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Bogotá Eyes the Irish Model

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When Colombia's trade minister visited the Journal's New York offices two weeks ago, the last thing I expected to come up in our conversation was Ireland. To my surprise, it was the first subject he raised.

No sooner had Luis Plata sat down than he started talking about the Irish economic transformation -- from impoverished ugly duckling to swanky swan of Europe in just two decades -- and why a similar growth model is just what Colombia needs.

Some of the necessary policy adjustments are already under way in Bogotá, he said, and with any success, the reforms can be deepened. But the big question mark is whether the U.S. Congress will approve the pending Free Trade Agreement. The FTA, Mr. Plata explained, is as important to Colombia's growth as European Union membership has been to Ireland's.

To think that Democrats might undermine Mr. Plata's visionary agenda is troubling. In 2006, U.S. official development assistance aimed at alleviating poverty around the globe was \$23.5 billion and it was pretty much money down a rat hole. That's because development requires economic liberalization, and leaders of poor countries have little incentive to disturb the status quo of monopolies and protectionism that put them in power. Their incentives are even less when rich-country handouts are flowing.

Now along comes Colombia, with a leader -- President Álvaro Uribe -- who is willing to risk political capital to open domestic markets, cut taxes and spur competition in a bid to grow fast à la Ireland. All his government asks from Washington is two-way trade, but Democrats want to slam the door in his face.

Before Mr. Plata became trade minister last year, he headed a government export agency. "We started going to Ireland several years ago, he says, "because we were looking at countries around the world that had been successful in attracting foreign direct investment. What we found was that Ireland had lowered its corporate tax rate from 40% to 12.5%," and as a result "was attracting investment, had lowered tax evasion and had increased tax collection. We went back to Colombia and said, 'why don't we just bring [our corporate rate] from 38% to 12.5%.'"

That wasn't a popular view with Colombia's treasury department. "It got me kicked out of their offices," Mr. Plata recalls.

No surprise there. Bean counters in every treasury in Latin America have tax-cut phobia in their DNA. It explains why they often get jobs at the International Monetary Fund in Washington after the collapse of the governments they've served back home. At the fund they can put into practice their deeply held convictions that the only responsible fiscal policy is one built on a static analysis to discover the "right" tax rate. Embracing the notion that production creates its own demand, and that government revenues expand under a low-tax regime, is considered high-risk behavior.

Mr. Plata is more sympathetic toward his treasury colleagues. He says that they have to balance the medium- and long-term benefits of tax cutting with the more immediate need to finance the government. Nevertheless, he was convinced that Ireland's experience could be applied to Colombia. Despite the initial reaction, his team "went to work" on the idea of attracting investment through tax cuts.

In a perfect world, he would have won a flat corporate rate. But he had to compromise and instead came up with the "single-enterprise free-trade zone." It expands the low-tax treatment that companies receive when they are located within a "free trade zone" -- normally an industrial park -- to any company that meets certain investment criteria. Businesses (excluding mining and oil) that qualify by meeting minimum investment amounts and employment targets now pay a 15% flat tax instead of 33%. They also import all raw materials with no tariffs and pay no value-added tax.

In addition to offering these tax advantages, the government is writing "stability contracts" to guarantee that the rules will not change when presidents do. It is also working to reduce the regulatory burden, since red tape is one of the most common complaints from foreign investors.

The "single-enterprise free-trade zone" was launched last May, and to date it has attracted about \$864 million in foreign direct investment. That number would be higher under a pure flat tax, and if Colombia is to rival the Irish miracle, it will have to move in that direction. But to persuade the treasury to adopt a broad-based flat tax, Mr. Plata will have to show some results with his initial experiment.

That's why the FTA is so important. Companies investing in Colombia are looking beyond the domestic market and, as the minister notes, the recent dustup with Venezuela -- in which President Hugo Chávez threatened to close the border -- demonstrates the fragility of Colombia's export market. About half of Colombian exports now go to Venezuela and Ecuador. Access to the U.S. market and to duty-free imports from the U.S. are both crucial for producers.

All of this begs the question of why congressional Democrats want to reject the Colombian trade agreement. They say it's because Mr. Uribe hasn't done enough to quell violence against labor leaders in the country. But murders are down dramatically, and as Mr. Plata says, "you can't make the case that killing the FTA will make things better."

What will make things better is investment, which is fundamental to reducing poverty. Peru, Mexico and Central America all have FTAs with the U.S., which means that Colombia is automatically disadvantaged if it is denied one. And that could harm national security, which is

so fragile. As Mr. Plata pointed out, "You don't win the peace with soldiers alone. You have to have a functioning economy." Surely Democrats can't be against that.

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