The Rebirth of the Colombian Oil Industry

Andrew Tye
Lehigh University

Follow this and additional works at: https://preserve.lehigh.edu/perspectives-v31

Recommended Citation
https://preserve.lehigh.edu/perspectives-v31/6

This Article is brought to you for free and open access by the Perspectives on Business and Economics at Lehigh Preserve. It has been accepted for inclusion in Volume 31 - Colombia: From Crisis to Renewal (2013) by an authorized administrator of Lehigh Preserve. For more information, please contact preserve@lehigh.edu.
Introduction

The origin of the Colombian oil industry dates back to 1905, when the first concession contract was granted to Roberto De Mares. At the time, the Colombian government had no experience regulating oil production and implemented the concession contract system that was already established in oil-rich nations, like Iran and Russia. This contract system allowed the holder of the concession the freedom to extract underground hydrocarbons, such as oil, from a designated plot of land in exchange for royalty payments to the government. Political and economic conditions later led to the implementation of the association contract system in 1974 and the ensuing establishment of Ecopetrol as the national oil company. The new association contract system mandated that all oil speculators finance the cost of upfront exploration and were legally obligated to share profits with Ecopetrol, now representing the government.

However, by 2003, the Colombian oil industry was on the verge of collapse. Foreign companies were not interested in partnering with a national oil company if they undertook all the risk yet still had to share profits. Furthermore, rising public debt and increasing guerrilla attacks created an extremely unstable investment climate in Colombia. The result was a flight of foreign direct investment that provided the impetus for a dramatic drop in production. Colombian oil output fell to 541,000 barrels per day (bpd) in 2003 after producing well over 800,000 bpd just four years earlier (Echeverry et al., p. 5).

Today, oil accounts for over 50 percent of Colombia’s exports (“Colombia’s New Oil . . .”) and is pushing Colombia to become a legitimate supplier in the world economy. This article provides an analysis of Colombian oil policy under the concession contract system (1905–1974) and the association contract system (1974–2003), with an emphasis on the modern exploration and production contract (E&P)
(2003–present) that is driving the Colombian oil resurgence. It is most useful to assess policy implications through the lens of three entities: the Colombian oil sector, Ecopetrol, and the Colombian government.

1905–1974: Concession Contracts

Pre-1951

Rooted deep in the history of Colombia is the concept of subsoil ownership, a residual effect of Spanish colonial rule (Bell, p. 133). Defined more clearly in Article 332 of Colombia’s current constitution, the state owns the rights to all subsoil and its economic benefits (Colombian Constitution). This gave the Colombian government the ability to grant exclusive production rights for a given parcel of land in exchange for royalties based on the oil extracted beneath the land—a concept that both defined and justified the original concession contracts in the early twentieth century. Royalties on these contracts ranged from 6 to 15 percent, and the contract length could range anywhere from 23 to 50 years, after which the concession, land, and all other assets relating to the concession revert back to the government (Segovia, p. 3).

Prior to 1951, two concession contracts granted in 1905 shaped the industry: the De Mares concession and the Barco concession. Together, they accounted for all hydrocarbon production from 1921 to 1941 (Santiago, p. 22). However, both faced significant resistance from the government after initially receiving the contract. Colonel De Mares sought to sell his concession to the Tropical Oil Company in 1919 as the concession appreciated significantly in value almost 15 years after De Mares originally purchased it from the government. Prior to approving the sale to Tropical Oil, the government mandated that the concession land be reduced by 80 percent, royalties be paid at 10 percent of gross oil rather than 15 percent of refined oil, and an oil refinery constructed at Barrancabermeja (Durán). The Barco concession was taken away in 1926 for “noncompliance,” nine years after being purchased by Gulf Oil, as oil production had yet to begin and the government could not collect royalties on a nonproducing well (Durán). The concession was eventually reauthorized in 1931 but only if Gulf agreed to pay a 6 percent royalty to the government and build a 263-mile pipeline to the northern coast port of Coveñas (Durán).

The exorbitant demands levied on both concessions highlight an important catalyst of early oil policy: the advancement of political objectives over oil industry growth. Colonel De Mares’ attempted partnership with Tropical Oil (an American company) came at a time when the Colombian government was still furious with the United States for its role in the secession of Panama (1903) and ensuing canal construction (1914). Colombians wanted to ensure the United States could not take advantage of them again, as evidenced by the government’s resistance to partnerships with American companies sought by the De Mares and Barco concession owners. The seizure and subsequent reauthorization of the Barco concession in 1926 was a way for the government to assert its presence on fields already in production. Furthermore, the mandated construction of both the Coveñas pipeline and Barrancabermeja refinery created assets the government would need to operate the oil production process when the concessions expired and reverted back to the government.

Despite the strained relationship between the government and the oil sector, the industry continued to grow. Shortly after purchasing the De Mares concession, Tropical Oil discovered the Infantas-La Circa field. Production increased from 1 million barrels per year in 1925 to 20 million barrels per year in 1928 (Durán); and by 1949, the De Mares concession (now owned by Tropical Oil) achieved production in 1,297 out of 1,373 wells drilled, or approximately 77 percent of the total country’s oil production at that time. As the 30-year reversion date of the De Mares concession neared, the Colombian government needed an organization to take over the expiring concession. On January 9, 1951 (Bell, p. 116), Ecopetrol was born to foster a smooth transition.

1951–1974

The creation of Ecopetrol came at a delicate time for both the oil sector and Colombia. Just three years earlier, the country entered a bloody civil war—La Violencia—that drove away foreign direct investment as soon as the
military junta took power beginning in 1957. Afraid of increasing social unrest, the government mandated that Ecopetrol subsidize fuel price increases created through exchange rate fluctuations and exploited Ecopetrol’s position as a government organization to freely use its profits. Within the oil sector, Ecopetrol’s identity crisis intensified. From 1951 to 1955, the role of Ecopetrol was primarily administrative and regulatory, as it served to oversee current concession contracts and to take over expiring concessions.

After the reversion of the first contracts, Ecopetrol began to expand its role in the oil sector. Initially, Ecopetrol generated profits through royalty collections and the operation of generally less profitable downstream activities like refining and distilling. The company operated three key refineries: the Barrancabermeja refinery; the Reficar refinery (the only northern refinery, in Cartagena); and the Orito refinery, which it established in 1972 (Argáez and Parra). Over time, foreign companies often consulted Ecopetrol for technical advice and in exchange provided Ecopetrol the option to partner in production. By 1974, however, Ecopetrol wanted more than just the option to enter into production contracts.

Oil exports had fallen from 15 percent in 1966 to zero percent in 1973 (García and Llamas, p. 18), as oil production could not keep pace with the rate at which the country was depleting its reserves. Colombia’s precarious position as an oil importer coincided with the 1973 oil shock that sent oil prices skyrocketing. Ecopetrol’s commitment to subsidize the price of oil in Colombia after La Violencia became incredibly expensive. The year 1974 also marked the end of the National Front government that had been in place since the end of La Violencia in 1957. The new government aimed to increase domestic oil production to make Colombia a net oil exporter, in turn increasing royalties and reducing Ecopetrol’s losses from oil price subsidies.


The political and economic situation in 1974 gave the Colombian government tremendous leverage in establishing Ecopetrol as the national oil company. In addition to collecting royalties, Ecopetrol retained exclusive oil exploration and exploitation rights in Colombia (Echeverry et al., p. 3), forcing international companies to form a joint venture with Ecopetrol.

Under the terms of the association contract system, from 1974 to 1989, a contract contained two phases: exploration and exploitation. The first phase lasted six years, and 100 percent of the costs of exploration were paid for by the foreign company interested in Colombian oil. If a commercial discovery was made, the company paid 20 percent in royalties to Ecopetrol based on oil produced. At the point of commercial discovery—initiating the exploitation phase—Ecopetrol would also assume 50 percent of the well production and 50 percent of further investments made in the well for an additional period of 22 years. Ecopetrol would not take part in production until 50 percent of the exploration costs had been covered (Echeverry, p. 5).

The terms of the new contract were undoubtedly less favorable for foreign speculators who now bore all of the exploration risk while essentially splitting their profits with Ecopetrol. By 1980, production fell to 131,000 bpd under the association contract system compared to 226,000 bpd in 1970 under the former concession contract system (Echeverry et al., p. 7). The discovery of 1,100 million barrels of oil in the Caño Limón field in 1983 by Occidental (Argáez and Parra) not only doubled Colombia’s proved reserves but also created false hope oil could still be profitable under the new contract terms. It is not a coincidence that the average number of association contracts per year increased from 9, from 1970 to 1982, to 21, from 1983 to 1989—beginning in the year Caño Limón was discovered (Echeverry et al., p. 15).

As foreign interest increased after the Caño Limón discovery, Ecopetrol again sought to change the terms of the association contract. The Colombian constitution signed in 1991 mandated greater royalty payments to local regions from which oil was being extracted. Furthermore, depressed oil prices throughout the 1980s made these payments more difficult and prevented the oil industry from taking advantage of foreign interest in Colombian oil.

The original association contract failed to take into account the size of the oil well—
Ecopetrol would assume 50 percent of production at the point of commercial discovery regardless of how much future oil the well produced. This meant that Ecopetrol effectively operated half of the well, with the other half operated by the multinational oil company. The new Minister of Mines and Energy—Margarita Mena de Quevedo—introduced the sliding scale by which Ecopetrol’s production stake increased 5 percentage points for every 30 thousand barrels of oil above 60 thousand per contract beginning in 1990. For smaller wells that produced less than 60 million barrels, the new sliding scale had no effect. However, Ecopetrol would now control 55 percent of production for wells producing 60 to 90 thousand barrels of oil. The sliding scale increased up to 70 percent for contracts with greater than 150 thousand barrels of production (Echeverry et al., p. 9). This is known as a Type B contract.

The signing of the present-day Colombian constitution in 1991 marked the beginning of a production boom for the oil industry. Wells at Caño Limón (1986) and British Petroleum–operated Cusiana (1992) helped propel Colombian production to a high of 838,000 bpd in 1999 and increased reserves to 1,359 million barrels in 1998 (Segovia, pp. 8–9). The association contract terms were changed to reflect the spike in production. Ecopetrol still sought to joint venture with foreign firms under the sliding scale concept, but Ecopetrol’s percent participation would now be determined by the well’s profitability taking into account total investment and current oil prices. Under the new Type C contract, profitability would be determined using an “R-factor.” The R-factor is computed using a formula that considers inputs, such as accumulated investment, total revenues, exploration costs, and costs refunded by the government, once commercial discovery had been established (Argáez and Parra). For the greater part of the 1990s, it appeared that the oil sector was booming.

The Oil Landscape Preceding 2003 and Impetus for Change

By the year 2003, oil production had fallen to 541,000 bpd from 687,000 bpd just three years earlier (UN Comtrade). How could the industry reach a historical production high in 1999 and call for change just four years later? History suggests that the fall in production could be explained by the introduction of the Type D contract in 2000. Under this contract, for the first time the new contract terms were actually more favorable for foreign companies. Royalties were no longer fixed at 20 percent; instead, they increased on a straight-line basis beginning at 5 percent based on production (Rojas, p. 259). Contract terms were extended to 30 years and the R-factor determined on a field-by-field basis instead of on a per-contract basis, which was previously used. All of this made smaller wells more profitable than ever. Moreover, Ecopetrol’s stake in each contract was reduced to 30 percent for most wells (Rojas, p. 266).

Three factors were particularly detrimental to Colombian oil production during this period: government liabilities, Colombian paramilitary attacks, and oil profitability. The signing of the constitution in 1991 created new liabilities for the government. Government pensions were now the responsibility of the central government and not local institutions as was previously commonplace. Education and healthcare initiatives were also subsidized, all of which increased the public debt to 35 percent of GDP in 1998 (World Bank).

The debt problem was compounded by irresponsible spending of rising oil royalties. The Colombian government deficit was at its highest at any point during the twentieth century in 2000, despite oil taxes and royalties paid to the government of $1.4 billion in the same year. This marked a substantial increase from 1995 in which oil sector revenues were just $747 million (Tordo et al., p. 6). The government simply had access to finances unlike ever before. This deficit had a direct impact on oil: How could the Colombian government afford to finance its postdiscovery oil field participation (30 percent) when it could not currently satisfy its current debt obligation for defense and social programs?

The paramilitary groups, Fuerzas Armadas Revolucionarias de Colombia (FARC) (Revolutionary Armed Forces of Colombia) and Ejército de Liberación Nacional (National Liberation Army), used their control of the isolated geography of Colombia to extort money from the oil companies by kidnapping employees and bombing the pipelines. The cost of these attacks,
including construction and the opportunity cost of lost oil transport, is estimated at $141.2 million (Pearce, p. 10).

After the terrorist attacks of September 11, 2001, the price of one barrel of oil plummeted below $20 and had only recovered to $30 by 2003, cutting into the profit margin on each barrel. The density of oil is measured by the American Petroleum Institute (API) based on its density relative to water. An API below 10 classifies the heaviest crude and indicates that the oil is denser than water. Oil with an API greater than 10 is considered light and floats on top of oil. Higher-density oil is thicker, significantly more expensive to extract, and less valuable to refineries. Most of Colombian oil has an API between 22.3 and 31.1 and is classified as medium oil. Although more profitable than heavy crude, it is not as profitable as the light crude abundant in Iraq and Iran. If the market price of oil falls far enough, the high cost to extract heavy oil makes its extraction simply not profitable for oil companies. Decreasing margins driven by depressed oil prices are another reason why foreign direct investment in Colombian oil fell to $300 million in 2003 (World Bank).

By 2003, it was clear a change was needed; the increased risk of investing in Colombian oil that came as a result of political instability and highly levered government debt was simply not worth the return. More importantly, it became clear that the government fiscal crisis was spilling into an oil industry that was competing for funds from the national budget. Ecopetrol was created purely as a regulator but, as a national oil company, it also became financially liable for the national deficit. Furthermore, through 2007 Ecopetrol had lost an estimated $10 billion annually by providing fuel price subsidies to consumers in Colombia (World Bank). This relationship further diminished investor confidence—there were seven exploration contracts signed in 2002 compared to 28 in 2001 and 32 in 2000 (Echeverry et al., p. 15).

The Modern Colombian Oil Era: Exploration and Production Contracts

Decree 1760 of 2003 marked the beginning of the new Colombian oil sector as it operates today, effectively denationalizing the entire industry. The decree created an oil industry regulator, the Agencia Nacional De Hidrocarburos (ANH) (National Agency of Hydrocarbons), and split off Ecopetrol into an independent entity whose majority owner is the Colombian government.

Since 2003, oil speculators can own two contracts: a technical evaluation contract (TEA) and a modern concession contract (E&P). The TEA lasts 18 months for onshore contracts and 24 months for offshore contracts (Cuervo, p. 5). During this phase, oil companies survey a block of land for geological properties and drill exploratory wells to determine oil and economic potential. The TEA can be converted into an E&P contract at any time. E&P contracts are granted through an open bidding process, although it is not uncommon for firms to negotiate directly with the state. The initial exploration phase of an E&P contract is six years followed by a flexible two-year evaluation period in which economic feasibility can be determined. For heavy oils with an API gravity below 15, the evaluation period can be extended an additional two years (“Working in Colombia”). Declaration of commercial discovery at any point during the initial exploration or evaluation phase is followed by a 24-year production phase. Each contract contains clauses that allow the ANH to revoke the contract if the land is not actively being explored or extracted to ensure maximum productivity.

The Colombian government, now fully independent of Ecopetrol, uses three methods to maintain financial interest in each contract signed: royalties, income tax payments, and payments to the ANH. Royalty payments are based on a sliding scale, beginning at 8 percent for production up to 5,000 bpd and increasing to a maximum of 25 percent up to 600,000 bpd (Echeverry et al., p. 9) per field. Most fields in Colombia today have a production capacity range of 55,000 to 75,000 bpd and pay associated royalty rates between 12 and 15 percent (“Ecopetrol Investor Presentation . . .”). To address the problem of expensive heavy oil, hydrocarbons with an API below 15 are only subject to 75 percent of the aforementioned royalty payments (Martínez). Income is subject to the statewide income tax rate paid by all corporations operating in Colombia. This fixed statutory rate is 33 percent except
in years when little or no taxable income is earned, in which case tax liability is determined as 33 percent of 3 percent of the company’s prior year net tax equity.

The ANH auctions predetermine onshore and offshore blocks of territory in several rounds throughout the calendar year. Oil companies bid on these blocks by offering percentage holdings in production to the ANH. In 2010, bids were received for percentages between 1 and 32 percent ("Las Regalías . . ."). Every 1 percent contributed to the ANH must be matched with a 0.7 to 1.1 percent contribution to the state, further increasing the state take. Using these three mechanisms, the Colombian government is able to maintain anywhere from a 40 to 64 percent interest in each modern concession contract signed ("Las Regalías . . ."). For contracts exclusively signed with Ecopetrol, special provisions allow the state take to reach 95 percent ("Las Regalías . . ."). Although these terms seem unfavorable to prospective oil speculators, until 1999 these same companies were still paying 20 percent royalties, conceding 50 percent of production to the state, and paying all exploration costs.

Under the modern E&P contract, oil companies own 100 percent of the reserves beneath contracted land. Although these companies pay taxes and royalties, Ecopetrol no longer has any equity interest in the post-commercial discovery production of these fields for contracts signed after 2003 ("Working in Colombia"). All contracts signed before the decree will be honored until the contract expires unless the contract included a provision for extension. Due to the leverage of Ecopetrol under pre-2003 contract terms, most field resources revert back to Ecopetrol upon expiration of the contract. For this reason there is little incentive for Ecopetrol to extend any pre-existing contracts.


Given the lagged relationship between oil investment and production, the successes and failures of the 2003 privatization of the Colombian oil sector can be assessed from the following perspectives: the oil sector, Ecopetrol, and the Colombian government.

The Oil Sector

In retrospect, the 2003 legislative change was a significant turning point for the oil industry in Colombia. At present, the 541,000 bpd in 2003 in oil production seems paltry compared to the 1.1 million bpd produced by the country in April of 2013 ("Colombia Exceeds . . ."). This April 2013 bpd figure represents the highest monthly total in history. By opening the oil sector to essentially free competition, Colombia was able to effectively attract foreign oil companies who refused to participate in the previously unfavorable investment climate. Booming foreign direct investment in the oil and gas sector is one of the biggest reasons for this improvement. Foreign direct investment increased to $2.8 billion in 2010 up from $300 million in 2003 ("Ecopetrol Investor Presentation," p. 10). This influx in capital has directly increased the land area under exploration from 12.5 million hectares in 2003 to 102.0 million hectares in 2011 (Segovia). Improved oil recovery technology has also increased sector production: 11 percent of total production came from secondary recovery in 2011 ("Ecopetrol Investor Presentation," p. 20). From a production and investment standpoint, the 2003 legislative change was a major success.

The renewed success of the oil sector in Colombia has also prompted transportation infrastructure expansion. The most significant of these investments is the Bicentennial Pipeline, jointly owned by Ecopetrol and Pacific Rubiales ("Colombia’s New Oil . . ."). The 150-mile pipeline—with a capacity of 120,000 bpd—will transport oil from the Llanos Basin in northeast Colombia. The Bicentennial Pipeline will then connect to the Caño Limón pipeline for transport to the shipping hub of Coveñas. Declining production in the Caño Limón field has depressed transport of oil in the pipeline to 70,000 bpd, well below its capacity of 220,000 bpd ("Colombia’s New Oil . . ."). By increasing transport capacity, the oil sector will be able to reduce supply chain constraints.

Although the 2003 regulation successfully infused necessary capital to grow oil sector investment and production, the oil sector remains hostage to paramilitary violence. Most recently, attacks on oil pipelines increased to 84 in 2011 up from 31 in 2010 (United States
Ecopetrol

Although the 2003 legislation severed Ecopetrol’s government ties as chief regulator of the oil industry, Ecopetrol struggled financially because it remained 100 percent owned by the struggling Colombian government. Ecopetrol had to compete with other government programs for limited resources, and its ability to issue debt remained capped by a government already deeply in debt (Tordo et al., p. 6). Although Ecopetrol could in theory make independent investment decisions, it was still restrained by Colombian government debt that was 55 percent of GDP in 2003 (World Bank). Law 1118 signed in 2006 authorized the sale of a 20 percent equity ownership of Ecopetrol through an initial public offering (IPO) that took place in September 2007 (Walsh), with the other 80 percent remaining under state ownership. The IPO raised $2.8 billion and for the first time allowed Ecopetrol to “define its own investments and release itself from fiscal accounts and the system of State” (Benavides). By selling stock first to the Colombian people, the government empowered the people to take ownership of oil production in the country. The government also wanted to encourage the Colombian people to support Ecopetrol because today most Colombians are customers, employees, or shareholders. Today, Ecopetrol trades on stock exchanges in Colombia (Bolsa de Valores de Colombia [BVC]), the United States (New York Stock Exchange [NYSE]), Peru (Bolsa de Valores de Lima [BVL]), and Canada (Toronto Stock Exchange [TSX]). As of April 30, 2013, Ecopetrol’s market capitalization of $98.25 billion makes it one of the 50 largest oil companies in the world and the fourth largest oil company in Latin America. Only 9.9 percent of the authorized 20.1 percent ownership stake has been issued (“Ecopetrol Investor Presentation”), providing an opportunity for further expansion of capital through stock sales. To put this into perspective, Ecopetrol’s market capitalization briefly passed Brazilian oil conglomerate Petrobras in May 2012 (Crooks et al.).

Today Ecopetrol appears to have gained the most since the introduction of the E&P contract in 2003. Capital obtained through refinancing (discussed previously) allowed Ecopetrol to increase capital expenditures from $617 million in 2004 to $3 billion in 2008 after the stock sale (Tordo et al., p. 6). This increasing trend has continued to the present day: Ecopetrol estimates capital expenditures to be $8.5 billion in 2011, a 386 percent increase since 2007 (“Ecopetrol Investor Presentation”). These investments have increased the company’s direct market share of exploration lands in Colombia to 40 percent as of September 2011 and have allowed Ecopetrol to sign E&P contracts in the United States, Peru, and Brazil (“Ecopetrol Investor Presentation”).

This financial flexibility has also dramatically increased production capacity for Ecopetrol. Ecopetrol has retained close to 80 percent of total oil production, primarily through preexisting association contracts (Segovia, p. 5). In August of 2012, only 113,000 bpd of 918,000 bpd produced by the country (12.3 percent) came from contracts signed after 2003. This figure will surely decline as the old association contracts expire, yet it remains a testament to the market presence of Ecopetrol.

Another area where Ecopetrol has benefited is in refining. Ecopetrol currently owns 100 percent of the 290,850 bpd in refining capacity spread across five refineries throughout Colombia (United States Energy Information Administration). In April 2012, Ecopetrol invested $3.8 billion to increase capacity at its Cartagena refinery from 80,000 bpd to 220,000 bpd. Ecopetrol also hopes to increase capacity at the Barrancabermeja refinery to 300,000 bpd. In total, refining capacity will increase by 215,000 bpd as a result of these improvements (United States Energy Information Administration). While refining is a downstream oil activity considered by many the least profitable segment of the supply chain, Ecopetrol stands to profit from its current monopoly on refining.

The Colombian Government

Finally, the Colombian government benefited from the 2003 restructuring from a fiscal
policy perspective. Royalties collected by the government from the oil and mining industry increased 70 percent from 2006 to 2011 (Embassy of Colombia). As an 80 percent majority shareholder, the government also stands to profit from its ownership of Ecopetrol while keeping national financial independence. This influx of revenue has allowed the government to revise the distribution of royalties to local governments. In addition to providing subsidies to all regions—oil producing or not—the central government hopes to reduce local corruption by replacing paramilitary bribes with legitimate government financing. In 2005, Congress approved Law 963—better known as the Stability Law—which honors the terms of a foreign investment contract regardless of subsequent legislation passed. This law, in conjunction with the creation of the ANH, has dramatically increased investor confidence. The ANH is currently auctioning off 109 blocks for E&P, the most in history.

The Future of the Colombian Oil Industry and the Economy

Just 10 years ago, the oil sector in Colombia was on the brink of collapse. That production has doubled since then is a testament to the success of the 2003 legislation. As the sector pushes beyond the 1,000,000 bpd production goal, it is important to highlight the opportunities and threats facing the industry, beginning with the neutralization of the FARC.

The Colombian government has tried to appease FARC demands for decades in hopes of a peace agreement, yet oil pipeline attacks persist. Two attacks in February 2013 prevented the transportation of more than 100,000 barrels of oil and reasserted the FARC’s presence in the country (“Colombia Oil Pipeline . . .”). Ecopetrol’s net income for 2012 fell 4.4 percent from 2011—a loss that CEO Javier Gutiérrez attributed to rising operational costs from infrastructure repair and depressed oil prices (“Colombia’s Oil Company . . .”). The instability created by the FARC is a major reason why Colombia lost its investment grade status from Moody’s for 11 years before it was upgraded in 2011 to Baa3. Despite the upgrade, Colombia’s rating is the lowest investment grade rating and increases the cost of debt for both the Colombian government and Colombian oil companies relative to countries with higher credit ratings.

The Asian market provides an intriguing opportunity for Colombian oil. On May 9, 2012, Colombian President Juan Manuel Santos reached an agreement with the state-operated China Development Bank that would create an $8 billion oil pipeline that runs to Colombia’s Pacific coast from the Llanos Basin (Hall). Although most experts anticipate the pipeline will not be completed until 2016 at the earliest, the pipeline is the first step toward increasing Asian exports. Approximately 60 percent of Colombia’s oil exports were sent to the United States Gulf Coast compared to only 27 percent that were sent to the Far East in the first half of 2011 (Walsh). The proposed pipeline will transport both Venezuelan and Colombian oil—an ancillary benefit to two historically incompatible nations. For Colombia the math is simple: China imported 5.69 million bpd of oil in the first quarter of 2012 and only 56,000 bpd came from Colombia (Hall), which achieved just under one million bpd of production in the same period.

Despite the tremendous growth of the oil sector, any country that becomes too heavily reliant on a single export becomes subject to Dutch disease. Named after the economic crisis in the Netherlands in the 1960s, Dutch disease occurs when a single commodity, or a heavy inflow of foreign direct investment, drives a significant percentage of the economy. Tremendous inflow of foreign capital in one sector of the economy increases the value of the local currency. A spike in currency valuation weighs heavily on other areas of the economy that are not experiencing the same rapid growth and makes other local goods relatively more expensive for foreign countries to purchase, symptoms already seen in Colombia. In 2005, petroleum accounted for only 37 percent of total Colombian exports—a figure that has since surged to 62 percent in 2012 (UN Comtrade). Furthermore, the Colombian peso appreciated in value by 9 percent against the U.S. dollar year to date in March 2012 (Montealegre). This currency appreciation is a direct result of disproportionately large oil exports and a tremendous influx of foreign direct investment in extractive industries.
that approximated $15 billion in 2012 (Dolan), or 85 percent of total foreign direct investment. The dominance of oil in the Colombian economy has already infected other sectors. Coffee and banana exports are at historically low levels. Colombian economist Carlos Gustavo Cano estimates that “the value of goods [from] mining and energy contribute[s] more than four-fifths of exports . . . though only generat[ing] 200,000 direct jobs” (“Cano: . . . ”). As the peso continues to appreciate, wealth is distributed only to a small percentage of Colombians while the cost of living rises significantly for the rest of the country. Resolving this issue could prove even more difficult. Although monetary policy can help devalue the Colombian peso, thereby appeasing local exporters in other industries, devaluing the currency will also raise prices in all areas for Colombian consumers.

Conclusion

Twentieth-century oil policy in Colombia largely resembled a sinking ship. As the government vainly tried to introduce new contracts to plug the proverbial leak, new problems arose. It was not until 2003 that policy makers finally realized that they needed a new ship—the denationalization of the oil industry. The oil industry has since benefited tremendously from an influx of foreign capital and a capitalist business environment. Ecopetrol was finally freed from government debt and was well positioned to dominate the new market. The Colombian government stands to benefit as the majority owner of Ecopetrol and can now divert resources once meant for oil to other government initiatives. Having learned from its mistakes, the Colombian oil sector must take advantage of its current position to become a legitimate player in the global oil economy.
REFERENCES


Colombian Constitution. Article 332.


