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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/149

3:00 p.m., October 10, 1984

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	T. Ramtoolah, Temporary
	P. Péterfalvy, Temporary
	X. Blandin
	J. Delgadillo, Temporary
	D. C. Templeman, Temporary
	T. Alhaimus
H. Fujino	T. Yamashita
	B. Goos
	Jaafar A.
	G. W. K. Pickering, Temporary
A. Kafka	
	N. Coumbis
	A. S. Jayawardena
	J. E. Suraisry
J. J. Polak	
	R. L. Bernardo, Temporary
	A. A. Agah, Temporary
	E. I. M. Mtei
	J. E. Rodríguez, Temporary
	A. K. Juusela, Temporary
N. Wicks	
Zhang Z.	

L. Van Houtven, Secretary
K. S. Friedman, Assistant

Also Present

Administration Department: H. J. O. Struckmeyer, Deputy Director; J. G. Keyes. European Department: U. Dell'Anno. Exchange and Trade Relations Department: M. Guitian, Deputy Director; G. Oliveros. Fiscal Affairs Department: A. L. Antonaya. IMF Institute: P. R. Rado. Legal Department: P. L. Francotte, Ph. Lachman. Research Department: B. E. Rourke. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; M. E. Bonangelino, A. Caetano-Filho, M. Caiola, D. S. Hoelscher, J. Jaramillo-Vallejo, C.-J. Lindgren, C. M. Loser, L. L. Pérez, S. J. Stephens. Advisors to Executive Directors: H. A. Arias, D. Hammann, E. M. Taha, A. Vasudevan. Assistants to Executive Directors: W.-R. Bengs, M. Camara, M. Lundsager, K. Murakami, D. J. Robinson, A. A. Scholten, Wang C. Y., A. Yasseri.

1. COLOMBIA - 1984 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/84/148, 10/10/84) their consideration of the staff report for the 1984 Article IV consultation with Colombia (SM/84/216, 9/18/84; and Cor. 1, 10/5/84). They also had before them a report on recent economic developments in Colombia (SM/84/220, 9/27/84; and Cor. 1, 10/5/84).

Mr. Coumbis commented that the authorities' efforts to stimulate the economy without intensifying inflationary pressures had not had the expected results. It was true that Colombia, unlike many developing countries, had been able to keep real GDP from declining in 1983, and that the rate of inflation had fallen from 26 percent in 1981 to less than 17 percent in 1983. However, real GDP growth in 1983 had been less than one third the expected rate, the rate of unemployment had risen to 12.5 percent, the overall balance of payments deficit had increased much more than expected--from $0.7 billion in 1982 to $1.8 billion in 1983--and reserves had fallen to $3.1 billion compared with $5.6 billion at end-1981. Moreover, net reserves had declined by a further $1.3 billion in January-July 1984, and the staff had concluded that, in the absence of policy changes, total reserves would fall to the equivalent of just 3 1/2 months of imports at end-1984.

The authorities apparently had little room for maneuver, Mr. Coumbis continued, particularly as wages had been rising faster than the rate of inflation in 1983 and 1984; the overall public sector deficit had increased from 4.3 percent of GDP in 1981 to 6.9 percent in 1983 and was expected to rise to 8.2 percent in 1984 if no additional measures were taken; and bank credit to both the public and private sectors had been increasing at rapid rates in recent years. Those developments suggested the need for a drastic change in the direction of policies as soon as possible in order to reduce the pressure on the balance of payments.

That the authorities agreed with the staff on the need to adopt tighter demand policies to reduce the pressure on the balance of payments was encouraging, Mr. Coumbis commented. The authorities had decided to reduce substantially the public sector deficit and its financing by the Banco de la Republica. To that end, they had taken steps to increase public expenditure restraint, bolster revenues, slow the rate of increase in credit to the private sector, maintain high interest rates, and substantially cut the rate of wage increases compared with the previous two years. In addition, the authorities intended to maintain the flexible exchange rate policy and the current rate of depreciation of the peso. They should be urged to act quickly and vigorously, but they must also show determination to persist as long as necessary with the effort to eliminate the pressure on the balance of payments and to halt the erosion of foreign reserves. The proposed decision was acceptable.

Mr. Goos said that he broadly agreed with the staff appraisal. The proposed decision should be approved.

Although Colombia's economic situation was favorable compared with that of most other Latin American countries, Colombia's internal and external imbalances had clearly deteriorated in recent months: despite the moderate recovery in general economic activity, unemployment had risen, the current account deficit had grown, net capital inflows had fallen drastically, international reserves had declined, and the external debt had increased. Moreover, the overall efficiency of the economy had been impaired by the complex system of exchange and trade restrictions.

Present trends would inevitably move Colombia farther away from a sustainable balance of payments position, Mr. Goos continued. There was a clear need for more appropriate financial and wage policies and for determined efforts to eliminate the trade and exchange restrictions. The authorities' recognition of the need to reorient their financial policies was welcome, and the remarkable curtailment of government outlays under the proposed budget was certainly a step in the right direction. However, a medium-term approach was needed to make permanent gains in reducing the pressure on the balance of payments.

The efforts under the 1985 budget to curtail government outlays, substantially reduce the public sector deficit, and limit its financing by the Banco de la Republica were welcome, Mr. Goos said. An accompaning series of measures would be introduced to strengthen the financial position of the public sector. In that connection, wage policy should play a prominent role in limiting public sector outlays. Public sector salaries had risen more quickly than the rate of inflation in recent years, and in the coming period their growth should be kept more closely in line with, and preferably below, the rate of inflation. However, a restrictive approach to minimum wages in particular might not be desirable, given the existing pattern of income distribution and the risk of intensifying social pressures should those wages be reduced.

He was surprised that the staff felt that financing the fiscal deficit by increased recourse to the capital market would be acceptable only as an emergency measure, Mr. Goos said. In his view, such financing would be welcome, as it would reduce the authorities' reliance on monetary financing of the deficit and might help to deepen the financial markets. That approach would of course involve a decline in the financial resources available to the private sector, but it would not change the degree of real crowding out, which was determined by the size of government expenditures and not by the financing of the deficit. Moreover, under the approach he favored, the inflationary "tax" on the overall economy owing to monetary financing of the deficit through the Banco de la Republica might eventually be lowered.

Colombia's external policy course in coming years should be aimed at preventing a further deterioration of the country's external net asset position and at alleviating the pressure from the already sizable debt burden, Mr. Goos commented. The staff's medium-term outlook clearly suggested the need to adjust immediately and to keep additional borrowing within prudent limits. The large overall balance of payments deficit, the decreasing international reserves, and the mounting external debt appeared to have been caused mainly by inappropriate domestic policies, although adverse external factors had perhaps also played a role. There was a clear need to increase domestic savings through appropriate policies. A flexible exchange rate policy should have a positive effect on the current account, would certainly be much more efficient than the present complex system of exchange and trade restrictions, and would help to diversify Colombia's exports.

Mr. Suraisry agreed with the main points in the staff appraisal and accepted the proposed decision. Until recently, Colombia had had a good record of stable growth and a strong balance of payments. During the previous two years, however, growth had been moderate and unemployment had risen sharply, despite the deliberate attempt to stimulate the economy. Moreover, the rate of inflation had fallen but was still high, serious fiscal and external imbalances had emerged, and reserves had declined markedly, thereby seriously weakening domestic and external confidence. Those problems could be traced partly to external factors, but also partly to inappropriate domestic policies. The authorities faced the difficult task of reversing the unfavorable trends, and their first steps were encouraging.

To bring the economy back on track, priority would have to be given to fiscal adjustment, and the comprehensive package of measures in the 1985 budget was therefore welcome, Mr. Suraisry continued. The planned combination of expenditure restraint, tax increases, and the reorganization of public enterprises was in the right direction, and he was pleased to learn from Mr. Kafka's opening statement that measures in those areas would be implemented by the end of 1984. Fiscal retrenchment was essential if monetary policy were to operate effectively. The large financing need of the public sector had caused rapid growth in the monetary aggregates, thereby undermining the effort to control inflation. The authorities' efforts to limit credit expansion and to finance more of the public sector deficit by nonmonetary means were welcome. It would be useful to know how much scope there was for selling government debt to the private sector, given the apparently limited size of the domestic capital market. He shared the authorities' concern about the recent liquidity problems of some commercial banks. Those problems would have to be handled firmly and quickly if confidence in the financial system was to be maintained.

Wage restraint was also crucial both to contain inflation and to restore external competitiveness, Mr. Suraisry said. The authorities' intention to limit the increase in central government salaries in 1985 was fully appropriate, and their efforts to strengthen control over wage increases in the rest of the public sector were welcome; the Government's efforts in the wage area should set an important example for the private sector.

The external position should improve in the short term due to the pickup in coffee prices and the strong performance of nontraditional exports, Mr. Suraisry commented. The balance of payments was also benefiting from the flexible exchange rate policy introduced in 1982. While Colombia was fortunate to have more room to borrow externally than many other developing countries, he agreed with the staff that continued prudence in contracting debt was needed in view of the sharp rise in the debt service ratio during the previous three years.

Colombia's increased reliance on exchange and trade restrictions was regrettable, Mr. Suraisry said. While it was true that other countries also relied on such measures, they were obviously costly and resulted in inefficient resource allocation. He was pleased that Colombia's restrictions were temporary, and he hoped that they would be dismantled as soon as possible.

Restoring the sustained growth experienced in the late 1970s would require continued implementation of firm domestic policies for some time to come, Mr. Suraisry considered. The authorities would also have to make well-designed structural reforms to diversify and expand the productive base. In that connection, the staff report could have usefully included an appendix describing Colombia's relationship with the World Bank, which apparently had made substantial loans to the country during the previous 18 months to finance agricultural research, small industrial enterprises, and coal exploration. In addition, Colombia had recently benefited from the first cofinanced loan to a Latin American country; the funds were to support a major electricity project, which was the kind of project that would provide the long-term framework needed for sustained growth in Colombia. The present combination of measures designed to achieve immediate adjustment and steps to ensure appropriate longer-term development should pave the way for achieving a sustainable external position over the medium term.

Mr. Pickering said that he broadly agreed with the staff appraisal. The proposed decision was acceptable.

The serious deterioration in Colombia's external position was a cause for concern, Mr. Pickering continued. It had been due partly to external factors, but domestic policies had played a major role. Given the deterioration in the external position, the unsettling increase in Colombia's debt burden, and the likely economic environment in coming years, the authorities' present macroeconomic policies were clearly unsustainable. Their intention to reorient those policies to reduce the imbalances was therefore welcome, and new measures should be implemented without delay, as the erosion in the level of foreign reserves had already substantially reduced the room for maneuver.

Commenting on the broad policy issues facing the authorities, Mr. Pickering said that, while it was true that Colombia's debt level was not high relative to that of other countries in the region, its rapid growth in recent years and the large debt servicing burden were causes for serious concern. The authorities would have to implement their financial policies with great determination if a serious debt problem was to be avoided.

The authorities' intention to achieve a sustainable balance of payments position over the medium term was welcome, but a clearer view of the precise policies needed should be enunciated by the Government, Mr. Pickering continued. On balance, the policy measures described in Scenario I were appropriate. Room for some additional external borrowing existed, but the authorities would have to exercise caution to ensure that the borrowing would yield adequate gains in production and exports.

He looked forward to the staff answers to the interesting questions about the exchange rate raised by Mr. Polak at the previous meeting, Mr. Pickering remarked. Given the information in the staff report, the policy of restoring international competitiveness through a crawling peg devaluation appeared appropriate. The recent upturn in nontraditional exports was encouraging, and it would be unfortunate if the authorities used the uncertainties about likely developments in that trade as an excuse to delay taking steps to bolster exports. Given the seriousness of the balance of payments position, Mr. Kafka's comment that the exchange rate policy would be monitored closely was welcome; it would be particularly necessary should inflation be worse than expected.

His authorities were concerned about the proliferation of exchange and trade restrictions in Colombia, Mr. Pickering commented. The country's exchange and trade policies had always been highly restrictive and cumbersome, and the increasing emphasis on such restrictions in response to the deteriorating external balance was highly regrettable. The absence of any movement to eliminate the multiple exchange rate practices was particularly unfortunate. In early 1984, the authorities had expanded export incentives through the exchange and trade system in order to promote nontraditional exports. Such initiatives were subject to abuse and, in any event, were unlikely to achieve the desired goal over the medium term. The authorities' intention to begin dismantling such practices by the end of 1985 was a positive step, but a clearer indication of their plans would be welcome. He hoped that a clearer liberalization program would be developed by the next Article IV consultation. It could not be emphasized too strongly that sound financial policies and a domestic environment conducive to efficiency were far more effective ways of easing external pressures and promoting a higher sustainable standard of living than a restrictive trade and exchange system.

The authorities' determination to maintain nonaccommodating monetary and credit policies was welcome, Mr. Pickering said. Their concern about the level of interest rates was understandable, but he tended to agree with the staff that an assessment of the appropriateness of the current rates must take into account the capital outflow thus far in 1984, the sharp decline in international reserves, and, although the staff had not highlighted it, the subsidized credit for selected sectors by the Banco de la Republica. As several Executive Directors had noted during the previous Article IV consultation, the Government's policies spurred capital flight and supported inefficient enterprises.

Greater fiscal restraint would be the key to containing monetary expansion while permitting an eventual easing of interest rates, Mr. Pickering considered. The efforts to increase tax revenues were particularly welcome, as the tax burden was relatively low and tax revenues as a proportion of GDP had been declining.

Wage policy would be crucially important, Mr. Pickering continued. During the previous two years, the adjustments in central government salaries and minimum wages had greatly exceeded the increases in the consumer price index. The authorities' intention to maintain a more prudent salary policy in coming months was encouraging. Although the determination of salary adjustments by the authorities was limited to salaries in the Central Government, such adjustments sent an important signal to the rest of the work force.

Under a new law, Mr. Pickering noted, supplementary budgets could be presented to Congress during a fiscal year for a cumulative amount equivalent to 10 percent of the original budget. The authorities should be prepared to implement measures to ensure that significant reductions in the public sector deficit would be achieved in 1985.

The reorientation of policies and the acceleration of the implementation of the adjustment program were welcome, Mr. Pickering concluded. However, a more comprehensive and determined effort was needed to increase the likelihood that the authorities' medium-term objectives would be met.

Mr. Delgadillo commented that Colombia had enjoyed a long period of economic success prior to 1983. Since then, the pace of economic growth had slowed, the level of international reserves had fallen, and the liberalization process initiated in 1980 had faltered, although the rate of inflation had been reduced from 26 percent in 1980 to 17 percent in 1983. The balance of payments had weakened mainly because of exogenous factors, such as the high interest rates abroad, the depreciation of Venezuela's currency, and the low international prices for coffee; however, the fiscal, monetary, and wage policies of the Colombian authorities had also played a role.

The authorities' main policy objective during the previous two years had been to revive the economy--the growth of which had virtually ceased--through expansionary fiscal and monetary policies and some external restrictions, Mr. Delgadillo said. External borrowing had been intensified somewhat to avoid a sharp reduction in reserves.

Hitherto, Mr. Delgadillo continued, the authorities' policies had reflected their feeling that the economy could afford some fiscal and monetary stimulus as a result of the prudent measures of earlier years, when reserves had been accumulated without excessive reliance on foreign financing. At present, the authorities had to decide whether expansionary policies would solve the problems facing the economy or merely postpone needed adjustment. The continuing large losses of reserves in recent months were a cause for concern, and the staff considered that, unless the authorities adopted tighter demand policies soon, the balance of payments would deteriorate further in coming months.

Like the staff and the authorities, he attached great importance to slowing the rate of credit expansion, Mr. Delgadillo remarked. To that end, the planned cut in the fiscal deficit would be helpful, but the authorities should be encouraged to reduce the rate of growth of credit extended by the Banco de la Republica. Their decision to maintain positive real interest rates was appropriate; such rates were needed to avoid further deterioration in the balance of payments position.

The proposed 1985 budget, which included a substantial reduction in the rate of growth of outlays, was encouraging, Mr. Delgadillo said. The authorities' efforts to raise revenues to complement their policy of expenditure restraint was welcome.

The Government's intention to maintain the flexible exchange rate policy was also gratifying, Mr. Delgadillo went on. It should enable Colombia to recover the international competitiveness lost over the previous several years and, together with the more restrictive demand policies, should place the Government in a position to eliminate the exchange restrictions.

He was encouraged to learn from Mr. Kafka's opening statement that the authorities had decided to accelerate the implementation of the adjustment program, Mr. Delgadillo commented. The new revenue measures, the reduction in bank financing of the deficit, the prudent wage policy, and an adequate exchange rate policy would greatly contribute to improving the country's economic performance.

Mr. Rodríguez remarked that as a result of the difficult regional and world economic environment, Colombia's rate of economic growth had slowed in 1983, and the overall balance of payments had continued to deteriorate. However, the rate of inflation had fallen to 15 percent in the 12 months to end-July 1984; in earlier periods, the entrenched inflationary expectations had prevented reductions in inflation. Moreover, the authorities had continued to diversify the economy, particularly in the agricultural and energy sectors. The substantial investments in nonoil energy sources were particularly welcome.

He agreed with the authorities, Mr. Rodríguez continued, that the effort to reactivate the economy should not be undertaken until the rate of inflation had slowed further and the external balance had improved.

Controlling the inflationary pressures and preventing further losses of reserves should continue to be the main overall objectives of economic policy. The authorities were aware that to achieve those objectives, demand--particularly in the public sector--would have to be more restrained than hitherto. On the revenue side, the recent adoption by the Congress of a reform package including significant measures to enhance tax revenues at the central and local levels was welcome. Those measures, together with the steps to improve expenditure control, would help to keep the overall deficit of the nonfinancial public sector relatively small.

The authorities' monetary and exchange rate policy measures had not had any significant effect on the balance of payments, Mr. Rodríguez noted. He agreed with the authorities that steady implementation of their monetary and fiscal programs, together with prudent external debt management, should enable them to achieve the desired objectives.

The staff representative from the Western Hemisphere Department explained that both the Executive Branch and the Congress were empowered to propose and implement fiscal measures. The Executive Branch had already increased import duties, effective August 24, 1984. In addition, the authorities intended to raise gasoline prices soon, and they were studying the tariff structure of the public entities and planned to increase the tariffs for electricity, water, and other items in the near future. Also, the Congress was debating certain fiscal measures which had been proposed by the Executive Branch, and the staff had suggested to the authorities that supplementary measures might be advisable if some of the measures to be approved by Congress were either delayed or amended. There was no certainty that the measures would be enacted, and it was difficult to estimate their likely impact. If all the fiscal measures were adopted, and the Government's expenditure policy plan were implemented, the deficit of the central administration could probably be halved. The impact of the Government's various measures on the rest of the public sector was more difficult to judge, as the extent of the adjustments in the public tariffs was not yet known. However, if the rise in salaries in the whole public sector could be kept to 10 percent, and if increases in tariffs were approved, there should be some reduction also in the deficit of the rest of the public sector.

The staff shared the concern of some Executive Directors about the need to strengthen the control over the overall public sector, the staff representative continued. The lack of sufficient information undermined efforts to adopt appropriate decisions and to maintain control of the operations of the overall public sector. Implementing a uniform salary policy over the whole public sector was particularly difficult. The authorities were concerned about the continuing need for transfers from the central administration to cover salary increases in the rest of the public sector, and one of the reforms proposed to the Congress would provide for transfers for increases in teachers' salaries up to, but not exceeding, the rate of inflation; in the past, the transfers had covered increases in excess of the rate of inflation. Proposals had also been made to modify the present system of automatic promotions for teachers that had resulted in corresponding increases in salaries.

The present annual rate of depreciation of the exchange rate was 28 percent, the staff representative remarked. The calculations on the effective exchange rate, which were based on the consumer price index, indicated that the loss of competitiveness in the late 1970s and early 1980s would be restored by the end of 1985. The actual outcome would of course depend on developments in prices in Colombia and in its trading partners; in projecting the exchange rate, the staff had assumed no deterioration in the inflation differential between Colombia and its trading partners. He agreed with Mr. Polak that the real effective exchange rate ought to be calculated on the basis of unit labor costs, but the necessary data were available only back to 1981 and, in any event, were unreliable. They suggested that unit labor costs had increased slightly more slowly than the consumer price index, presumably because of gains in productivity.

The appropriateness of the pace of the depreciation of the Colombian peso was a cause for concern and had been discussed with the authorities, the staff representative commented. The effective exchange rate was of course only one indication of the appropriateness of the pace of depreciation; the state of the current and capital accounts also had to be taken into account. The authorities preferred to maintain the crawling peg, and they were worried that accelerating the depreciation or a large one-step adjustment of the exchange rate would make it difficult for them to maintain an appropriate wage policy; they had stressed their intention to permit only the minimum possible increase in wages. However, they had not ruled out exchange rate action, if necessary. They felt strongly that they should implement their financial, fiscal, and salary policies before considering any alterations in exchange rate policy.

The interest rate on 90-day deposits--the rate set by the banking system itself--was 35 percent, the staff representative noted. The World Bank had recently arranged cofinancing for Colombia; the Bank itself had agreed to provide $200 million to finance projects in the electricity sector, and foreign commercial banks $170 million. In addition, the World Bank was to provide $180 million to finance a large hydroelectric project, $50 million to finance agricultural diversification, $40 million to support industrial development, and $20 million to finance a sewage project.

Mr. Kafka commented that the authorities were constantly alert to the possible need to adjust their exchange rate policy. They were not wedded to the purchasing power parity theory. However, the system of minidevaluations had begun to have a positive effect on minor exports. Moreover, demand would have to be brought under control before the authorities could successfully make any significant changes in exchange rate policy. And it was important to bear in mind the possible upward pressure on wages of an exchange rate adjustment. Wage demands of public sector workers had been moderate in recent years, and the Government's policy of restraining wages in the sector could be placed in jeopardy by a major devaluation.

It was incorrect to assume that the loss of reserves in recent months would continue in the coming period, Mr. Kafka remarked. The evolution of reserves had traditionally been characterized by seasonality: reserve losses had tended to decline in the final quarter of the year; and the drop in late 1984 would be particularly pronounced because of the Government's emphasis on demand restraint. Any suggestion that the reserve loss was out of hand was greatly exaggerated.

When faced with an unexpectedly large loss of reserves, Colombia, like many other countries, had responded by introducing import restrictions, followed by tighter demand management, Mr. Kafka said. The authorities intended to remove restrictions as soon as demand was under control. In the circumstances, the authorities would not wish to remove the restrictions before demand was contained.

As speakers had stressed, Mr. Kafka commented, Colombia was in a much more favorable position than most other Latin American countries: it still had considerable reserves; and the authorities had accelerated the adjustment effort and would continue to introduce appropriate measures as quickly as possible. Moreover, the Government's considerable effort to diversify the economy, particularly the agricultural and energy sectors, had already begun to show positive results.

The Acting Chairman made the following summing up:

> In concluding the 1984 Article IV discussion, Directors noted with deep concern that Colombia's financial situation had continued to deteriorate markedly since the previous Article IV consultation, as reflected, for example, in the large loss of net international reserves. Reference was made to last year's consultation, when concern had already been expressed about the dangers inherent in the anticyclical action the authorities had intended to pursue. Directors emphasized that it was now urgent to adopt decisive action to reduce substantially the public sector deficit, to cut the rate of growth of credit from the Banco de la Republica, and to seek a major improvement in the competitive position and in the external current account of Colombia.
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> Directors welcomed the indications given by the authorities that they would halt the erosion of foreign reserves both through a tightening of demand management policies and a further real depreciation of the currency. In this connection, Directors looked with favor upon the initiatives being taken by the authorities to raise public sector revenues and to limit expenditure growth. However, Directors also pointed out that, thus far, the policy responses of the authorities had been less substantive and slower than appeared necessary, given the magnitude of the internal and the external imbalances. Directors, therefore, noted the urgent need for action on the Government's fiscal proposals, and for the preparation of supplementary measures if action on these proposals were delayed.

The fall in the share of government revenues to GDP in recent years was noted, together with the rapid increase in government expenditures and the increase in the overall deficit to more than 8 percent of GDP in 1984. Directors believed that a major reduction in that deficit should be achieved in the short run, and they encouraged the authorities in their attempts to increase the nonmonetary financing of the remaining deficit. Directors further observed that there was a need to keep the increase in public sector salaries moderate, and they welcomed the authorities' intention to limit such increases to 10 percent in 1985, following large wage increases in the past few years. The importance of ensuring that wage moderation would be achieved throughout the economy also was emphasized, since wage increases in real terms in recent years appeared to have been excessive in the view of a number of Directors.

Concern was expressed about the relatively easy course of monetary policy, and Directors emphasized the importance of reducing sharply the credit expansion of the Banco de la Republica. In this context, Directors also observed that the difficulties experienced by local banks were unfortunately affecting the efficient conduct of monetary policy. Directors welcomed the authorities' decision to halt the efforts made in the past to induce a reduction of interest rates, and they emphasized that interest rate policy should effectively stimulate domestic savings and discourage capital outflows.

Directors took note of the real depreciation of the peso since the end of 1982, which had resulted from the combination of an acceleration in the nominal rate of depreciation and a decline in the rate of domestic inflation. However, some Directors observed that the real depreciation appeared to be smaller when viewed in terms of relative wage increases, although a sufficiently long time series was not available. Directors generally welcomed the intention of the authorities to pursue an exchange rate policy aimed at recovering the loss of international competitiveness in recent years, although recently there had been a recovery of the growth rate of minor exports, the category most responsive to the exchange rate. In particular, Directors cited the decline in exports and the rise in the current account deficit in recent years as important signs that Colombia's external competitiveness had deteriorated. A number of Directors wondered, however, whether the present pace of real depreciation would produce a sufficiently rapid change in Colombia's real exchange rate, given the seriousness of the balance of payments difficulties and the magnitude of the adjustment required.

Directors expressed regret about Colombia's increased reliance on exchange and trade restrictions as a means of protecting the balance of payments. These policies were seen as inappropriate and unhelpful in Colombia's circumstances, as well as an indication of the need for more significant exchange rate adjustments. Directors encouraged the authorities to proceed as rapidly as possible with the adoption of policies that would facilitate the removal of such restrictions.

Directors noted that, while Colombia's external debt was less onerous than that of many other countries in Latin America, both the debt and the debt service ratio had significantly grown in recent years. While some increase in foreign debt might be manageable, Directors encouraged the authorities to keep additional borrowing within prudent limits.

It is expected that the next Article IV consultation with Colombia will be held on the standard 12-month cycle.

The Executive Board then took the following decision:

1. The Fund takes this decision relating to Colombia's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1984 Article XIV consultation with Colombia, in the light of the 1984 Article IV consultation with Colombia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Colombia maintains a complex system of restrictions on payments and transfers for current international transactions and multiple currency practices as described in SM/84/216. The Fund encourages the authorities to reverse the intensification of exchange restrictions and multiple currency practices that was implemented recently, and to proceed with a simplification of the exchange system. The Fund also notes that Colombia maintains bilateral payments agreements with two Fund members, and encourages Colombia to take early steps for their elimination.

Decision No. 7823-(84/149), adopted
October 10, 1984

APPROVED: July 15, 1985

LEO VAN HOUTVEN
Secretary