

The contents of this document are preliminary and subject to change.

GRAY/21/726

March 17, 2021

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

We thank staff for the interesting set of reports and Mr. Romeo Tarazona for his informative Buff statement. The pandemic has hit Colombia hard, leading to the largest recession on record with significant social consequences. The economic situation has improved somewhat since September, but the situation remains challenging and risks are tilted to the downside. While near-term policies must continue to focus on saving lives and cementing the recovery, timely implementation of the planned fiscal reform package will be key to facilitate the necessary adjustment in public finances in the medium term. **We concur with staff's appraisal and offer the following remarks for emphasis.**

Targeted fiscal support should be maintained, accompanied by a strong commitment to return to the fiscal anchor. The temporary suspension of the fiscal rule was appropriate and allowed the authorities to respond timely to the crisis. Uptake of emergency spending measures were however lower than expected in 2020, and we agree that unspent resources could be used in 2021 to fund the vaccine programs and the extension of targeted transfer programs. A small narrowing of the fiscal deficit is still desirable and could be achieved by a gradual phasing out of emergency spending and limiting low-priority spending. After 2021, fiscal consolidation is needed to return to the fiscal anchor, and we support staff's proposal to extend the adjustment horizon of the structural deficit rule to five years to avoid a sharp fiscal tightening. This would still require a budgetary adjustment of 8 percent of GDP by 2026, requiring a sizeable increase in revenues to safeguard key public spending. **Timely implementation of the planned medium-term fiscal reform package will be key** in this regard, and we underline the importance of a comprehensive and durable reform of the tax system focused on eliminating preferential regimes for business, broadening the base for personal income taxes and trimming the vast net of VAT exemptions. We encourage the authorities to also consider staff's proposal for a carbon tax that would also assist climate mitigation efforts. *Earlier attempts at addressing VAT exceptions in 2018 were met with large opposition and were eventually watered down to become revenue neutral. We note from the BUFF statement that the current reform includes VAT refunds to the vulnerable*

population that potentially could ease implementation while safeguarding the poorest households. Could staff comment on the implementation process and risks regarding the current reform?

We see considerable downside risks to the debt trajectory. We note staff's assessment that Colombia's public debt is expected to remain sustainable in the medium term in a baseline scenario with no further lockdowns, and where the authorities seek to return to the fiscal rule, and thus to primary surpluses from 2024. While staff's baseline forecasts are not systematically biased based on historical projection errors, we highlight the unprecedented nature of the current crisis, with considerable uncertainty around the near-term outlook combined with a fiscal adjustment that is larger than those made historically. Moreover, the share of public debt held by non-residents has continued to rise from an already elevated level, and while financial conditions are still supportive, recent episodes of market turbulence have showed that Colombia is vulnerable to volatile capital flows, highlighting the risk that non-residents sell and exit for a long period. Colombia is currently rated one notch above non-investment status by two agencies and we are concerned about possible knock on effects if downside risks materialize. *We welcome staff's comments.* These risks are also relevant for external financing requirements which have risen notably, and *staff's views on the possibility that Colombia will need to draw further on the FCL are welcome.*

Monetary policy accommodation should continue to support the recovery and boost private sector demand. The Central Bank's timely response to the crisis included easing the policy rate to a historical low, providing ample liquidity, and allowing the exchange rate to adjust within the inflation targeting regime. Colombia's flexible exchange rate should continue to be the first line of defense against external shocks. The Central Bank also has scope for further monetary easing if downside risks materialize, both through policy rate cuts and provision of liquidity. We agree with staff that macroprudential policy should continue to support credit supply, while safeguarding stability risks through intensive monitoring of the financial system.

Renewed focus on structural policies is necessary to ensure sustainable and inclusive growth in the longer term. As the recovery takes hold, continued support to the most vulnerable must be complemented by measures to facilitate the recovery of formal sector jobs and enhance productivity. This should include addressing structurally high non-wage labor costs, as well as non-tariff barriers to trade, some of which would not only reduce trade costs but also the scope for corruption. We welcome the initiatives to ensure transparency and conduct audits of emergency spending and encourage the authorities to further enhance the coverage and data quality of the electronic government procurement system. We share staff's concern that money laundering investigations and enforcement are still not in line with Colombia's risk profile and call on the authorities to move forward with the implementation of the 2018 AML/CFT assessment recommendations.