Jones Lang LaSalle

Real value in a changing world

Perspectives on Global Supply Chains

Q2 2013

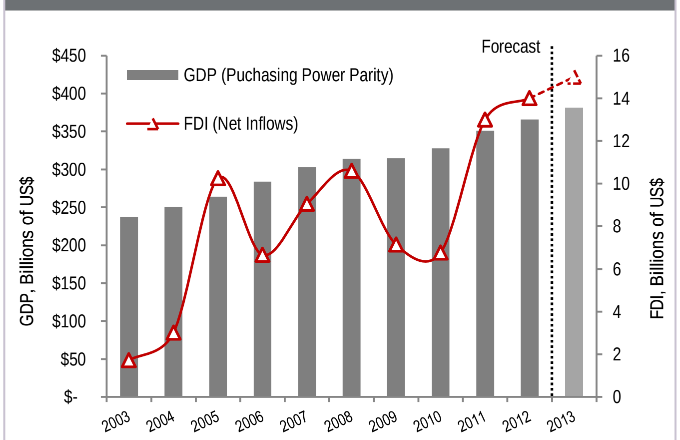
Could Colombia's Free Trade Regime Benefit your Supply Chain?

Introduction

After decades of high investment risk owing to widespread corruption and security issues, Colombia is embarking on a new chapter characterized by a diversified, technology-driven economy, a stable currency, improved security, and a growing middle class. Years of fiscal prudence and economic liberalization have been rewarded with never before seen levels of foreign investment and upgraded risk profiles from ratings agencies. Across the globe, businesses are beginning to take note of Colombia's growth story and are making plans for expansion to access its consumer market and labor pool at a time when the global economy is ripe with stagnation and uncertainty in many other places.

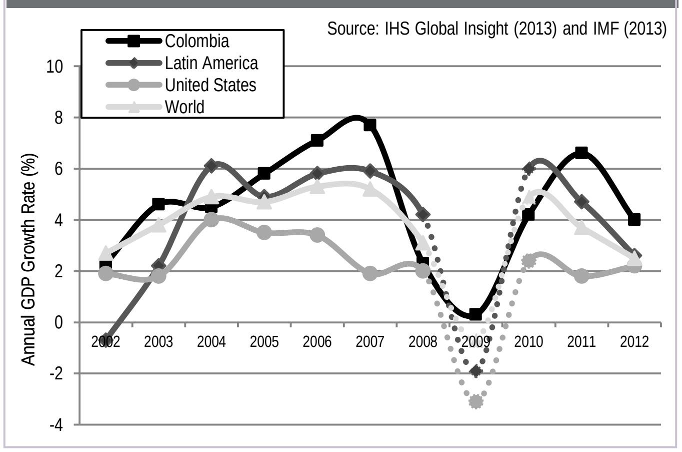
The national government has made supporting business growth a priority, recognizing the unique opportunity for Colombia to take advantage of these favorable conditions. As part of this initiative, they have passed laws encouraging the proliferation of Free Trade Agreements (FTAs) and Free Trade Zones (FTZs). FTAs are trade agreements between nations that eliminate tariffs and quotas on most imports. FTZs are specially designated, enclosed lands where companies are granted full or partial exemptions on income, VAT, customs, and property taxes. These two strategies form the backbone of the government's plan to put Colombia on the road to prosperity.

Figure 1. Colombia GDP and Foreign Direct Investment (Billions of USD)



Source: IHS Global Insight (2013) and IMF (2013)

Figure 2. GDP Growth Comparison, 2002-2012



*Colombia's economic growth stayed positive in 2009 despite the global recession, and has outpaced the rest of Latin America and the world for most of the past decade.

Why Colombia?

Colombia is regarded as one of the most promising and dynamic emerging markets in the world. Typically it only takes one visit for tourists or businesspeople to realize that its perception as a violent drug haven is far outdated. Those who look beyond this stereotype will benefit from several efficiencies that Colombia has to offer, including the following:

1) *Strategic Location*: A growing number of multinationals are establishing their headquarters in Colombia to take advantage of location. Sharing borders with Panama, Venezuela, Ecuador, Peru, and Brazil, Colombia is the bridge that connects North and South America. Its centrality makes it a key link in supply chains that connect not only these continents, but also east and west. Meanwhile, rising oil prices have driven a new trend in logistics known as "near shoring" where companies are placing added importance to more condensed, regionally-integrated supply chains rather than assembling in far-flung corners of the world.
2) *Growing and Decentralized Consumer Base*: Latin America's 3rd largest country with 45 million inhabitants, Colombia is also one of its most economically and demographically diverse. 6 cities have a population of over 1 million (Bogotá, Medellín, Cali, Barranquilla, Bucaramanga, and Cartagena), while another handful are over

500,000. Instead of one capital city with dominant port, education, governmental, and private sectors as seen in other countries such as Peru, Argentina, Chile, and Venezuela, these "specializations" are spread among Colombia's metropolises. While Bogotá is the undeniable cosmopolitan center, Medellín is the main manufacturing city, Bucaramanga is an education hub with the lowest unemployment rate, Cartagena is the main tourist attraction, Barranquilla is a major Caribbean port, and Cali is a leader in medicine and medical research. Considering Colombia's highly regionalist culture, these cities all present unique logistical and retail opportunities.

3) Skilled Labor: Colombia offers a growing and maturing labor pool across all sectors. A study by PriceWaterhouseCooper identified Colombia's manual workforce as South America's most productive, with the highest employment adaptability and availability. It boasts some of Latin America's best universities – both private and public – as well as competitive worker training programs through SENA, a public sector vocational educational program. While there remain large gaps in education levels between different regions and across income levels, education has improved drastically in recent years, which has boosted productivity across all sectors.

4) *Market-Based Culture:* Colombia has traditionally maintained a positive attitude towards international trade. The most recent *Ease of Doing Business* survey by the World Bank ranked Colombia 3rd overall in Latin America behind Chile and Peru. Among the individual categories where Colombia ranked highest in the region were "administrative procedures," "time in starting a business," "protecting investors," and "resolving insolvency[1]." This business-friendly culture has lured investment from all over the world; the Central Bank recorded over $14 billion in FDI in 2012, making it the 2nd straight record-breaking year. This trend looks set to continue in 2013 (Figure 1).

5) Sound Fundamentals: Colombia's economic indicators have been steady for over a decade now. Real annual GDP growth has oscillated between 2%-8% throughout the past decade (with the exception of the global recession in 2009, though it was still one of the few countries to post positive growth that year). Inflation, among the lowest in Latin America, has remained within the target range of 2-4% for the past 5 years. This has paved the road for a large swath of the population to accumulate wealth. In its economic outlook, IHS Global Insight points out that "Domestic demand, specifically private consumption and investment, will drive Colombia's economic growth," a testimony to the emergence of a formidable middle class. The government has responded to its revenue windfalls not by exhausting them arbitrarily, but by investing in foreign reserves and reducing its debt-to-GDP ratio from 45% in 2004 to 35% in 2012. In response, ratings agencies have upgraded Colombia's bonds to "stable," a grade that is on par with Panama, Peru, and Brazil[2].

Figure 3. Colombia Economic Forecast 2011-2015

	2011	2012	2013	2014	2015
Real GDP (% Change)	6.6	4	4.2	5.3	4.9
Nominal GDP (US$ bil)	333.3	365.6	393.7	424.9	459.2
Nominal GDP Per Capita (US$)	6,784	7,062	7,476	8,132	8,947
Consumer Price Index (% change)	3.4	3.2	3.2	3.9	3.8
Policy Interest Rate (%)	4.75	4.25	4.25	4.37	4.45
Unemployment Rate (%)	11.5	11.2	11	10.6	10.1
Current Account Balance (% of GDP)	-2.9	-3.1	-1.8	-0.9	-0.4
Exchange Rate	1,942	1,768	1,814	1,829	1,851

Source: IHS Global Insight (2013)

Challenges

Some key issues continue to plague the nation. The government's strategy of "democratic security" was largely successful in pushing criminal elements out of urban areas and making it easier for people and goods to travel throughout the country. However, there remain some "hot spots," mainly in remote, sparsely-populated areas where law enforcement is logistically difficult. These areas include the Pacific coast, the border regions near Panama, Venezuela, and Ecuador, and the vast jungle that covers the southern half of the country. The government is currently negotiating a peace treaty with the FARC that could end the longest running armed conflict in Latin America.

A second challenge involves Colombia's highly inadequate transportation infrastructure that makes road travel (especially for truck cargo) cumbersome and expensive. This is compounded by daunting geography, frequent flooding, and landslides that significantly damage highways and complicate repaving and widening projects. Substantial recent investments in infrastructure endowments - undertaken mostly in partnership with the private sector - should yield improvements, especially since the growing business sector will put more pressure than ever on the government to follow through.

The greatest and most pressing challenge that Colombia faces is to take advantage of the current circumstances and deliver real benefits to the large segment of the population living in poverty. According to World Bank data, Colombia ranks 157 out of 167 countries in income inequality, a sobering reminder of how much work remains to be done[3]. The current administration is seeking to improve this situation by introducing tax and land reforms, the goal of which is to arrive at a more equitable distribution of resources.

1. The World Bank's annual *Doing Business* survey ranks all countries according to the following elements: administrative procedures, trading across borders, paying taxes, protecting investors, obtaining permits, labor legislation, getting credit, and registering property. For more information, see http://www.doingbusiness.org/.
2. IHS Global Insight. *Colombia Country Report.* Accessed May 2013.
3. World Bank Gini Index (2011).

Free Trade Agreements

Free Trade Agreements are designed to enhance a country's trade capacity and global competitiveness by eliminating tariffs, import quotas, and subsidies on most goods. Some of these are eliminated immediately and others incrementally over a given period, usually 10-15 years, though a select basket of products essential to national security such as oil, sugar, or rice are typically excluded from the agreement. FTAs are a common strategy among smaller developing countries not only because they facilitate foreign investment, but also because it allows their exporters to sell in larger quantities, thus achieving higher economies of scale and more competitive selling prices to the consumer.

Free Trade Agreements, whether bilateral (between two countries) or multilateral (between many, such as the agreements reached through the World Trade Organization) have had a profound impact on Colombia's economy. This has especially been the case in the last 15 years as these policies, combined with massive investments in national policing, urban security, and infrastructure, have freed up the movement of people and goods. GDP per capita (PPP) nearly doubled from 1998 to 2012, while exports and imports more than tripled over the same period. Today Colombia has become a more diversified economy, specializing not only in coffee but also in the production of textiles and clothing, chemicals and petrochemicals, iron and steel, oil, natural gas, and coal. These last three commodities, especially, have driven a sharp growth in exports that has contributed to a positive current account balance in 2011 and 2012 (see Figures 5 and 6).

Figure 4. Change in Import Regime (US-Colombia FTA Examples)

Product	Trade Flow	Tariff Before FTA	Tariff After FTA
Apparel	Colombia to US	9.5%	0% Immediately
Footwear	Colombia to US	14%	0% Immediately
Glass and Glassware	Colombia to US	10.3%	0% Immediately
Textiles	Colombia to US	8-11%	0% Immediately
Agricultural Equipment	US to Colombia	15%	0% Immediately
Furniture	US to Colombia	15%	Phase out incrementally over 15 years
Iron and Steel	US to Colombia	20%	Phase out incrementally over 15 years
IT Products	US to Colombia	6-8%	0% Immediately

Source: US Chamber of Commerce, www.export.gov

Figure 5. Composition of exports, 2006-2012

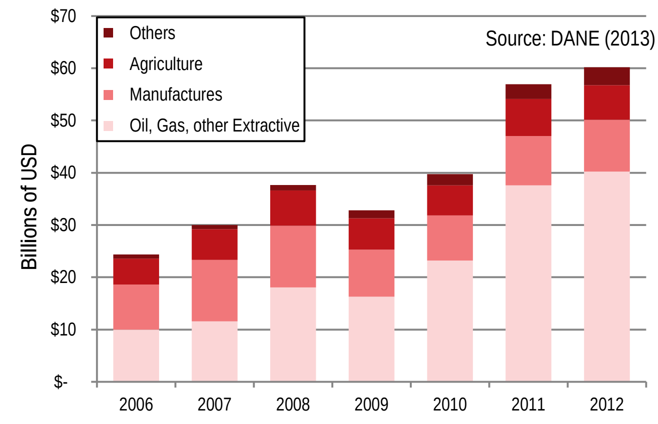
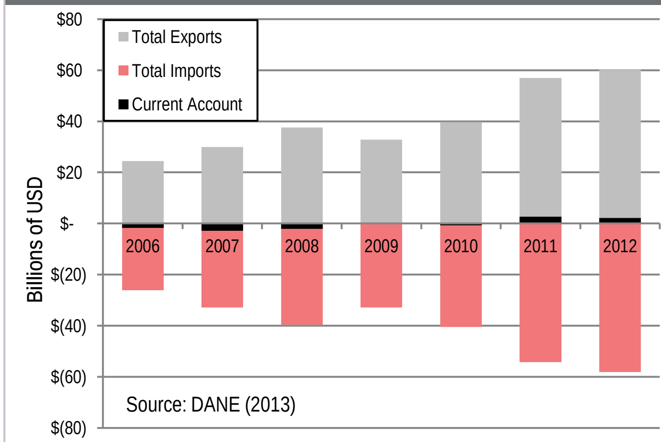


Figure 6. Colombia Current Account, 2006-2012



Companies who stand to benefit the most from the FTA regime are exporters of consumer and industrial products such as computers, automobiles, medical and scientific equipment, yarn and textile inputs, and farming machinery – all of which were subject to tariffs of anywhere from 5-25%, but will now enter duty free. In exchange, Colombian exports of coffee, finished textiles, and fuel sources will now enter FTA-friendly countries duty free. Foreign companies operating within Colombia can also take advantage of Colombian Free Trade Agreements as if they were of Colombian origin. For example, a Brazilian manufacturer of semiconductors could use Colombia as a base to export its products to Mexico and the US, two countries with whom Brazil does not currently hold trade agreements. American companies working in Colombia can use Colombia's associate membership with MERCOSUR to import certain inputs from the MERCOSUR bloc at cheaper rates than they would receive in the US.

Bilateral and Multilateral Trade Agreements Involving Colombia

Existing Agreements: USA, Chile, Canada, El Salvador, Guatemala, Honduras, CARICOM (Mexico, Venezuela, and several Caribbean nations), MERCOSUR (Argentina, Brazil, Paraguay, Uruguay, and Venezuela), and Comunidad Andina (Ecuador, Peru, and Bolivia)

Awaiting Ratification: South Korea, European Union (should go into effect in 2013)

In Negotiation: Panama, Turkey, Israel, Pacific Alliance (Chile, Mexico, Peru)

Free Trade Zones

In addition to FTAs, the Colombian government has been pursuing Free Trade Zones as an added impetus to creating jobs and investment. A Free Trade Zone is an enclosed area in which goods may be landed, stored, assembled, reconfigured, modified, and re-exported without the intervention of domestic customs authorities. From a customs point of view, goods in these zones never actually enter the country, but rather enter a special economic area where they are subject to a differential tax system. Only when merchandise in an FTZ is delivered to consumers within the country where the FTZ is located, do they become subject to domestic customs duties.

Free Trade Zones and a Free Trade Agreement compliment each other in the following ways:

- FTAs provide incentives between partnering countries, while FTZs incentivize firms to export to or import from any country in the world.
- FTA regimes are administered by the national government; FTZs are administered by private operators with support from municipal and regional governments, therefore forcing cities and regions to compete amongst each other for investment and jobs.
- FTAs provide exemptions mostly on customs duties, while FTZs provide exemptions and incentives on a wide range of taxes (detailed on Page 5).

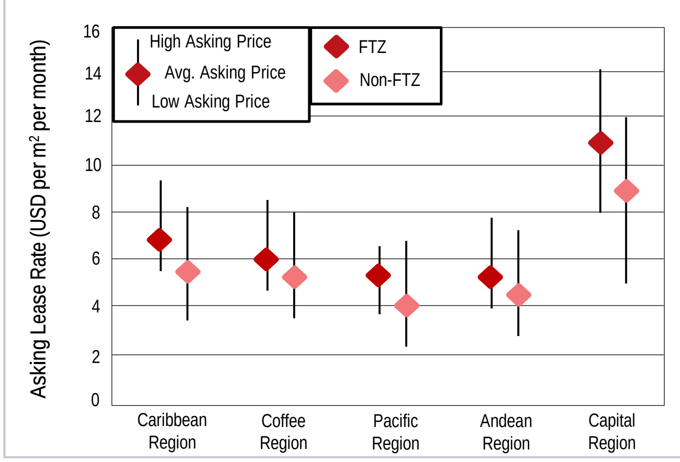
> *FTAs provide exemptions mostly on customs duties, while FTZs provide exemptions and incentives on a wide range of taxes such as property, income, and value added.*

FTZs are beginning to spring up all over the country. In 2000 there were 10 operating throughout Colombia; today there are 16 in operation and another 18 that have been approved, expected to be operating within the next few years. Different Free Trade Zones will have different specializations, tailoring their infrastructure to the main economic activity of their respective region. For example, the FTZs on the Caribbean are focused on port activities and have large lots set aside for storing TEU containers. FTZs in the coffee region are based on the processing, warehousing, and transport of coffee and other agricultural products. Others that are located in more highly educated areas such as FTZ Intexzona in Bogotá and FTZ Santander in Bucaramanga are wired with state-of-the-art fiber-optic and telecommunication infrastructure to facilitate data center operations.

Due to their superior infrastructure and tax incentives, companies who are interested in establishing themselves inside a Free Trade Zone will be subject to more stringent criteria than in a typical industrial park. Since the main objective is to stimulate job growth and strategic investment, all users must meet minimum requirements with respect to employment and committed investment. These requirements vary depending on how big the operation is and what type of user they are (i.e. call center vs. manufacturer vs. logistics). If these targets are not met within the allotted time period, the company will lose their FTZ status (investment requirements are detailed on Page 5).

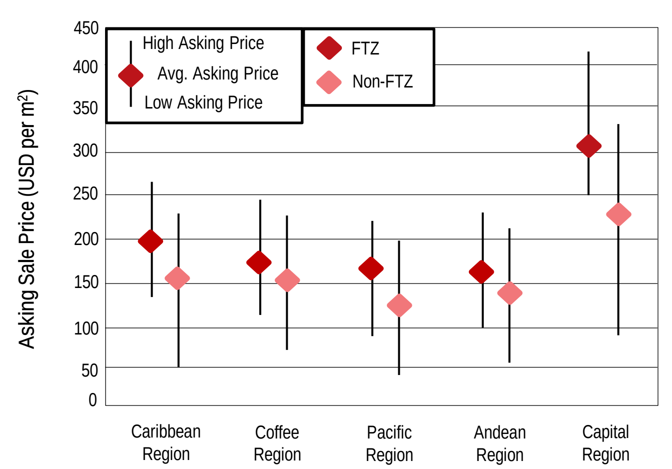
Free Trade Zone companies will also pay a premium in lease and sale values. As shown in Figures 7 and 8, prices for land or warehouses can be anywhere from 15%-25% higher in an FTZ than in a regular industrial park. Prices are much higher in Bogotá than in any other part of the country, due to the high demand and limited supply of space.

Figure 7. Warehouse Lease Rates by Region (USD/m²/Month)



*See Page 6 for a geographic reference of Colombia's regions

Figure 8. Lot Prices by Region (USD/m²)



Permanent vs. Individual Free Trade Zones

In Colombia there are 2 types of Free Trade Zones: Single User FTZs and Permanent FTZs. Permanent FTZs are more traditional – an enclosed industrial park with several types of operators ranging from logistics and warehousing to heavy manufacturing to call centers and data centers. Single User Free Trade Zones are granted to individual companies who comply with investment and employment requirements but operate in their own facility. Single User FTZ licenses are often more difficult to obtain, though they can be very beneficial for certain types of companies. There are currently 34 approved Permanent FTZs in Colombia and another 40 Single User FTZs.

Figure 9. Requirements for Industrial and Commercial Users in Permanent FTZ

Assets (USD)	Investment Requirements
< $109,000	No employment or investment requirements.
$109,000 - $1,000,000	At least 20 employees.
$1,000,000 - $6,500,000	At least 30 employees and at least $1,000,000 in investments (3 years to achieve).
> $6,500,000	At least 50 employees and at least $2,500,000 in investments (5 years to achieve).
Definition: Industrial users provide services related to manufacturing, production, transformation, assembly, or storage. Commercial users include any operator who provides services related to marketing or commercialization.	

*For every $5 million in investment, 15 employees reduced (given a minimum of 50)

Figure 10. Requirements for Industrial Users of Services in Permanent

Assets (USD)	Investment Requirements
$2.5 - $11.7 million	At least 500 employees.
$11.7 - $23.5 million	At least 350 employees.
> $23.5 million	At least 150 employees.
Definition: Any user who provides service related to logistics, transport, distribution, packaging, repackaging, telecommunications, scientific research and technology, medical treatment or general health, tourism, or any operator involved in processing, storage, or transmitting of information.	

Figure 11. Requirements for Individual FTZ Entities

Must create a new legal entity (i.e. FTZ entity must be separate from non-FTZ entity.
Minimum 150 employees.
No minimum amount of occupied space required. Investment criteria determined on a case-by-case basis. FTZ status awarded upon completion of investment requirements. If requirements are not met within 3 years of establishing FTZ entity, company will lose FTZ license.

Figure 12. Requirements for Permanent FTZ Developers

Must be developed on minimum 20 hectares of land.
Minimum 5 operators must have purchased or leased land inside the park.
5 years to complete 100% of investment requirements. If requirements are not met within 5 years of establishing permanent FTZ, developers will lose FTZ license.

FTZ Tax Incentives

Income tax

- ✓ Single 15% income tax rate for industrial users and also for FTZ operators and developers. Commercial users are subject to the general tax rate of 33% that applies outside the FTZ.
- ✓ No income tax on stakeholder dividends.

Value added tax

- ✓ 0% VAT on imported equipment to be used inside FTZ.
- ✓ 0% VAT on prime construction materials, compared to 16% VAT outside. This is estimated to save on average 9.6% on construction costs.
- ✓ VAT exemption on merchandise sold abroad.
- ✓ Exports produced within Free Trade Zones benefit from international trade agreements signed by Colombia.

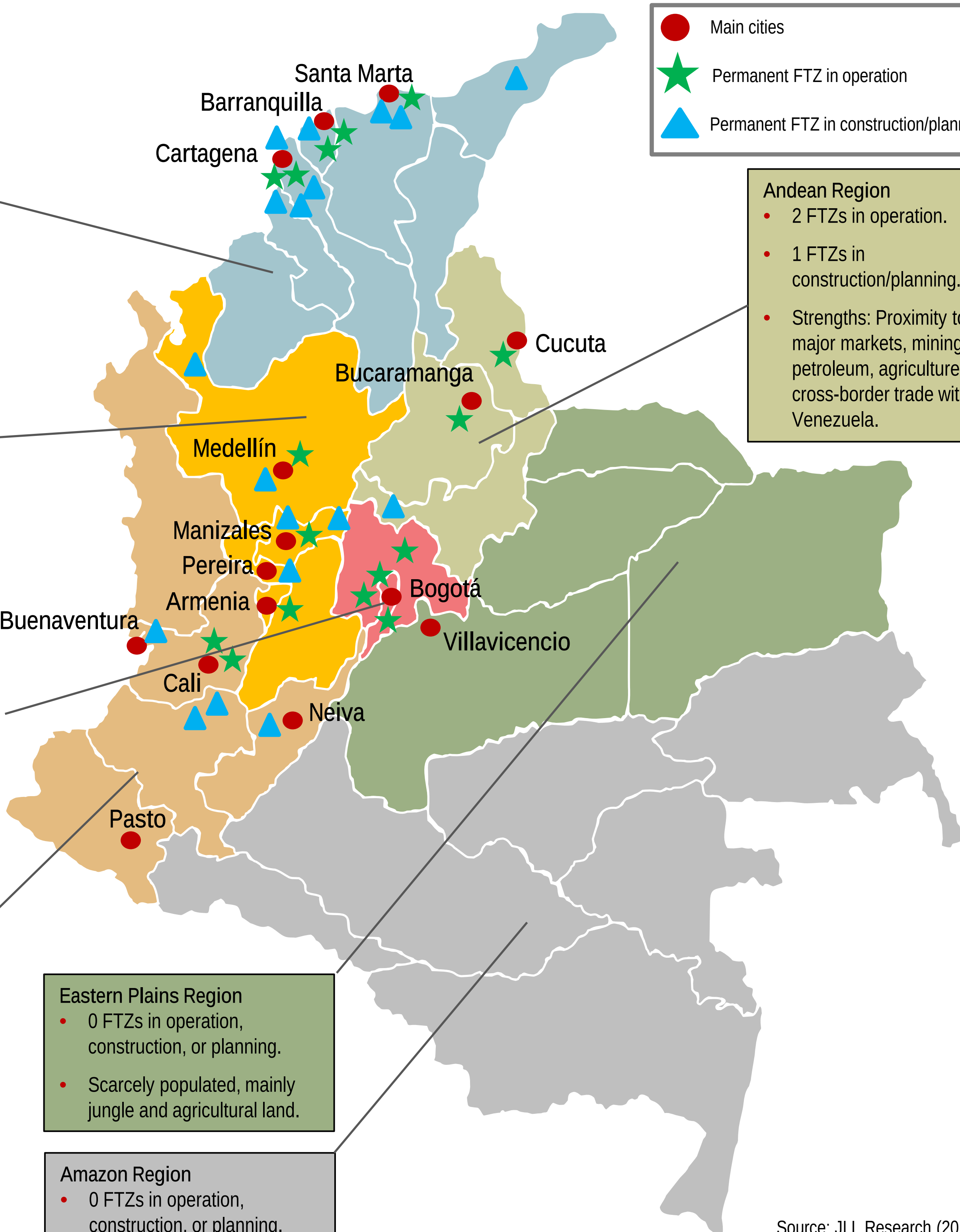
Customs Tax Customs taxes

- ✓ 0% customs tax for imported equipment to be used inside FTZ.
- ✓ Everything produced is like it was made in another country.
- ✓ Companies can bring in merchandise from anywhere and not pay taxes; so they will take advantage and bring in the most expensive items (machines, computers, etc.). The idea is to encourage dissemination of technologically advanced capital.
- ✓ Tax free unlimited storage of foreign merchandise. Partial importation of merchandise without time limits.
- ✓ Partial product processing in the National Customs Territory (TAN), without the payment of taxes or execution of customs processes.
- ✓ Partial nationalization: Companies may pay nationalization taxes on the goods they require and not on the entire merchandising.
- ✓ Possibility of nationalizing goods manufactured inside the Free Trade Zone.
- ✓ Simplified paperwork and processing procedures.
- ✓ Companies may take advantage of the DTA (Custom Transits Declaration) to transport goods from ports and border crossings into the FTZ.

Property tax

- ✓ Exporting companies pay 0% property tax.
- ✓ Companies pay taxes in proportion to how much they export.
  - A company who exports 100% will pay 15% property tax.
  - A company who exports less will pay closer to 33% property tax.

Colombia Permanent Free Trade Zones



Caribbean Region
- 5 FTZs in operation.
- 8 FTZs in construction/planning.
- Strengths: Ports, logistics, import/export, agriculture, proximity to 3 major markets.

Coffee Region
- 3 FTZs in operation.
- 5 FTZs in construction/planning.
- Strengths: Central location, proximity to several markets, agriculture, coffee, logistics, mining.

Capital Region
- 4 FTZs in operation
- Strengths: Central location, proximity to primary consumer market (Bogotá), agriculture, manufacturing.

Pacific Region
- 2 FTZs in operation.
- 4 FTZs in construction/planning.
- Strengths: Port of Buenaventura, access to Cali market, agriculture, cross-border trade with Ecuador.

Andean Region
- 2 FTZs in operation.
- 1 FTZs in construction/planning.
- Strengths: Proximity to major markets, mining, petroleum, agriculture, cross-border trade with Venezuela.

Eastern Plains Region
- 0 FTZs in operation, construction, or planning.
- Scarcely populated, mainly jungle and agricultural land.

Amazon Region
- 0 FTZs in operation, construction, or planning.
- Scarcely populated, mainly jungle and agricultural land.

Source: JLL Research (2013)

Key Takeaways

- Companies looking to expand in Latin America should strongly consider Colombia. It is one of the most promising emerging markets in the world owing to its strategic location, a young and diversified population, a growing labor pool, a market-based tradition, and sound macroeconomic fundamentals.

- Colombia offers aggressive incentives in the form of Free Trade Agreements and Free Trade Zones that could provide significant benefits to firms that have a substantial import or export component.

- Free Trade Agreements - either bilateral or multilateral - have been signed with over 30 countries. These accords eliminate tariffs, import quotas, and subsidies on most goods, some immediately and some incrementally over a prolonged period of time. They have been critical in enhancing Colombia's export capacity as well as facilitating the importation of technologically sophisticated inputs.

- As a compliment to FTAs, Colombia offers Free Trade Zones, which encourage companies to export to anywhere in the world by providing income, VAT, customs, and property tax incentives as well as other benefits such as expedited customs procedures. These incentives differ depending on whether the company is an industrial user (i.e. manufacturing) or service provider (i.e. logistics or data center). Some incentives are also scaled depending on how much the company is exporting.

- Companies who set up inside an FTZ must comply with certain investment and employment criteria in order to qualify for the FTZ regime. These requirements also differ depending on the type of user.

- Prices for land or warehouses can be anywhere from 15%-25% higher in an FTZ than in a regular industrial park.

About Jones Lang LaSalle

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Jones Lang LaSalle's research team delivers intelligence, analysis, and insight through market-leading reports and services that illuminate today's commercial real estate dynamics and identify tomorrow's challenges and opportunities. Our 300 professional researchers track and analyze economic and property trends and forecast future conditions in over 70 countries, producing unrivalled local and global perspectives. Our research and expertise, fueled by real-time information and innovative thinking around the world, creates a competitive advantage for our clients and drives successful strategies and optimal real estate decisions.

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