benedict Mander
Caracas Correspondent

Stephanie Gray
Commissioning Editor

Steven Bird
Designer

Andy Mears
Picture Editor

For commercial information regarding Latin America, contact:
John Moncure on: +1 212 642 6362; email john.moncure@ft.com or **Alejandra Mejia** on: +1 212 641 2466; email alejandra.mejia@ft.com

All FT Reports are available on FT.com.
www.ft.com/reports

Train leaves the station, slowly

Guest Column
HUNTER T. CARTER

You understand a lot about the investment climate in Colombia once you get out on the road.

Bounce over Bogotá's rutted El Dorado Avenue, for years a series of construction sites that eventually led from the city to the airport. Experience the rugged and often single-lane switchbacks south of Medellín. Creep slowly for more than 100km from the Pacific cargo port of Buenaventura to Cali, a regional capital, behind container trucks struggling with washed-out roads.

It is only then that you realise fully that none of the natural resources, consumer products or manufactured goods that entice so many investors will get to market quickly without better transport infrastructure.

At the same time, however, potential infrastructure investors see more than rugged terrain when they contemplate the $100bn of improvements the government says it expects over the next 10 years.

They see bidding processes that have often been mired in bureaucratic delays, projects tied up for years in bidding challenges and planning delays. They also know about public corruption.

Investors – and Colombians generally – are understandably discouraged by scandals, one of the worst of which involved the Nule brothers, whose Grupo Nule controlled the road works on El Dorado Avenue and more than 50 other public projects in Bogotá.

The Nule brothers recently went to jail for seven years for corruption in a bribes-and-kickback scheme that also resulted in the expulsion of Samuel Moreno, Bogotá's previous mayor, his imprisonment on criminal charges, and the disappearance of more than $400m of public money.

The government has responded with two bills. The first is a public-private partnership regime that will replace a creaky public concessions bidding process. The second is an anti-corruption bill aimed at public officials in particular.

It will take more than new legislation and a handful of convictions to end cronyism, tame bureaucracies and expose corruption. But both bills could help expedite a bulging pipeline of projects.

The public-private partnerships legislation is designed to rescue a bidding process that has often been sunk in technicalities and bureaucracy. It replaces old-style concession bidding with public private partnerships and applies to all projects worth more than about $2.1m.

Hunter Carter: rules prohibit former officials from providing support services, representation or advice for two years

One of its features is that financial strength, not just construction experience, is used to rank bidders. Another is that bidders get pre-qualified. This is designed to prevent post-award litigation by disappointed contenders.

It also allows private-sector operators to make their own project proposals. These can be submitted without solicitation, and must then be evaluated for approval within 90 days. This leads to a public tender if the project requires public funds. Otherwise, there is a public posting of the proposed contract for up to six months, giving time for third parties to register their interest.

The new law comes on the heels of a big rewrite of the anti-corruption law that bans for 20 years anyone from participating in public contracts (and public private partnerships) who has been sentenced to jail "for committing offences against public administration"; or who has been "convicted of offences relating to membership, promotion and funding of illegal groups, crimes against humanity, drug trafficking in Colombia or abroad, or bribery".

In a country wrestling with the vestiges of paramilitaries and leftwing guerrillas, this provision will doubtless see a lot of action, especially since the law includes "companies in which such persons are partners, its parent and its subsidiaries, except for publicly-held corporations".

Notably, the provision does not include close family members.

It also attempts to limit corrupt influence on elected officials. Large campaign donors are prohibited from contracting with governments led by the officials they supported.

"Revolving door" rules meanwhile prohibit former public servants from providing "support services, representation or advice" for two years after leaving office, and forever on specific matters handled while in office.

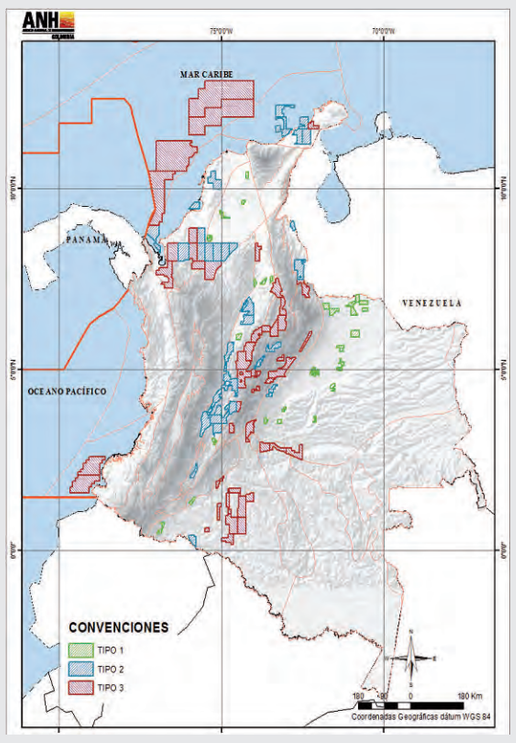
The Santos administration has spent the best part of two years designing a better framework for infrastructure works. The delay has produced frustrations. Still, last month, two road projects were successfully tendered. Colombia's infrastructure train may at last be leaving the station, even if slowly.

Hunter Carter is a partner at New York based law firm, Arent Fox, co-chairs its Colombia working group, and blogs on Colombian issues at www.colombialawbiz.com and tweets @ColombiaLawBiz

COLOMBIA:
The perfect environment for Hydrocarbons exploration and production

The **ANH**'s pleased to invite you to participate in the Road Show of the bidding process Ronda Colombia 2012 where 109 blocks will be offered for E&P and Technical Evaluation Agreements.

RONDA Colombia 2012



ROAD SHOW 2012

We are pleased to announce Ronda Colombia 2012 in Mumbai, India on May 9th.

Agenda

- General aspects, bidding process and ANH Contracts
  Orlando Cabrales Segovia, President ANH
- Technical session
  Luis Ernesto Ardila, Technical Advisor ANH

Please register at rondacolombia2012@anh.gov.co

www.rondacolombia2012.com

ANH
AGENCIA NACIONAL DE HIDROCARBUROS
COLOMBIA

Trouble in Venezuela brings benefits to its neighbour

View from Caracas

Benedict Mander finds an increasing flow of rich people crossing the border

When Juan Manuel Santos, Colombia's president, travelled to Cuba in March, it was ostensibly to visit Raúl Castro to discuss the Caribbean island's participation in the Summit of the Americas, which he was to host the following month.

But his simultaneous visit to Hugo Chávez, who was recovering from surgery in a Havana hospital after a recurrence of cancer first diagnosed in June 2011, betrayed a keen interest in the health of the Venezuelan leader, which is potentially of greater importance to neighbouring Colombia.

Although he is leading in the polls ahead of presidential elections due in October, some fear that a collapse in Mr Chávez's health might not only trigger chaos in Venezuela, it could also disturb the broader region.

Mr Santos, once a bitter enemy of Mr Chávez, recently described him as a "factor of stability" for the region.

The Venezuelan leader's critics at home see things differently. "Any president with the slightest idea about the importance of Venezuela's relations with Colombia would be a hundred times better than Chávez," says Beatriz de Majo, an opposition columnist and specialist on relations with Colombia.

The business community in Colombia seems to agree. In a typical comment, one businessman says: "Of course, there will be instability for a while [should Chávez die], but when it settles down, whatever comes will be better than Chávez."

As it is, given the dismal investment climate in Venezuela thanks to the socialist president's hostility towards the private sector and pervasive state intervention in the economy, there is a steady and increasing flow of wealthy Venezuelans to Colombia.

The 22,000-odd Venezuelans estimated to be living in Bogotá have pushed up prices at the high end of the capital's property market, as well as leaving fewer places for Colombians at its best schools. Still, there is a common refrain, "Chávez is the best president Colombia has ever had", which reflects the fact that, to a large degree, Colombians have Venezuelans to thank for the extraordinary growth of their oil sector in recent years after thousands of highly trained oil men were fired in 2003 from Venezuela's state oil company, PDVSA.

Many ended up in Colombia and are behind the success of three of the country's most prosperous oil companies, Pacific Rubiales, Alange and Vectra, which between them account for a big chunk of the almost 1m barrels a day the industry is producing, nearly double production just six years ago.

But it is not just Venezuela's oil expertise: many Venezuelan businesses are migrating to Colombia and the situation has reached such extremes that Polar, Venezuela's biggest privately owned company, now exports its food and drinks produce from the neighbouring country.

Businesses on both sides of the border received a serious blow when Mr Chávez froze diplomatic and commercial relations with Colombia after a plan by Mr Santos' predecessor, Álvaro Uribe, to allow the US to expand its military presence in Colombia in 2009. After bilateral trade peaked in 2008 at almost $7.3bn, of which more than $6bn was accounted for by Colombian exports to Venezuela, it dropped to $1.7bn in 2010.

Last year, bilateral trade recovered to $2.3bn, and Fernando Gerbasi, a former Venezuelan ambassador in Bogotá, reckons it could top $3bn this year. "But that doesn't take into account the informal cross-border trade," he says, guessing that its value could be even greater.

According to José Rozo, president of the chamber of commerce of Venezuela's border state Táchira, 10m gallons of petrol are smuggled to Colombia each month from his state alone.

There are many other goods too, such as food and medicine, whose prices are regulated by the Venezuelan government, but which can be sold for much more after they have been smuggled across the border. "If you can't find foods in government subsidised stores here, you can find them in massive quantities in Colombia," says Mr Rozo.

Nevertheless, the recovery in formal cross-border trade, albeit slow, is thanks to the conservative pragmatic attitude of Mr Santos to Venezuela's controversial leader, who he called his "new best friend" after being elected.

Mr Gerbasi explains that the Colombian leader has gained significantly after a radical change in strategy from his predecessor, Mr Uribe, who accused Mr Chávez of turning a blind eye to the presence in Venezuela of Colombian insurgents. Not only are trade relations improving, but the two countries are co-operating more effectively in their attempt to prevent narcotics trafficking.

While many are sceptical about Mr Chávez's commitment to addressing the problem of cocaine smuggling and the presence of Colombian rebels in Venezuela, María Teresa Romero, a Caracas-based analyst in international relations, says both sides have gained.

"Not much, but nor have they lost that much. It's a relationship of convenience more than of commitment or solidarity," she says.

Risks worth investment in exploration of virgin territory

Oil industry

Naomi Mapstone considers the prospects for a booming sector

Colombia, Latin America's fourth biggest oil exporter, is tantalisingly close to hitting its 1m barrel-a-day target after almost doubling production since 2006.

In spite of a rash of labour disputes and a rise in guerrilla attacks on pipelines and oil workers, production averaged 930,000 b/d up to March.

For Ronald Pantin, chief executive of Canada's Pacific Rubiales, the biggest private producer, the oil sector will continue to boom.

"Five years ago, it was very hard to sell the Colombian story because of the problems with guerrillas and drug dealers and all of that. There was a stereotype in investors' minds," he says. "Now it's totally different – people see the opportunities here and just ask, Where do I sign?"

Almost 40 per cent ($5.08bn) of all foreign direct investment last year flowed to the oil sector. Mr Pantin and a management team comprised largely of fellow Venezuelan expatriates who used to work at Venezuela's state oil company PDVSA have taken Pacific Rubiales from 14,000 b/d 250,000 b/d in five years.

Both Pacific Rubiales and Ecopetrol, the partially privatised state oil company that produces 60 per cent of total output, have been aggressive in both exploration and acquisition in pursuit of their own 1m b/d goals.

Ecopetrol aims to produce 1m b/d by 2015 and 1.3m b/d in 2020. It has blocs – mostly exploration – in Brazil, Peru and the US and it is developing a joint venture with PDVSA to drill in the ageing reserves of Lake Maracaibo in western Venezuela.

Javier Gutierrez, Ecopetrol's chief executive, said recently that Colombia's biggest company would not need to exercise its right to sell an 8.5 per cent stake in itself to finance $8.47bn of investments this year.

Meanwhile, Pacific Rubiales is shooting for 500,000 b/d in the next three years, and 1m b/d within a decade.

Mr Pantin says it has four blocs in Peru, two in Guatemala and is on the verge of announcing further acquisitions. Although focused on Latin America, it is looking as far afield as Asia and Africa.

It is also among several minority partners, including Petrominerales of Canada and Hocol of Colombia, in Ecopetrol's $4.2bn Bicentennial pipeline project, the first stage of which is due to be completed in the third quarter of this year. The 450,000 b/d pipeline will be the longest in the country, running from Casanare in the east to Coveñas port.

"If you don't have a good marriage, you won't be able to do what we have done together," Mr Pantin says of Pacific Rubiales' relationship with Ecopetrol.

"For sure, in any marriage you have problems, domestic problems, but nothing special."

The kidnapping of Chinese workers employed by Emerald Energy of the UK last year served as a reminder of the risks oil companies still face in parts of Colombia, however.

Guerrillas from the Revolutionary Armed Forces of Colombia (Farc) and the National Liberation Army (ELN) also stepped up attacks on pipelines at the start of the year, and as companies encroach on guerrilla territories such as Caquetá and Putumayo in the south near the border with Ecuador, or along the Venezuelan border to the north, the risks increase.

Mr Pantin acknowledges the risks but remains optimistic: "It's very hard to find virgin areas nowadays in the world, and in areas that are not very tough geologically. This is not the Congo. This is kind of easy.

"With all the security problems Colombia had, you couldn't be here 10 years ago. And now it's an open space for exploration."

Daniel Linsker, Latin America analyst at Control Risks, agrees that while security is still significant, it is not the biggest risk oil companies face in Colombia. "It's actually geological. While exploration has ramped up considerably, finds of a significant size have been rare, and most of the production has come from greater recovery rates in existing fields."

Mr Pantin says that improving recovery rates even further is the simplest and fastest answer to Colombia's main challenge – boosting its reserves.

At present, the country has about 2bn barrels, or 2,000 days worth of production, when 20 years, or 10bn barrels would be a more comfortable margin.

Exploration will continue to be crucial to the industry, he says, but Pacific Rubiales alone could double reserves just by adopting technology that had been in use across the border in Venezuela since the 1960s.

"We have 4.6bn barrels of oil in place, but the recovery factor is only 15 per cent. We can increase that to 50 per cent, or 2.3bn barrels," says Mr Pantin.

In the pipeline: first phase of $4.2bn Ecopetrol project is to be completed soon Bloomberg

IF YOU WERE TO INVEST IN A LATIN AMERICAN COUNTRY, WHERE WOULD YOU GO?

FIND OUT THE ANSWER AT

COLOMBIA INSIDEOUT
A CLOSER LOOK

Colombia Insideout brings together Colombian senior government officials, CEOs, CFOs and business leaders. Together they will explore the business opportunities, innovative strategies and challenges of Colombian capital markets.

CONFERENCES

NEW YORK: MAY 22ND - 2012
The Waldorf=Astoria
301 Park Avenue, NY 10022 9:00 a.m.

LONDON: MAY 25TH - 2012
London Stock Exchange
10 Paternoster Square, London EC4M 7LS 8:00 a.m.

Visit: colombiainsideout.com

Hosted By: BVC Colombia Securities Exchange

Deceval

Main sponsor: 200 YEARS citi

VIGILADO SUPERINTENDENCIA FINANCIERA DE COLOMBIA

Mining Security gains against rebels open up vast areas for prospecting

Colombia is about to fire the starting pistol in a race to develop its mineral resources after a year-long freeze on new concessions and the rearrangement of its regulatory agency.

Already the world's fourth biggest exporter of coal, the country is keen to exploit its gold and copper sectors now that security gains against the Revolutionary Armed Forces of Colombia (Farc) have freed up vast areas for exploration.

"Colombia has become a very attractive country for mining capital. It's clear," says Mauricio Cárdenas, mining minister. "There's a constant flow of companies and people coming to this office to talk about their plans. I travel very little now. Everybody's coming here."

Pent-up investor demand will finally have an outlet this month when Colombia opens the National Mining Agency, which will oversee the promotion and granting of exploration and mining concessions and regulate the industry. The move follows a lengthy review brought on by a spate of corruption and safety scandals.

More than 300 miners died in Colombia between 2010 and 2012 and Mr Cárdenas's predecessor has described the mining registry as a "catastrophe". Speculation in mining permits was rife, the former minister says, allowing the stagnation of concessions and the issuing of some permits in protected nature reserves.

Mr Cárdenas, formerly a senior fellow at the Washington-based Brookings Institution, says an "explosion" in the number of titles under the old system led to stagnation in both exploration and mining.

"We have about 9,000 titles that have been granted and, of those, only 60 per cent pay royalties. That shows there are a large number of titles that are remaining idle or that were acquired by individuals with only speculative purposes," he says. A new mining code to be put to Congress in July will contain measures to rescind clearly inactive titles, he adds.

Aside from gold, copper and coal, the government is prioritising exploration for phosphate, potassium and magnesium ores, platinum, uranium, iron and coltan. Juan Manuel Santos, the president, has set aside 2.9m hectares of land for mining.

The government is under enormous pressure to get the restructuring right at a time of surging investor interest and an increase in community and environment-based opposition to extractive projects.

The Fraser Institute 2011 mining survey, an important indicator of investment climates, saw Colombia slip down the rankings after making significant gains between 2006 and 2010. "We are very open, very friendly to foreign investment. But we also want to make sure that this engine of economic growth is sustainable, and for that it needs to be structured in a way that the population sees the benefits," Mr Cárdenas says.

Both Mr Cárdenas and Mr Santos have opposed raising mining royalties, as some lawmakers have proposed, although they are open to a debate based on facts. "We in the government are committed to stability in the rules of the game," says Mr Cárdenas.

Mining juniors are driving interest in gold, often targeting areas in which informal miners are already present. In these cases, Mr Cárdenas says, the companies will be asked to restore damaged areas before proceeding with their own operations.

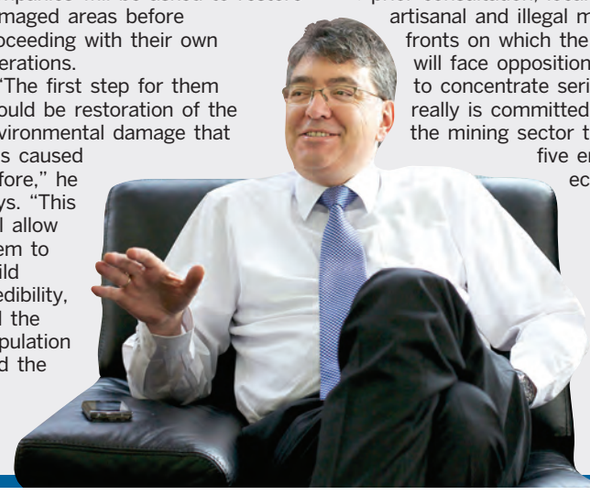
"The first step for them should be restoration of the environmental damage that was caused before," he says. "This will allow them to build credibility, tell the population and the government that they're really serious about high standards in terms of environmental and social impact."

Formalising "traditional" miners should also be a part of investors' plans, he says. About a third of gold production comes out of the informal sector, Mr Cárdenas says, but he draws a distinction between "traditionals" and criminal groups, such as the Farc, which pose serious security risks. The new mining code would introduce greater technical aid to "traditional" miners and shore up the powers of the security forces to destroy equipment used by criminal groups.

Daniel Linsker, Latin American analyst at consultant Control Risks, says the test for the mining agency and the regulatory code will be in the field, "far from the words and actions of a national government not too keen on antagonising both activists and local politicians in defence of mining".

"Debates over the new mining code and the creation of a new national mining agency are just the opening salvos in a battle to decide whether Colombia turns into a mining country or it remains a country with mining," he says. "The battle will certainly be long as the stakes are very high: royalties…Environmental and community issues, social unrest and prior consultation, local politics – and artisanal and illegal mining – are all fronts on which the government will face opposition and will have to concentrate serious energy if it really is committed to developing the mining sector to be one of the five engines of economic growth."

Naomi Mapstone



Mauricio Cárdenas, mines minister