Box 1
PROFITS OF FOREIGN COMPANIES IN COLOMBIA: SECTOR MOMENTUM AND PROSPECTS

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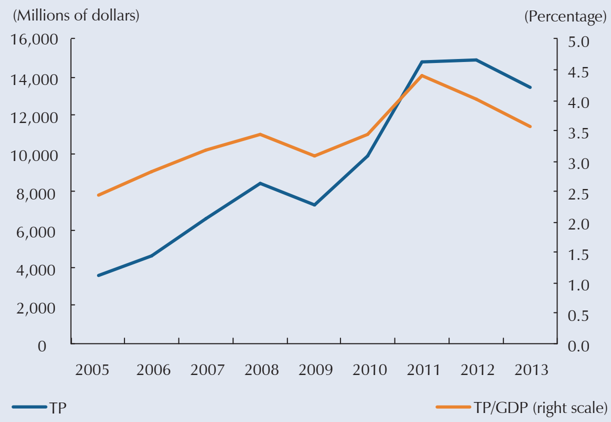
1. Profits and Current Account Deficit

In recent years, the country has supplemented its shortage of savings with different sources of external funding, with foreign direct investment (FDI) being one of the most important. Capital flows of this type are characterized by greater stability and by the potential benefits FDI can generate for the economy, such as technology transfer, capital formation and chaining between sectors, among others.

Funding through FDI and good performance by the sectors that capture these resources have been related to increased profits for companies with foreign capital. This indicator rose significantly in the last ten years, from US$4,590 m (2.82% of GDP) in 2006 to US$ 13,432 m (3.56% of GDP) in 2013 (Graph B1.1). Accordingly, this sector increased its share of external outflows and has been a source of important pressure on the current deficit (Graph B1.2).

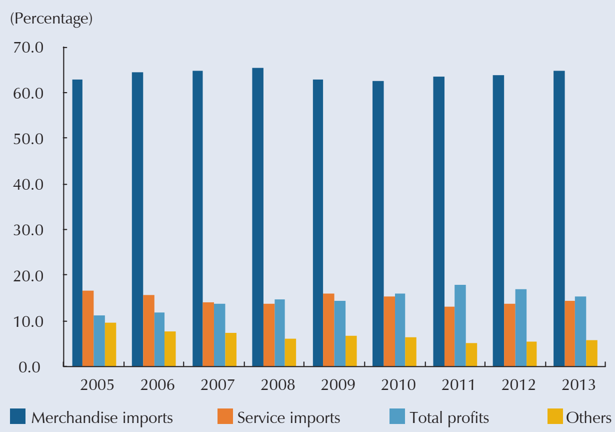
This phenomenon is not exclusive to Colombia and has been observed in other countries in the region. The Economic Commission for Latin America and the Caribbean (ECLAC, 2013)[1] says the profits of firms in Latin America and the Caribbean with foreign capital quintupled between 2002 and 2011, due to an increase in the supply of FDI and its added profitability. According to the same report, the latter was associated with higher international prices for commodities and economic growth in the region's major economies, facts that favored firms with foreign capital investment that are dedicated to the extraction and export of natural resources, as well as firms focused on the sale of goods and services to the domestic market.

Graph R1.1
Total Profits



Source: Banco de la República

Graph R1.2
Composition of Current Account Outlays in the Balance of Payments



Source: Banco de la República

2. Sector Development

The growth in earnings reported by foreign firms in Colombia has been bolstered by the financial results of oil and mining companies, followed by those involved in transport and communications, industry, public utilities and commerce. The profitability of tapping natural resources has been favored by the sharp rise in international prices for these commodities and the amounts being produced. Indeed, between 2005 and 2013, export prices for oil and coal increased 101% and 84%, respectively (Graph B1.3). In the other sectors mentio-

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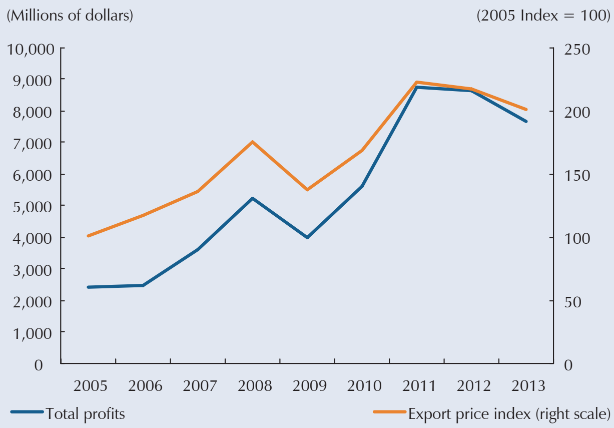
1 Cepal (2013), "La inversión extranjera directa en América Latina y el Caribe, 2012", informe anual.

Graph R1.3
Total Profits and Export Prices in the Mining and Petroleum Sectors



Source: Banco de la República

ned, there has been a consolidation of foreign investors, who have benefited particularly from the growth in domestic demand.

The profitability implicit[2] in mining and oil extraction has been close to 16% in the last four years. This is above the average for the other sectors (10%). ECLAC (2013) says that foreign investment in the extraction of raw materials has obtained a return of more than 10% in some countries, such as Bolivia, Chile, Colombia, Peru and the Dominican Republic, as opposed to an average yield of 7.8% for the region as a whole.

Profits from the mining and oil sectors have a different impact on the current account deficit than those from other activities. In the first case, income and, therefore, profits originate mostly with exports, mitigating the impact on the current account. In turn, the other sectors (commerce, public utilities, financial services, communications and a portion of industry) are engaged mainly in the domestic market and do not register a significant amount of foreign income to cushion the profits reported in the balance of payments.

Finally, it is important to point out that some of the total profits recorded as outlays in the current account are reinvested in the country as a component of FDI. Sectors other than mining and oil use a higher proportion of their earnings (three quarters, equivalent to US$3,200 m) to finance their domestic operations. Of the total earnings reinvested in the country, 73% is attributed specifically to the manufacturing industry, transportation and communications, public utilities, and financial services.

3. Prospects

Considering the international price outlook for mining and energy products, these markets would be experiencing the end of the cycle of high prices observed in recent years, which favored the arrival of FDI in the Colombian case. With a likely reduction in international prices for products such as oil and coal, it is estimated that FDI flows to these sectors could decline. This, in turn, would imply less factor income associated with these investments; it would also be related to a drop in foreign income derived from these exports which, in net, could mean additional pressure on the current account deficit.

The increase in FDI for other sectors poses an additional challenge to the deficit in the medium and long term. The arrival of resources in sectors other than mining, such as transportation, the financial sector, commerce and telecommunications, which relay largely on the domestic market, could mean a future increase in current spending if the growing momentum in domestic demand continues, since these sectors contribute the least to the direct generation of foreign exchange that mitigates the effect of remittance of profits. In this respect, large-scale infrastructure and telecommunications projects, as well as the current boost from strong domestic demand, will continue to enhance the relative importance of these sectors, which could result in an increased outflow of resources through the remittance of dividends and profits.

An international environment favorable to investment in emerging countries also meant an important increase in FDI in Colombia, not only through added equity investments, but also via the momentum in reinvestment of profits, bolstered by low rates in international markets and uncertainty in the advanced economies. This situation could be reversed by prospects for a recovery in international markets and normalization of monetary policy in the United States, reducing capital flows to the emerging countries and, in this sense, slowing the growth in returns on foreign capital.

Finally, although FDI in Colombia has grown, the extent of the build-up in assets by Colombians abroad has improved as well. This is important to note and could offset part of the pressure on the current account through income from profits on these investments in the years ahead.

2 This is the ratio between the outflows generated by the profits that are registered in the balance of payments and the capital stock of each sector that comprises the international investment position (IIP) under the concept of foreign direct investment (FDI).