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March 17, 2021

**Statement by Mr. Merk and Mr. Fragin on Colombia
(Preliminary)
Executive Board Meeting
March 19, 2021**

We thank staff for the informative report and Mr. Romero Tarazona for his helpful Buff statement. We broadly concur with the thrust of staff's assessment. Colombia's macroeconomic policy frameworks have demonstrated resilience in 2020 despite volatility in capital flows and hydrocarbon prices. In particular, the flexible exchange rate combined with a swift loosening of monetary and fiscal policy have helped mitigate the pandemic shock. The external position has proven resilient and external financing conditions have improved swiftly after the initial shock, and gross reserves have strengthened even further in 2020. Going forward, we concur with staff that risk levels remain elevated and that accommodative policy should be gradually reduced, while remaining mindful of the economic recovery.

On fiscal policy, we take positive note of the authorities' aim to reform the fiscal rule. Regarding Colombia's elevated external financing needs, it seems important to set a clear anchor for fiscal policy while preserving its flexibility to absorb future shocks. Recalibrating the fiscal rule to avoid rising debt levels in the long run as well as establishing an independent fiscal council and specifying the applicability of the escape clause could increase fiscal credibility. In this regard, we also concur with staff that reinstating the fiscal rule already in 2022 – while providing for a realistic, more gradual fiscal adjustment than provisioned by the authorities – would be beneficial. In doing so, a more abrupt adjustment can be avoided at a later stage.

Medium-term fiscal adjustment could be supported by a tax reform to increase revenues and tap potential efficiency gains. Colombia's central government tax to GDP level is low compared to the Latin American average. In this context, we see merit in further work on the personal income tax, as also suggested by staff. The tax reform could also be used as an instrument to address structural challenges, such as persistent inequality.

Moreover, measures such as the introduction of a carbon tax could come with benefits to steer the economy away from reliance on hydrocarbon energy.

We support staff's recommendation to continue building reserves and safeguard against further volatility in financing conditions and hydrocarbon prices. Reserves are currently at 145 percent of ARA (including the purchase under the FCL) but external financing needs are projected to remain elevated over the coming years. It is therefore imperative to maintain adequate buffers and safeguard against future external shocks.

We note that Colombia's financial sector has weathered the crisis well, not least thanks to the strong regulatory framework. Nevertheless, the authorities are encouraged to keep macroprudential measures in place until the crisis abates and to continue closely monitoring NPL levels. We also note staff's word of caution on the profitability risks of financial conglomerates that have sizable exposures to Central America.

On structural policies, we support the authorities' commendable efforts to integrate Venezuelan migrants into the labor market. The new TPS program seems to be a useful addition to the existing toolkit, which offers migrants a pathway to economic and social integration in Colombia.

As regards transparency and governance, we echo staff's recommendations to improve the anti-corruption framework, inter alia by fostering the use of electronic procurement and big data analyses. Enhanced efforts in fighting money laundering and terrorism financing remain critical.

Overall, a clear strategy on how to exit from the FCL would be welcome. Openly communicating guidance on such an approach could underscore the authorities' commitment to stability-oriented economic policies and – if backed by continued sound policies and reforms – could be perceived as a signal of strength, conducive to supporting market confidence.

Finally, we encourage the authorities to consent to the publication of the staff report.