Summary Foreign Direct Investment Attraction and Promotion- Internationalization Mission

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Colombia's inward FDI flow has been on a plateau since 2014 commodity price crisis and its composition remains concentrated on extractive industries and on a group of regions within the country. In the last decade FDI inward flows in Colombia have increased considerably, but since 2014 it has reached a plateau, reaching 14% of GDP which lies below regional and aspirational peers. In the same period FDI composition has changed, but it remains suboptimal and dominated by extractive industries. Moreover, FDI inflows in manufacturing declined by half from 2013 to 2018, caused both by firm exits and slow growth of incumbents, and exhibit a rising importance in labor intensive sectors within manufacturing (World Bank, 2021). Despite a moderate diversification, with a promising trend on greenfield investments especially in manufacturing, on average, between 2015 and 2019 FDI inflows in extractive industries represented 30% of total FDI. In addition, inflows are also concentrated in few regions of the country; in the last decade only 6 regions captured around 85% of manufacturing FDI. (World Bank, 2021).

The level of efficiency-seeking FDI attracted in Colombia is lower than in countries with similar levels of development. According to the World Bank, based on the FDI markets database, between 2012 and 2015 FDI in extractive activities accounted for 30% of the total value of announced investments in Colombia. For countries with the same level of income per capita as Colombia, it is estimated that investments in search of natural resources fluctuate between 10% and 25% of total announced investments, during the same period. Given the importance of the local market of the Colombian economy, an important amount of investments in the country are focused in production of goods and services for the local market. Between 2012 and 2015, investment announcements in domestic commercial activities accounted 10% of total FDI announcements, which is aligned with the development level of Colombia. Finally, analyzing FDI announcements in manufacturing activities that are not related to local sales between 2012 and 2015, only approximately 15% of the total value are related to efficiency-seeking FDI. This value is significantly lower than countries with similar income per capita, where the expected value lies between 20% and 40% of total investments (World Bank, 2017).

Investors value Colombia's dynamic economy and political stability, but alert on regulation instability (Fedesarrollo, 2016). The survey concludes that what foreign investors value most when investing in Colombia is having a dynamic economy and its political stability. In addition, one of their main motivation is the size of the Colombian market, rather than the possibilities of exporting. Nonetheless, their biggest fear is the constantly changing rules of the game, regarding tax uncertainty. The survey stated the instability of tax regulations, the high tax burden for companies, the deficiencies in justice, the dilation of judicial processes and corruption are the main factors that negatively affect the growth of FDI in Colombia. (Garavito A, Iregui, & Ramirez G., 2012) also point that if Colombia wants to increase its FDI inflows, it is necessary to adapt its regulatory framework to international conditions, reduce uncertainty and complexity in the tax regime, simplify processes and excessive regulations that regulate FDI, and reduce corruption. Evidence shows that maximizing the positive impact of FDI on economic growth and diversification could not have been achieved without policies that provided investors enough certainty and predictability to operate and expand their business operations in the long term (Moran 2012; Moran, Graham, and Bolstrom 2005). As efficiency seeking FDI is highly competitive, countries must generate policies where governments are able to respond to the needs of investors to upgrade their processes and productivity, by anticipating such needs through a close communication between investment policy makers and investors. Investment retention is as important as attraction, as approximately 30% of global FDI flows come from reinvested earnings. (World Bank, 2020).

Multinational firms' overall performance in the country is consistent with documented experiences, however their impact shows heterogeneity across sectors and regions in Colombia (World Bank, 2021).

Multinationals in Colombia are on average larger, more capital intensive and productive, hire more labor, and are more successful in tapping into GVSs. For instance, over 2007-2018 the Annual Manufacturing Surveyshows that controlling for firm age, macroeconomic shocks and sectorial and regional difference, multinationals invested nine times in fixed assets, hired nearly three times more labor, produced ten times the output and tripledlabor productivity compared to Colombian manufacturing firms. In addition, analysis on matched firm and custom data shows that multinationals probability to participate in GVCs in 22% higher than domestic manufacturing firms. Hence, analysis indicate FDI in manufacturing influence in improved allocation efficiencies, increasedregional employment and trade in Colombia. However, multinationals in extractive industries are less productive than Colombian firms. And on the other hand, multinationals impact on employment and efficiency differs between top investment destinations and laggard regions in Colombia. Multinationals lead on capital intensity and labor productivity over local firms is higher in laggard regions than in top FDI destinations. (World Bank, 2021).

Positive spillovers generated by FDI in manufacturing in Colombia are also driven by the type of investment and linkages (World Bank, 2021). For an average manufacturing firm, a 10% increase in the market share of multinationals in upstream industries in Colombia leads to an increase in labor productivity by 12%, compared to an increase of 2% when analyzing the market share of multinationals in the same industry. In addition, the impact of FDI on domestic firms differs between labor intensive and capital and skill intensive industries, as significant positive spillovers due to forward linkages are only associated with investment in capital investment industries. Moreover, World Bank analysis also showed that overall FDI spillovers through backward linkages are insignificant. This indicates there are higher efficiency gains from quality intermediate inputs produced by multinationals, but probably limited use of Colombian inputs by multinationals. However, is important to note multinational investment in laggard regions generate not only vertical spillovers due to forward linkages, but also generate horizontal spillovers with domestic firms in the same industry, which differs from exclusive spillovers from forward linkages in top FDI destinations (World Bank, 2021).

Colombia should focus on attracting efficiency-seeking FDI and enhance nearshoring opportunities. It is essential for the country to strengthen its FDI policy through a focalization on investment attraction of sectors that bolster the diversification and productivity improvement process, by means of the country's insertion to regional and global value chains (World Bank, 2017). As mentioned, with an importance share of labor intensive sectors, a small share of GVC industries with extensive supply chains in manufacturing, and difference in multinationals' spillovers across industries, there is a potential benefit of shifting FDI from labor intensive to capital and skill intensive industries in Colombia. While seeking these sectors of growth and efficiency, Colombia could benefit from prioritizing green investments that also promote inclusive and environmental sustainability, as many of the pandemic's impacts mirror potential climate change impacts (World Bank, 2021). In addition, to enhance the contribution and spillovers of multinationals to the Colombian economy, the country should implement further and more aggressive strategies to produce backwards linkages to strengthen multinational and domestic supplier linkages to benefit from economies of scale and technology transfers. (Alfaro 2015; Rojec and Knell 2018). In order for Colombian companies to further integrate into GVCs by supplying to multinationals, is important to improve domestic conditions by promoting competitive markets and financial sector development, and creating a dedicated multinational-local supplier linkage program, that initiates with a demand-supply assessment of existing linkages between domestic and multinational firms. (World Bank, 2021). Furthermore, resilience and diversification drivers are influencing the reconfiguration of GVCs and investment, which constitute an opportunity for Latin America and Colombia. In this regard, identifying niche sectors with high growth potential and articulating the country's value position, including a nearshoring value proposition, is key in today's context. Analyzing and aligning incentives should be a priority in the context of an economic recovery post COVID-19 as some sector and investors will be more affected than others. However, little evidence of assessments of cost effectiveness of targeted incentives, and persistent geographic and sectoral concentration of FDI in manufacturing suggests limited impact of these incentives (World Bank, 2021).

Reducing regional unevenness of FDI inflows requires policies that balance efficiency and equity concerns (World Bank,2021). The effectiveness of spatially targeted fiscal incentives should be continuously assessed and monitored for decision making, but they are not enough as limited entrance and regional concentration of FDI is a reality. Improvements in regional investment climate and stronger coordination mechanisms between the national entities and regional networks are crucial to attract and retain FDI. Among others, broad-based improvements in infrastructure, human capital, institutional efficiency and regulatory quality, are crucial for regional investment climate, and transiting roles of different intensity levels between the national IPA (Procolombia) and regional IPAs at the various stages of investment, is also key to ensure coordination with regions in each stage of the investment process (World Bank, 2021)

Colombia has to design an integral FDI policy that tackles each phase of the investment cycle to leverage FDI benefits. The country must work towards an integral FDI policy that combines pillars and features of attraction, promotion, facilitation, retention, expansion and productive linkages to receive efficiency-seeking FDI. According to the World Bank's investment reform map consultancy in 2017, the key elements of such policy should include: (i) improve the legal and regulatory frameworks in order to reduce barriers to the entry and operation of private investments in the country; (ii) design incentive programs based on cost-benefit studies; (iii) strengthen institutions and authorities governing FDI policy to guide and monitor FDI development; and (iv) implement mechanisms that protect investors from arbitrary government behavior or adverse changes in regulations. (World Bank, 2017). Regarding the last element, developing countries should place particular policies and programs that ensure investment permanence and expansion, such as investor-state conflict management mechanisms (CMMs), that lie in the middle between traditional aftercare services and dispute resolution in the investor-state conflict continuum. CMMs are intergovernmental mechanisms that track, identifies patterns and addresses complains and issues that arise from government conduct, reducing political risk at their source. (World Bank, 2020).

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Review of Foreign Direct Investment (FDI) in Colombia

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I. FINDINGS

- Due to changes in external conditions and the high level of production and export concentration in primary products, Colombia should focus on attracting efficiency-seeking FDI.
- According to investor surveys in Colombia, the instability of tax regulations, the high tax burden for companies, the deficiencies in justice, the dilation of judicial processes and corruption, are the primary factors that negatively affect the growth of FDI in Colombia.
- To attract efficiency-seeking FDI Colombia has to adapt investment regulatory frameworks to international conditions, simplify procedures and reduce uncertainty. In this area, is key to review regulation that limits competition, mainly in the services sector.
- To leverage the benefits of FDI, the underlying policy must consider the country's development position and the entire investment cycle. This means a robust policy should not only highlight pillars and features of attraction, promotion, but also facilitation, retention, expansion and productive linkages to receive efficiency-seeking FDI.
- Investment attraction and promotion instruments and incentive programs, such as free trade zones, should be designed according to the type of investment the country desires to boost, and should consider stability and predictability as basic pillars. Instruments should be evaluated to consider their continuity or adjustment, ensuring the maximization of their economic impacts.
- The political economy and institutions governing FDI policy should be strengthened to guide and monitor FDI development. This includes higher level contact points, regional articulation and FDI protection and retention programs.

II. DIAGNOSTIC

a. Institutional Framework and FDI performance

The Ministry of Commerce, Industry and Tourism formulates foreign direct investment (FDI) policy and coordinates government strategies to increase the country's competitiveness to attract FDI. Within the Ministry, the Viceministry of Trade has a directorate for investment and trade. The directorate's function is to design, coordinate and lead FDI attraction, services trade and intellectual property strategy, as well as the international negotiations in these disciplines. Additionally, Procolombia is the promotion agency of non- extractive goods and services, which is focus on the promotion of exports, the attraction of FDI, the expansion of Colombian companies, positions the country as a tourist destination, and manages Colombia's Country Brand (Procolombia, 2020).

In 2009 the Colombian Government created an FDI joint technical committee (SIFAI), led by the Ministry of Commerce, Industry and Tourism, to promote and coordinate actions to monitor investment and coordinate actions to remove FDI obstacles. Given that each stage of the investment process has specific challenges and demands different policy actions, the IED-SIFAI Joint Technical Committee was created to permanently carry out coordinated tasks. Until then SIFAI operated as an information tool, rather than an institutional arm that coordinates and directs policy. In 2018, the creation of this Committee was formalized within the framework of the National System of Competitiveness, Science, Technology and Innovation. The committee has representation of: the Presidency (represented by the High Council for the Private Sector and Productivity), the National Planning Department, the Ministry of Finance and Public Credit, Procolombia, the Private

Competitiveness Council (representing the private sector) and the Ministry of Commerce, Industry and Tourism, entity that holds its technical secretary. The main objectives of the committee are: Identify opportunities to improve the country's business climate, manage and coordinate actions aimed at solving the improvement opportunities regarding procedures or regulations identified with relevant entities, analyze the improvement opportunities identified and prioritized by Procolombia as administrator of the SIFAI platform. This platform gathers investors' claims and obstacles.

The FDI regime in Colombia has been characterized by three stages: import substitution, economic liberalization and FDI attraction reforms (Fedesarrollo, 2007). The first stage lies between the end of the 1960s until the beginning of the 90s, in which the regulation of FDI was restrictive and an imports substitution model was imposed to promote domestic productive development. The second stage began with the economic liberalization of the early 90s, in which the FDI regime was modified, a package of reforms was defined and FDI was positioned as an important factor for economic development. The third stage was developed since the beginning of the year 2000, which is characterized by the deepening of the reforms of the FDI regime in search of simplicity and better conditions to attract FDI, the negotiation of various bilateral agreements, the adjustment of the corresponding regulation to meet the needs of foreign investors and new investment alternatives, the updating of free zone regime and promoting FDI in non-traditional sectors, among others.

Colombia receives an adequate level of FDI, but its composition is focalized on extractive industries. Compared to countries with similar income per capita, Colombia receives an adequate level of FDI, however, its composition has been focalized in the oil and mining sectors. This contributed to a high concentration in these sectors, which impacted on exports concentration and made the country vulnerable to the reduction and volatility of oil and coal international prices, since the beginning of the last decade (World Bank, 2017). In this regard, investment flows expanded from US$2,536 million in 2000 to $16,169 million in 2014. Between 2000 and 2010, the investment boom was mainly motivated by the mining sector, when investments in this sector went from a participation of 5% to a participation of 76% of the FDI. In 2019 FDI in oil and mining sectors represented 31.2% of total FDI (US$4,548 million). The remaining 68,8% (US$$10,024 million) corresponded to FDI in non-mining sectors. According to statistics from the Central Bank of Colombia, in the period of 2010 to 2019, Colombia's FDI inflows reached a value of US$134.010 million, primarily from the United States (17%), Panama (14%), and Spain (11%). During this period, investment was made mainly in the oil sector (27%), finance service sector (15%), mining sector (13%), and the manufacturing sector (13%). Although FDI could be considered high, it has not contributed significantly to employment creation (Gonzalez-Perez, Piedrahita Vargas, Jaramillo Echeverri, & Restrepo Rey, 2018).

The level of efficiency-seeking FDI attracted in Colombia is lower than in countries with similar levels of development. According to the World Bank, based on the FDI markets database, between 2012 and 2015 FDI in extractive activities accounted for 30% of the total value of announced investments in Colombia. For countries with the same level of income per capita as Colombia, it is estimated that investments in search of natural resources fluctuate between 10% and 25% of total announced investments, during the same period. Given the importance of the local market of the Colombian economy, an important amount of investments in the country are focused in production of goods and services for the local market. Between 2012 and 2015, investment announcements in domestic commercial activities accounted 10% of total FDI announcements, which is aligned with the development level of Colombia. Finally, analyzing FDI announcements in manufacturing activities that are not related to local sales between 2012 and 2015, only approximately 15% of the total value are related to efficiency-seeking FDI. This value is significantly lower than countries with similar income per capita, where the expected value lies between 20% and 40% of total investments (World Bank, 2017). Even though FDI in services sector has been increasing its participation since 2010, it was concentrated in consumer direct services[1], which accumulated 38% of FDI in 2019; while sectors related with professional and financial services represented 20% and manufactures only represented 11%. Similarly, a study on the distribution of investment announcements of

[1] Transport, electricity, gas, water, construction, communications, commerce, restaurants, hotels, communal services.

tangible assets or Greenfield, registered by the FDI markets data base, reveals professional services activities only concentrated 13.6% of total investment projects between 2007 and 2017. (IDB, 2019). The low participation of FDI reception in the manufacturing sector in Colombia highlights a warning sign, since this sector along with professional services, concentrate the highest inflows of efficiency FDI in the world. In these group of activities cost savings is a decisive competitive factor, hence, the importance when selecting the investment location (UNCTAD, 2018).

Since 2013 the number of Greenfield investment projects has increased annually, on average, but their average value has decreased. Colombia received an average of 95 Greenfield investment projects per year since 2003, a figure that increased to 122 projects on average per year since 2013. These figures represented an average annual investment of US $5,234 million and US$4,760 million, respectively. This implies that the number of projects received each year by Colombia has increased, but its average size in terms of value has decreased. Greenfield projects tend to be low in magnitude. For example, only 5% of all projects announced in 2016 involved an investment of more than US$100 million (IDB, 2019).

b. FDI Instruments and Policy

The Conpes 3771 of 2013 "Strategy for the Promotion of Colombian Direct Investment Abroad" defined strategies to promote Colombian FDI, which served to facilitate and promote this activity and extend its benefits to the Colombian economy. The objectives were: to consolidate a leading agency that is in charge of the activities of promotion of the Colombian investment abroad, to develop relevant legal instruments that facilitate investments abroad, to establish national bodies of coordination and solution of difficulties and disputes for investors, and to develop communication and training actions to strengthen the knowledge of institutions, instruments and instances available to investors (CONPES, 2013). Currently, Procolombia promotes and facilitates companies´ expansion process to international markets, ensuring efficiencies in their internationalization and exporting processes and competitiveness.

One of the main instruments for attracting FDI is the free trade zone regime. Initially, free zones were an instrument to promote exports, but later it became a mechanism of industrialization, investment attraction, and employment generation. Free trade zones were created by Law 105 of 1958. Subsequently, Law 109 of 1985 established the statute of the free zones. With Law 1004 of 2005, a new regulatory framework for free zones was created, which operates up to date, and encourages job creation, new capital investments attraction and promotes regional competitiveness where these projects are established. Additionally, this regime establishes a difference between permanent free zones, special permanent free zones, and transitory free zones. (Garavito A., Iregui, & Ramirez G., 2012). Currently, the free zone regime is regulated by Decree 2147 of 2016 and by Decree 1054 of 2019, the latter regulates the corresponding extensions (in time) of free trade zones established.

Since 2018, the Ministry of Commerce, Industry and Tourism works on developing and strengthening its strategy to effectively attract, facilitate, retain and expand efficient FDI. Within this pillar the government has developed different regulatory and non-regulatory changes. In the Economic Growth Law, the Mega-investment regime was designed, but additional dispositions were created to alleviate the tax burden of FDI. A special regime for holding companies in Colombia was established to exempt dividend and occasional income taxes. In addition, 6 dispositions were introduced, which apply to all FDI: (i) progressive reduction in the nominal income tax (reduces from 33% in 2019 to 30% in 2022); (ii) progressive elimination of presumptive income tax; (iii) fixed assets VAT discount; (iv) deduction of taxes over income (excluding wealth tax); (v) flexibilization in the sub-capitalization rule; and (vi) fiscal neutrality in fusions. Finally, beyond tax incentives, the country has been strengthening its FDI attraction, facilitation and retention strategy, through various initiatives. Among others, a red-carpet strategy is being executed to build high-level contact points to facilitate procedures, a fast-track mechanism is being created to accelerate exceptional procedures, and the Investment Single Window is being design. The Ombudsperson figure is also in the process of construction, and instruments that foster economic linkages, such as a "supplier" catalogue or directory[2], are being improved. In addition, the free trade zone regime is being studied, in order to: promote the establishment of investments in the services sector; promote technology transfer and value-added production; introduce labor flexibilities and e-commerce operations; and streamline procedures, among others. Finally, it is important to highlight that since 2019 the Ministry, along with Procolombia and the US Embassy, have been working in a nearshoring strategy to attract previously identified companies that are looking to relocate. This strategy is developing a special coordination with regional actors to improvetheir business climate and investment proposals to attract specific investments.

The mega-investment regime was approved by Law 2010 of 2019 (article 75) and is focused on attracting projects with investments of at least USD 330 million. This regime offers investors better conditions in the income tax rate, early depreciation of assets, the possibility of signing legal stability contracts and wealth tax exemption, among others. In exchange, the investor must commit to a minimum investment, and an employment generation of 400 jobs or 250, in the case of projects belonging to sectors with a high component of emerging and fast-growing technologies. This regime excludes projects for evaluation, exploration, and exploitation of non-renewable natural resources.

Additional regimes that focus on special economic zones and areas most affected by conflict were established recently. Through the National Development Plan, Law 1955 of 2019, a tax benefit was established for investment in special social economic zones (ZESE, for its initials in Spanish), where the applicable income tax rate will be 0% in the course of the first 5 years and 50% of the general rate in the following 5 years. This benefit is intended to attract national and foreign investment and contribute to the improvement of living conditions and job creation in the departments of La Guajira, Norte de Santander, and Arauca. These regions were chosen based on employment indicators. In addition, Law 1819 of 2016, establishes a tax benefit for the areas most affected by the conflict (ZOMAC, for its initials in Spanish), which provides an exemption and gradual removal of withholdings until 2027, the proportion of the general rate will be of 0% between 2017-2021, in the 2022-2024 period of 25%, between the years 2025-2027 of 50% and from 2028 of 100%. This benefit is intended to help 344 municipalities affected by the conflict, defined by the Ministry of Finance and Public Credit, the National Planning Department, and the Territory Renewal Agency.

The 'Program to Support the Diversification and Internationalization of the Colombian Economy' (2019) is a programmatic-loan with the Interamerican Development Bank, which includes a component to attract and facilitate non-extractive FDI. The objective of this component is to increase FDI flows through the implementation and use of tools to systematize and rationalize investment procedures and promote and attract efficient investment. To meet this objective the project will finance, among others: (i) the design and implementation of an Investment Single Window; (ii) establishment of an Ombudsperson figure, which resolves consultations and obstacles an investor faces when settling or operating its investment in order to prevent investor-state disputes and improve the business climate; (iii) strengthen promotion and attraction tools that respond to the need to attract efficient FDI; (iv) strengthen Procolombia's institutional capacity to anticipate investor's needs, reinforce personnel capacity in specialized market intelligence to attract efficient FDI and implement facilitation instruments such as Single Windows.

c. FDI Evaluations and Analysis

Colombia maintains limited restrictions to FDI, in comparison to other countries in the region. However, there are disparities within different regions of the country, and processes to establish an investment in Colombia are complex and information is dispersed. According to the OCDE's FDI's Regulatory Restrictiveness Index, among Latin American economies, Colombia is the country with the lowest FDI barriers, and shows lower barriers than the OCDE average. Even though restrictions are minor, some of them may result

[2] The supplier directory is an instrument designed by Procolombia, which consolidates updated information regarding a variety of suppliers that can provide strategic services to investors.

in entrance barriers that affect the operations of strategic sectors in search of efficiency, such as the services sector. (World Bank, 2017). In addition, according to the IDB, government entities at the central level manage 2,454 different processes, while regional entities manage 46,000 additional processes. Colombia is the thirdcountry in Latin America that requires more time to complete a process (7.4 hours on average), only belowBolivia and Peru. Similarly, one of every four processes in Colombia require at least 3 interactions to finalize its process, which lies above the region's average (IDB, 2019). Another measure involves the World Bank's Doing Business report. In 2019 the country ranked in the 65th position, which is better compared to other countries in the region, but there is room for improvement in areas such as international trade, tax payment, establishment of new companies and contractual compliance. In particular, there is a great disparity in business environment within the different regions and cities of the country, while some have levels similar to the ones in Austria, Germany or Poland others more similar to Venezuela's.

Investors value Colombia's dynamic economy and political stability (Fedesarrollo, 2016). The survey concludes that what foreign investors value most when investing in Colombia is having a dynamic economy and its political stability. In addition, one of their main motivation is the size of the Colombian market, rather than the possibilities of exporting. Nonetheless, as they value stability in fields such as the tax regime, their biggest fear is the constantly changing rules of the game, regarding tax uncertainty. The survey stated the instability of tax regulations, the high tax burden for companies, the deficiencies in justice, the dilation of judicial processes and corruption are the main factors that negatively affect the growth of FDI in Colombia. Likewise, Free Trade Agreements (FTAs) are highly valued by investors, but to import raw materials rather than as an investment trigger, Bilateral Investment Agreements (BITs) and Double Taxation Treaties (DTTs) are a necessary but not sufficient condition to invest in Colombia (Fedesarrollo, 2016). Regarding tax uncertainty, The World Bank identified that in terms of investment attraction and promotion, in the past years a foreign investor valuating Colombia does not have predictability in the applicable rules. In particular, if there will be changes in the incentives' regime in the following tax reform. This is the case of the free trade zones regime, where there have been successive changes in the income tax (World Bank, 2017).

Foreign companies benefit from DTTs and BITs, but the mechanisms are not widespread in the business community. (CONPES, 2013) shows that Colombian investors point out as a problem the lack of mechanisms to alleviate international double taxation. However, since 1989, Colombian legislation contemplates the possibility of discounting taxes paid in the country, for income incurred abroad. The study shows that, if there is a mechanism to resolve double taxation, the problem is that it is not known to businessmen, which denotes a coordination opportunity between public and private actors.

Some of the expected benefits of FDI have not been evident or are not very significant in the Colombian case. In the opinion survey of Fedesarrollo´s Economic and Social Research Center, from 2017, (Vallejo Almeida, 2017) analyzed the following aspects: i) FDI is mainly reaching sectors in which Colombia does not have an adequately trained workforce to be competitive compared to foreign workers. ii) FDI is mainly concentrated in the hydrocarbon and mining sector; therefore, no changes in the productivity of the country's productive resources have been observed. In this case, there is little room for local firms to imitate the practices and processes of foreign firms, due to the low impact on other sectors of the economy. iii) The main role of FDI in Colombia has been to mitigate the growing current account deficit caused by the increase in the level of imports and the gradual decrease in exports.

According to several studies, investment promotion agencies (IPAs) and their corresponding structure, play an important role in the effectiveness of FDI attraction. The study shows Colombia's IPA (Procolombia) structure could be more efficient, according to the needs and objectives described in the investment attraction policy. The Investment Vice presidency is structured around world geographies, with investment managers for Latin America, North America, Asia and Europe, and sectorial advisors work and generate support across all regions. In contrast, the internal basic operations of an IPA respond to the areas of: Facilitation, Promotion,Intelligence and Post investment or Aftercare (IDB, 2019). In addition, targeting and prioritizing certain sectors, countries and investment projects over others has an impact on the effectiveness of investment promotion activities**.** Virtually all Latin America and OECD IPAs prioritize certain sectors or source countries as well as investment projects. However, according to a study developed by the IDB, Procolombia does not prioritize nor excludes sectors/countries, projects or investors, according with the targeting intensity index created by the authors. A large proportion of IPA's re-examine their priority sectors and countries annually, which does not mean that those priorities change frequently (Martincus & Sztajerowska, 2019).

On free trade zones regime, results from different studies vary. On one hand, (Gomez Restrepo, Mitchell Restrepo, & Gallo, 2014) indicate that the effects of the instrument on the economy have been positive, since they promote job creation, investment, regional development, business agglomerations formation and productive chains, dynamism of exports, among others. The economic and export dynamism of strategic sectors such as manufacturing or high added value services is essential for the country since it compensates for the drop in production in traditional sectors such as oil and coal. On the other hand, (Melendez, 2015) finds that free zones do not have the expected effects on improvements in the export performance of users (neither in non-traditional sectors, nor in those with comparative advantages). On the contrary, their effects are associated with lower tax rates that impose fiscal costs, with the unevenness of the playing field between competitors in the same sector, with the idea of bringing activity to declining areas and with no customs clearance. Therefore, the author concludes that it is important to evaluate the impact of such instrument to evaluate its continuity or adjustment. Finally, (Garcia-Caceres & Ospina-Estupiñan, 2017) show that Latin American countries have one of the highest development dynamics of the free zones, both in number and employment, however, the impact is low on the development of value, both in the human aspect and in innovation.

III. RECOMMENDATIONS

Colombia should focus on attracting efficiency-seeking FDI. This type of investment is key to work towards productive diversification. It is essential for the country to strengthen its FDI policy through a focalization on investment attraction of sectors that bolster the diversification and productivity improvement process, by means of the country's insertion to regional and global value chains. Incentives´ regimes and FDI attraction instruments should be designed according to Colombia's level of development and the type of investment it wants to boost, and should be evaluated periodically. An analysis on diversification opportunities and new FDI announcements in Colombia, shows that sectors, focused in goods, such as machinery for heavy industry and pharmaceuticals, should be considered emerging sectors to attract FDI (World Bank, 2017).

Colombia has to adapt its investment regulatory frameworks to international conditions, simplify processes and reduce uncertainty and complexity, mainly in the tax regime. FDI grew significantly since 2003, which was motivated by internal factors such as regulatory stability and reforms such as tax exemptions, legal stability contracts, adjustment in oil contracts, and free zones. Likewise, the recovery of the economy and the favorable international situation contributed favorably to these results (Fedesarrollo, 2017). However, (Garavito A, Iregui, & Ramirez G., 2012) points that if Colombia wants to continue receiving large investment flows, it is necessary to adapt its regulatory framework to international conditions (given the strong competition among developing countries to attract this type of external financing), reduce uncertainty and complexity in the tax regime, simplify the excessive regulations that regulate FDI, reduce corruption, among others.

Colombia has to design an integral FDI policy that tackles each phase of the investment cycle to leverage FDI benefits. Colombian authorities know they must diversify its investment sources towards higher value- added sectors. Nonetheless, the country must work towards an integral FDI policy that combines pillars andfeatures of attraction, promotion, facilitation, retention, expansion and productive linkages to receive efficiency- seeking FDI. According to the World Bank's investment reform map consultancy in 2017, the key elements of such policy should include: (i) improve the legal and regulatory frameworks in order to reduce barriers to theentry and operation of private investments in the country; (ii) design incentive programs based on cost-benefit studies; (iii) strengthen institutions and authorities governing FDI policy to guide and monitor FDI development; and (iv) implement mechanisms that protect investors from arbitrary government behavior or adverse changes in regulations. (World Bank, 2017). The main recommendations in each investment phase or pillar are:

a. **Vision and Strategy:** Define a "supra-ministerial" authority or instance that prioritizes FDI policy within its agenda, and follows up effectively its strategy implementation, revision and actualization. Strengthen the Ministry's capacity to better articulate export promotion and FDI attraction policies and the institutional capacity and personnel of the investment and services directorate of the Viceministry of Trade. It is equally important to strengthen the monitoring and evaluation strategies for IED. And at the regional level, there should be an increased institutional coordination and more training programs that promote knowledge transfer, for regional actors to foster FDI attraction and retention at the local level.
b. **Attraction and Promotion:** On one hand, it is important to reduce the number of sectors that the promotion agency (Procolombia) actively promotes to attract FDI. The number of prioritized sectors that the agency works with, is above countries that promote both, investment in search of domestic markets, and in search of efficiency. In addition, the free trade zones regime should be analyzed and reconsidered according to international practices. This analysis should evaluate whether it is an effective instrument to foster efficient FDI, and if it is adequate to respond to investments in the sector of value-added services. Free trade zones in Colombia have location incentives, which should be considered according to their type. According to empirical studies, for investments that seek natural resources, market access, and access to strategic assets, incentives are used or considered in a limited way. In this regard, incentives' regimes should be aligned with the type of investments the country wants to attract and should consider stability and predictability as basic pillars.
c. **Facilitation:** Colombia has to facilitate the provision of information and assistance services to the investor, during the whole investment cycle. Procolombia and the Ministry have to generate efficient channels to execute procedures and consultations with the different public agencies that an investorhas to deal with. In this area, it is important that the country considers the development of an FDI Single Window that centralizes, simplifies and rationalize the establishment and operational investment procedures.
d. **Entrance and Establishment**: Colombia should analyze the relevance of regulations that limit economic competition in services sectors such as baking, insurance, telecommunications and logistics. FDI liberalization in these sectors can increase competitive pressure in established businesses, which in turn can deter excessive concentration, reduce uncertainty and knowledge and technology transfer costs. In this area, the country should also review the procedures involved in the movement of people involved in businesses, and validation or accreditation of professional degrees in Colombia. This strategy can facilitate the hiring process of qualified foreign professionals to meet investors' needs when local human capital is limited.
e. **Protection and Retention:** In order to prevent international disputes, foster confidence to retain investment, mitigate political risks, and improve the investment climate, the country should implement a systemic investment response mechanism. The Colombian government has to build the institutional framework to react in a coordinated way, to respond effectively to an investment claim or issue that is raised by a government conduct, before the conflict intensifies and transforms into a legal dispute. The institutional infrastructure must be able to identify, evaluate, determine and implement the best course of action to respond to a specific claim efficiently, according to the laws, regulations and international investment agreements of the country.
f. **Local Economic Linkages**: The development of linkages between foreign investors and local businesses is a key element that different governments look for when designing FDI policies. In this area, Colombia should create and improve economic linkages' programs that connect FDI with local businesses, fostering immediate opportunities and improving local supply capacity. These programs should include matchmaking and supplier development strategies.

FDI enhancement not only requires policy and interventions in every phase of the investment cycle, but also in important business climate and development conditions. (Kalin, 2009) indicates that it is necessary to continue creating conditions to attract investment. Among others, these conditions include: enhancing trade agreements, improvement in quality infrastructure, availability of skilled labor, technological capacity (technological capacity of local firms and capacity to absorb the technology and skills of foreign investors), improvement of business climate (macroeconomic and political stability, institutional and tax quality), promotion of linkages between FDI and the local economy. Similarly, (Vallejo Almeida, 2017) highlights the need to modernize the national workforce, invest in infrastructure, and eliminate entry restrictions to the financial system.

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Annex – Foreign Direct Investments (FDI), R&D and innovation in Colombia

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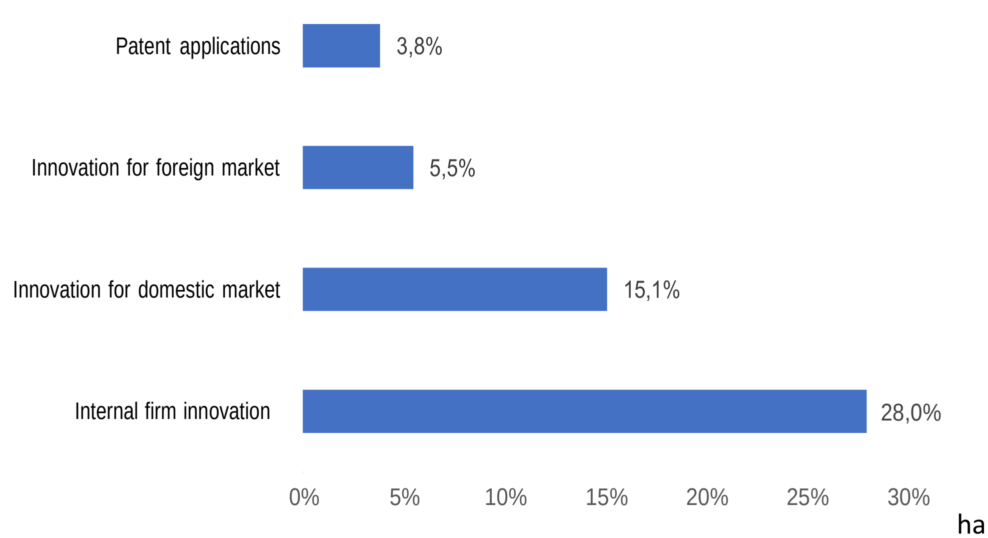
A large body of literature suggests the existence of positive effects of Foreign Direct Investment (FDI) on developing economies (Alfaro, 2014)**.** FDI has favorable effects on innovation practices and productivity of domestic firms due to greater market competition, spill-over effects of technology adoption, and superior managerial practices. Other positive effects of FDI are increased job creation and tax revenues. However, new empirical evidence shows that FDI could have heterogeneous effects on innovation capabilities and productivity of domestic firms particularly in developing countries (Giroud, Jindra, & Marek, 2012; Crespo & Fontoura, 2007). Subsidiary firms may not generate positive spillover effects on domestic enterprises if their approach towards innovation is to adapt headquarters' processes and products into the host market –competence-exploiting firms. In contrast, subsidiary firms that invest on new products and processes directly in the host country –competence-creating firms– may generate positive effects on the overall domestic firms' innovation capabilities and productivity.

Using a data panel from 2003-2012, an empirical study for Colombia finds that while the presence of FDI through competence-creating firms has positive effects on domestic productivity, presence through competence-exploiting firms fails to increase productivity on local firms (Albis & Álvarez, 2017)**.** In fact, the authors find that only 32.5% of the subsidiary firms operating in the country (176 out of 540 subsidiaries) can be classified as competence-creating. Complementary to that, for the 2008-2016 period, we find that only 52% of subsidiary firms in the country have at least one innovation outcome as measured by the successful development of internal firm innovations, innovations for domestic market, innovations for foreign market, or patent applications. Moreover, only 3.8% and 5.4% of subsidiary firms have innovations related to competence-creating firms such as patent applications and international market innovations respectively, while 28% and 15,1% of firms have innovations more related to competence-exploiting strategies (Figure 1).

Figure 1.Average percentage of foreign firms by innovation output. 2008-2016



Source: Authors' calculations based on DANE - EDIT 2008-2016

In regards to R&D investment by subsidiary firms in the country, Langebaek & Vásquez (2007) **and Arbelaez & Parra** (2011) **find that subsidiary firms invest more in R&D activities but they are less likely to make the decision to innovate**. This result is consistent with Albis & Alvarez (2017) described above, suggesting that most R&D activities are being held at the subsidiary's headquarters which minimize the spillover effects of technology adoption necessary for FDI to produce positive effects on the host economy. Finally, though R&D investment is more intense for subsidiary firms, most of the financing resources are domestic. Our analysis shows that for the 2017-2018 period, 99.2% of R&D investment by subsidiary firms originated within the country which suggests that Colombia has challenges attracting foreign capital to develop new knowledge.

Furthermore, evidence suggests that investment intensity of subsidiaries is concentrated on basic and intermediate capacities such as the acquisition of local incorporated and unincorporated technology suggesting that foreign enterprises prefer to stablish technological facilities in the country rather than generate new knowledge (Albis & Álvarez, 2017)**.** Our analysis for the 2017-2018 period reinforces that by showing that subsidiary firms in Colombia cooperate in a greater extent with external partners that with internal ones. Thus, only 13,4% of subsidiary firms cooperated with internal partners to carry out technological innovations and improvements.

Finally, regarding public policy designed to foster FDI into R&D investments, ARCO methodology mapped that free trade zones have been setting R&D investment requirements. For example, in 2019 the government created four new free trade zones in Nariño, Cauca, Tolima and Bolivar, and demanded that at least 8% of the investment must go to R&D activities. This incentives to R&D in free trade zones are important to foster FDI, particularly in cities such as Bogota, where 29% of the firms located in the free trade zones are multinational companies, 20 of which are tech related – out of 40 tech companies between domestic and foreign.

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