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Does Colombia Have the Right Plan for Oil & Gas Reforms?

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Q and A: Does Colombia Have the Right Plan for Oil & Gas Reforms?

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The administration of Colombian President Juan Manuel Santos submitted a constitutional reform proposal to Congress on Aug. 30 that seeks to "more equitably distribute" oil and mining royalties. Amid projections that revenues from those sectors will surge, the proposed reforms would allocate royalties more evenly across regions, rather than the current concentration in oil-producing states, and create a stabilization fund overseen by the central bank. Is the measure likely to pass and, if so, with what changes? What effects would the reform bill have on long-term financial stability? How does Colombia's strategy to manage revenues from natural resources compare to efforts made by other countries in the region?

Hernan Arizmendi, CEO of LAGO Energy:

"This is the right time for Colombia's new government to lead a constitutional reform, and definitely change its current royalties distribution system by proposing a stronger, more equitable and efficient system that will save the robust resources coming from the exploitation and delivery of the country's nonrenewable assets. For many of us, it is clear that after years of applying today's distribution scheme, the 'benefits' are weak in terms of real progress for the region's populations, including subpar infrastructure developments and a lesser quality of life for not only these producing oil and mining states—where often there are high levels of corruption and inefficiency—but for the rest of the nonproducing states in the nation as well. Although it will not be easy, there is a good chance that this measure will pass, and positive changes will be forthcoming, starting with the creation of a stabilization fund overseen by the central bank, possibly accompanied by other proposed fiscal and tax reforms. Firm controls and good management of the future billions of dollars of income will secure the success of the government's new macro-social and economic agenda, thereby reducing destabilization and the gap between the country's richest and poorest regions. Whether one considers the similar experiences of other countries or not, with the possible approval of the reform bill, one of the government's pet projects, the long-term financial stability of the country will be more solid thanks to additional factors like the success of winning the war against the guerillas and the drug cartels, permitting the continuation of direct foreign investment in the country. The key to success is how well Colombia is prepared to properly manage its economic growth and strategy to administer revenues from its natural resources, while still needing to work hard to control their fiscal deficit and maintain the country's positive image among the worldwide investing community."

Heather Berkman, analyst at the Eurasia Group's Latin America practice: "The Santos administration is quite likely to secure congressional approval of its reform proposal, which aims to distribute oil and mining royalties more equitably among Colombia's subnational governments. The administration is clearly looking at the models of other energy producing countries and seeking to prudently manage a projected influx of oil and mining royalties. However, the proposal is already proving to be quite controversial. Legislators who represent oil and mining producer states, including those who are part of the ruling U Party and other coalition members, will oppose the bill and seek to retain as much control over royalty revenues as possible at the regional level. Furthermore, legislators will try to exert as much pressure as possible to ensure that more resources are delegated to the subnational level—and thus benefit their constituents—rather than to the central government. The large number of votes required for passage will create ample opportunity for legislators to make demands and water down the bill. A total of eight votes will be needed to pass a constitutional reform. Consequently, some of the reform's most market-friendly elements, including the creation of a stabilization and savings fund to be overseen by the central bank; and the delegation of oversight of royalties distribution to the Ministry of Finance, may be watered down. Additionally, some legislators may try to introduce more stringent rules to increase transparency and enforce taxes on oil and mining companies. Despite this, any moves by legislators to raise taxes or royalty rates on these companies will probably be stymied by the Santos government."

Enrique Gómez-Pinzón, partner at Holland & Knight in Washington: "The current government had the courage to face upfront and from the outset a structural problem, which is that eight departments (territorial entities) with 17.3 percent of Colombia's population receive 80.5 percent of the total royalties that Colombian natural resources exploitation generates. The remaining 24 departments, with 82.7 percent of the country's population, receive a negligible amount. To make it worse, these eight 'blessed' departments showed lower development levels than those achieved by the 'nonblessed' departments. When the current constitutional provision was adopted, the exploitation of natural resources in Colombia did not play such a significant role in its GDP, so the regulation seemed to be a fair distribution of royalties. However, currently natural resources exploitation, such as oil, mining and gas, compose a substantial part of Colombia's GDP. Therefore, it is not fair that resources that belong to the Colombian state are enjoyed by only a few citizens who reside in the lucky eight departments. With this reform, the government is seeking to distribute, in a fair and equitable way, the royalties between all departments. To accomplish this, the reform proposes the creation of two funds, one for the distribution of the royalties and the other for saving part of them to be used in times of crisis, similar to the funds incorporated in Chile, Mexico and Venezuela. These funds will be managed by the national government and the central bank, respectively, and with their experience and expertise, it is expected that the impact on long-term financial stability will be positive. It is likely that the senators and representatives from those lucky eight departments are going to oppose the reform, but the remaining congressmen, seeking to protect the best interests of the people and being the majority should approve it, with no significant changes."

The Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at kuleta@thedialogue.org with comments.*