DOCUMENT OF INTERNATIONAL MONETARY FUND
AND NOT FOR PUBLIC USE

FOR AGENDA

SM/83/101
+ Corr. 1

CONTAINS CONFIDENTIAL
INFORMATION

May 26, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Colombia - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Colombia. A draft decision appears on page 19.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Bonvicini, ext. 73081.

Att: (1)

Other Distribution:
Department Heads

CONTAINS CONFIDENTIAL
INFORMATION

INTERNATIONAL MONETARY FUND

COLOMBIA

Staff Report for the 1983 Article IV Consultation

Prepared by the Staff Representatives for the
1983 Consultation with Colombia

Approved by Eduardo Wiesner and Manuel Guitian

May 24, 1983

The 1983 Article IV consultation discussions with Colombia were held in Bogota from March 20 to April 7, 1983.1/ The principal representatives of Colombia in these discussions were the Minister of Finance; the Minister of Economy; the Minister of Mines and Energy; the Director of the National Planning Department; the Vice-Minister of Agriculture; the General Manager and Deputy Manager of the Banco de la Republica; the Economic Advisor to the President; and the Advisors to the Monetary Board. The staff representatives were Edison Zayas (Head-WHD), Jorge Bonvicini and Antonio Caetano (both WHD), Pierluigi Molajoni (ETR), Angel Antonaya (FAD), and Patricia Herran (Secretary-STAT).

I. Background

Economic conditions in Colombia deteriorated in 1982. While there was a modest deceleration in the pace of inflation, it was accompanied by a further slowdown in the rate of economic growth and emergence of a large deficit in the balance of payments, after seven consecutive years of surpluses.

Real GDP rose by 1 per cent in 1982, down from 2 per cent in 1981, a yearly average of around 4-3/4 per cent over 1979-80, and a peak of almost 9 per cent in 1978 (Table 1). The weak growth performance last year primarily reflected the contraction of output in agriculture and manufacturing, which together account for more than 40 per cent of GDP. Stagnation in coffee production and output declines in cotton, tobacco, and a number of basic food crops were the new factors behind a 1 per cent decline in agricultural value added in 1982. Rising costs and a weakening of demand in foreign and domestic markets have contributed to a serious decline in manufacturing output during 1981 and 1982.

1/ Colombia continues to avail itself of the transitional arrangements of Article XIV.

Table 1. Colombia: Economic Indicators

(In per cent)

	1978	1979	1980	Prel. 1981	Est. 1982
Change in GDP at constant prices	8.5	5.4	4.1	2.1	1.1
Change in GDP at current prices	27.0	30.7	32.8	25.9	25.0
Change in agricultural value added (at constant prices)	8.1	4.8	2.2	2.9	-1.0
Change in industrial value added (at constant prices)	10.0	6.1	1.2	-2.7	-1.8
Change in consumer price index (Dec.-Dec.)	17.8	29.8	26.5	26.7	23.9
Change in index of nonfood prices (Dec.-Dec.)	27.0	27.1	27.7	24.8	22.8
Unemployment rate (end of year)	8.4	8.6	9.2	7.1	9.0

Sources: National Department of Statistics (DANE); Banco de la Republica; and Fund staff estimates.

Following the accummulation of reserves of more than US$5 billion during 1975-81, Colombia's overall balance of payments shifted into a deficit in 1982 with net official international reserves declining by US$740 million. The U.S. dollar value of exports stagnated for the second consecutive year in 1982 at about 80 per cent of the level reached in 1980 (Table 2), principally reflecting a continued world excess supply of coffee and weak foreign demand for Colombia's nontraditional export goods. A modest rise in imports resulted in a widening of the trade deficit in 1982. The current account deficit rose to 5.7 per cent of GDP last year, up from 4-1/2 per cent in 1981 and virtual balance in 1980. Primarily because of a general tightening in world financial markets, net capital flows into Colombia during 1982 slowed down from the record level reached in 1981; net mediumand long-term borrowing by the nonfinancial public sector declined by some US$200 million, and total capital inflows fell from about US$1.9 billion in 1981 to US$1.7 billion last year.

Table 2. Colombia: Balance of Payments

(In billions of U.S. dollars)

	1978	1979	1980	1981	Prel. 1982
Current account	0.4	0.6	0.1	-1.7	-2.2
Exports	3.3	3.6	4.4	3.5	3.4
Of which: coffee	(1.9)	(2.1)	(2.2)	(1.5)	(1.5)
Imports	-2.6	-3.0	-4.3	-4.8	-5.2
Services and transfers (net)	-0.3	--	0.1	-0.4	-0.4
Capital account	0.2	0.9	0.9	1.9	1.7
Private	0.1	0.4	0.2	0.9	0.9
Long term (net)	(0.1)	(0.6)	(0.3)	(0.7)	(0.7)
Short term (net)	(--)	(-0.2)	(-0.1)	(0.2)	(0.2)
Public					
Long term (net)	0.1	0.5	0.7	1.0	0.8
Errors and omissions (net)	0.1	0.1	0.3	-0.1	-0.2
Overall surplus or deficit (-)	0.7	1.6	1.3	0.2	-0.7
Memorandum item					
Current account balance as a percentage of GDP	1.7	2.0	0.4	-4.5	-5.7

Sources: Banco de la Republica; and Fund staff estimates.

The rate of increase in consumer prices slowed moderately to about 24 per cent over the 12-month period ended December 1982 and to 22 per cent in the year ended February 1983, down from around 27 per cent a year on average during 1980-81. The lowering of inflation over the last year made it possible to reduce correspondingly the general wage adjustment for government employees and contributed to a scaling down of wage increases across the economy. Recorded national unemployment rose to 9 per cent in December 1982, up 2 percentage points from a year earlier.

The deterioration in the fiscal situation was a factor behind the weakening of the balance of payments in 1982. The overall deficit of the nonfinancial public sector, which had risen to 3-1/2 per cent of GDP in 1981 from about 1 per cent in 1978-79, increased to almost 5-3/4 per cent of GDP in 1982, as a deterioration in the savings performance was accompanied by a further increase in investment spending (Table 3). The bulk of the deterioration in the savings performance in 1982 reflected a further weakening in the finances of the Central Administration. The steady decline in income tax receipts, the lowering of the tax on coffee exports, and mounting transfer payments to decentralized agencies and local governments have been important factors behind the emergence of a deficit on current operations in the Central Administration, compared with surpluses equivalent to 1-1/2 per cent of GDP in 1980 and 2-1/2 per cent in 1978. With the intention of reversing this trend, a package of revenue and expenditure control measures was announced at the end of 1982. While some of the measures have already been implemented, the introduction of the most important revenue actions has been delayed by a Supreme Court ruling on jurisdictional grounds. For the first time in a number of years, in 1982 the domestic banking system became the main source of financing of the public sector deficit.

Table 3. Colombia: Public Sector Operations

(As per cent of GDP)

	1978	1979	1980	1981	Est. 1982
Current revenue	21.3	22.0	22.3	21.6	20.1
Of which: taxes	(11.0)	(10.4)	(10.4)	(9.9)	(9.5)
Current expenditure	14.8	15.0	15.4	15.5	15.6
Of which: transfers	(1.6)	(1.9)	(2.2)	(2.2)	(2.6)
Current account surplus or deficit (-)	6.5	7.0	6.9	6.1	4.5
Capital revenue	0.5	0.5	0.6	0.8	0.7
Capital expenditure	8.1	8.7	10.0	10.5	11.0
Overall surplus or deficit (-)	-1.1	-1.2	-2.5	-3.6	-5.8
External financing (net)	0.4	1.8	2.0	2.7	2.1
Domestic financing (net)	--	-1.3	0.5	1.9	3.4
Of which: Banco de la Republica (net)	(-0.3)	(-1.3)	(0.5)	(1.4)	(3.3)
Other	0.7	0.7	--	-1.0	0.3

Sources: Controller General's Office; Ministry of Finance; Banco de la Republica; and Fund staff estimates.

The direction of monetary policy began to change in 1982. Access to Banco de la Republica rediscount facilities was eased, monetary controls started to be gradually relaxed, and the yield on short-term instruments issued by the Banco de la Republica was lowered. As the liquidity problems faced by a number of private financial intermediaries became more pronounced after midyear, the authorities stepped in to intervene and liquidate those institutions and they extended emergency assistance to other institutions confronted with serious drawdowns in deposits. With the system regaining a certain stability by the end of 1982, the use of monetary policy to attempt to spur economic activity was intensified. In early 1983, most of the monetary controls imposed since 1977 to moderate the impact on the domestic economy of substantially increased foreign exchange receipts were eliminated. At the same time, credit operations by the Banco de la Republica at subsidized interest rates in favor of specific sectors--a practice that had been curtailed during the 1970s--were reactivated. Also, interest rates on securities issued by the Banco de la Republica were reduced further and the authorities stepped up pressure on private financial intermediaries to lower lending interest rates.

There was a slowdown in the growth of the financial system's liabilities to the private sector, from some 30 per cent in 1981 to less than 25 per cent in 1982 (Table 4); the growth in such private sector holdings in real terms was a little smaller in 1982 than in 1981. Last year's growth in domestic credit of the financial system, meanwhile, was similar to that of 1981 as some weakening in the expansion of credit to the private sector was compensated by a brisk acceleration in credit to the public sector.

Coffee policy in 1982 continued to be aimed at enabling the National Coffee Growers Federation to finance the accumulation of coffee stocks without generating excessive pressures on the other sectors of the economy. To this end, the domestic support price set by the Federation was varied in such a manner that, together with the use of other instruments of coffee policy, it limited the increase in earnings of coffee growers to some 6 per cent in nominal terms from 1981 to 1982, which represented a loss of nearly 15 per cent in real terms.

Recently, Colombia's trade system has become increasingly protectionist. Primarily because of the aim of promoting the recovery of the domestic manufacturing sector, but also as a means to protect the country's balance of payments, more than 500 customs categories previously imported without restriction were placed on the list of items requiring prior license in October 1982. Further action along these lines was taken in April 1983, raising to 80 per cent the proportion of customs categories subject to prior licensing.

Table 4. Colombia: Summary Accounts of the Financial System

	December 1978	December 1979	December 1980	December 1981	June 1982	Prel. Dec. 1982
	(Percentage change over preceding 12 months)1/					
Net international reserves	9.6	15.4	10.9	0.7	-2.4	-6.5
Net domestic assets	22.9	19.1	42.3	30.3	35.7	33.8
Central Administration (net)	-1.0	-5.0	2.4	5.2	5.9	11.0
Rest of public sector (net)	-2.0	-1.5	-0.9	-0.1	-0.2	-0.2
Official capital and surplus	-1.6	-1.2	-2.2	-2.6	-2.1	-0.4
Private sector	24.9	24.0	38.9	28.2	29.6	20.3
Interbank float and unclassified assets (net)	2.6	2.8	4.1	-0.4	2.5	3.1
SDR allocation and valuation adjustment	--	1.9	2.3	1.1	1.8	3.2
Medium- and long-term foreign liabilities	1.3	1.0	1.4	0.1	0.2	0.2
Liabilities to the private sector	31.2	31.6	49.5	29.8	31.3	23.9
Broad money supply (M-2)	27.9	18.2	33.7	27.8	27.8	19.0
Narrow money supply (M-1)	(13.5)	(10.7)	(11.6)	(7.6)	(8.0)	(8.5)
Quasi-money	(14.4)	(7.5)	(22.1)	(20.2)	(19.8)	(10.5)
Bonds and certificates	0.5	3.9	4.9	-0.1	0.1	3.9
Advance import deposits	0.3	1.4	0.7	-0.1	-0.2	-0.3
Other liabilities	2.5	8.1	10.2	2.2	3.6	1.3
	(End of period, as per cent of GDP)					
Liabilities to the private sector	33.5	33.7	38.0	39.1	...	38.8

Sources: Banco de la Republica; and Fund staff estimates.

1/ Measured in relation to liabilities to the private sector at the beginning of the period.

Exchange rate policy in Colombia continues to be characterized by a system of small frequent adjustments in the value of the Colombian peso in terms of the U.S. dollar. Over the first nine months of 1982, and in large part due to the substantial appreciation of the U.S. dollar against major currencies, the Colombian peso appreciated in real terms by close to 10-1/2 per cent vis-a-vis a basket of currencies that covers Colombia's 18 major trading partners. Concern over the loss of external competitiveness led the authorities to accelerate the pace of depreciation of the peso last October. This policy and the absence of a major further strengthening of the U.S. dollar in world markets brought about a real depreciation of the peso in terms of the same basket of currencies of nearly 4 per cent between October 1982 and March 1983 (Chart 1).

II. Report on Discussions

1. Aims and strategy of economic policy

Paramount in the minds of the Colombian authorities is their determination to reactivate the economy, the growth of which has virtually ceased over the past year. The authorities said that they consider this situation to be politically unbearable, and in the discussions the Colombian representatives focused on the policies they believed would be compatible with the achievement of this goal, together with the implications for the country's financial stability and longer-term growth.

The Colombian authorities believe that under present conditions of low capacity utilization and weak domestic demand, stimulative fiscal and monetary policies for the current year could produce a moderate revival of the domestic economy without jeopardizing their objective of achieving a slowdown of inflation. They feel that a growth of real GDP of at least 2-1/2 per cent and an inflation rate of about 20 per cent by year-end--compared with a 1 per cent GDP growth and a 24 per cent increase in the consumer price index in 1982--are targets that are within reach for 1983. To attain these objectives, the authorities intend to use part of the country's official international reserves and to intensify their foreign borrowing operations. The authorities explained that their economic policy strategy has been made possible by the prudent policies of the past, whereby international reserves were accumulated in periods of favorable external payments developments and the recourse to foreign financing was limited. The authorities felt that use of this margin of flexibility at a time when social problems were being intensified by the current recessionary conditions was appropriate and fully justified.

For the medium and longer term, the authorities said their development plan called for the implementation of policies of structural adjustment, such as a fiscal reform designed to increase the flexibility and efficiency of the tax system and a restructuring of the financial sector in order to enhance its ability to attract domestic savings and to channel them to high priority areas. The plan also called for increased incentives to production through tax and credit subsidies (mainly to promote nontraditional exports), support prices for staple agricultural products, and an increase in the flow of financial resources toward the low-cost housing industry. The authorities believe that--besides alleviating a social problem--reactivation of the housing sector would have large positive effects on other sectors of the economy, with only a very limited impact on the balance of payments. They said that most of the relevant measures are already in place and expressed confidence that the fiscal reform package, which is up for consideration in a special session of Congress, will enter into force by midyear. On this basis, the Colombian authorities expect a substantial improvement in fiscal performance in 1984 and expect to attain approximate balance of payments equilibrium, based on a continuing availability of external financing--in line with their policy of borrowing abroad only to supplement domestic savings for the financing of high-yield projects.

The staff concurred with the authorities that a growth in real GDP of 2-1/2 per cent in 1983 appears likely on the strength of an expected recovery in agricultural production, from a decline of 1 per cent in 1982 to a rise of about 3 per cent in the current year, together with moderate growth in other sectors. An encouraging development has also been the slowdown of inflation in recent months, partly as a result of moderate and forward-looking wage adjustments, which have contributed to a scaling down of inflationary expectations. It was noted, however, that this gain on the price front could be easily lost because of a tightening of trade and exchange controls in an attempt to limit the growing balance of payments deficit occasioned by the expansionary policies being followed. In fact, the authorities stressed that they would be resorting to the tightening of trade and exchange controls, but only as a temporary expedient. They said that they agreed with the staff on the importance of reducing the overall public sector deficit, and they only differed on the timing. They stressed in this connection that they would be acting to reduce the public sector deficit in 1984, and would take whatever action would be needed to assure a viable balance of payments.

2. Monetary policy

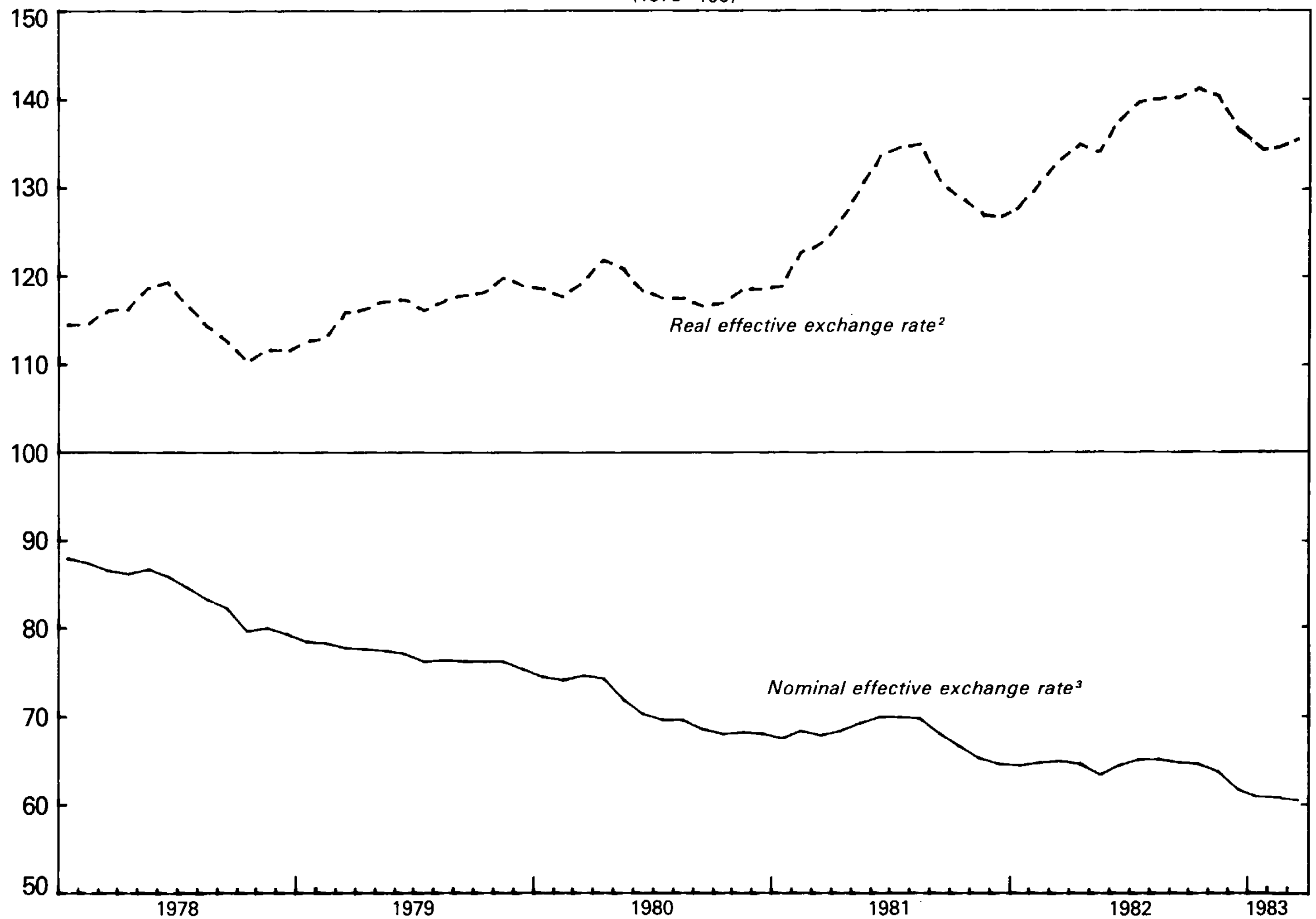
The authorities have acted on the belief that the economy can be stimulated through the expansion of domestic bank credit, and over the past six months their policies have been set on this course. In this period a number of measures have been taken to loosen the monetary controls imposed during the period when the external sector has been booming. The measures taken have included: (1) the reduction of reserve requirements on bank deposit liabilities; (2) the elimination of the 5 per cent discount applied on the early conversion of exchange certificates from certain exports and invisibles; (3) the creation of new credit facilities and the expansion of the operation of special funds in the Banco de la Republica directed to the extension of credit at subsidized interest rates to selected areas of the economy; and (4) the lowering of certain rediscount rates of the Banco de la Republica accompanied by an intensive campaign to induce private banks to reduce their lending rates.

CHART 1

COLOMBIA

EFFECTIVE EXCHANGE RATE INDICES[1]

(1975 = 100)



[1]Expressed in units of a foreign currency per Colombian peso. Thus, an increase (decrease) in the index represents an appreciation (depreciation).

[2]Adjusted for the relative evolution of prices with respect to the trading partners.

[3]Calculated on the basis of a weighted average of the exchange rates for the currencies of Colombia's main trading partners.

The authorities are persuaded that high real interest rates in the past year have been partly responsible for the stagnating economy and hence lower interest rates were necessary for its recovery. The mission warned that while the expansionary monetary policy being followed might produce some stimulation of activity in the short-term, at the same time it involved the generation of pressures on the balance of payments and domestic prices. In particular, the lowering of interest rates may induce the transfer abroad of domestic financial savings in search of higher yields, and the pursuit of expansionary monetary policy may damage confidence and raise further questions about the adequacy of exchange rate policy. The mission also noted its concern about the renewed emphasis on the creation and expansion of special funds in the Banco de la Republica for the granting of credit at subsidized interest rates, given the effects of this mechanism on the efficiency and competitiveness of the favored sectors and the rigidity that it introduced in monetary management.

The authorities said that they did not underestimate these potential drawbacks of their current monetary policy, but they believe that under present conditions of depressed demand the danger of adverse effects is not great. They went on to say that Banco de la Republica has been monitoring developments in this area very closely, and that it was prepared to make any adjustment in policies whenever excess liquidity or other undesirable repercussions occurred. The authorities observed that even after a recent reduction in interest rates these rates are still quite high in real terms, suggesting that there is still a margin for further cuts before the decline in interest rates might be said to have undesirable effects on the behavior of domestic savings.

3. Fiscal policy

The operations of the public sector were expansionary in 1982 and this general policy will continue in 1983. The overall public sector deficit rose from 3.6 per cent of GDP in 1981 to 5.8 per cent in 1982, and it is projected to exceed 6 per cent in 1983. The widening public sector deficit in 1982 coincided with a decline in official external borrowing and domestic bank financing of the public sector expanded sharply. In 1983, however, domestic borrowing requirements may not be much higher than last year because of the intention of the authorities to intensify their use of foreign financing. But this enlarged use of foreign financing is not yet assured and failure to raise the planned amount (which for 1983 would appear to be in the neighborhood of US$1.1 billion net, compared with US$0.8 billion in 1982) would mean either a serious curtailment of domestic bank financing of the private sector or a large balance of payments deficit and domestic price pressures. Although the authorities recognized the dangers of a growing deficit, they remarked that their primary concern this year was to reactivate the economy; for the medium and long term, however, high priority would be given to fiscal reforms designed to improve and strengthen the financial situation of the public sector.

To expedite the adoption of appropriate fiscal measures, the President of Colombia declared last December a state of economic emergency. Thereunder, a series of executive decrees was issued involving administrative and tax reforms, most of which were subsequently voided by the Supreme Court on jurisdictional grounds. The Executive has since then submitted to Congress the respective bills for consideration at a special session that was called, and the authorities are confident that Congress will act favorably on these bills. As regards the Central Administration, the reform package gives the highest priority to measures designed to enhance the yield of the tax system, which has shown to be inelastic and highly dependent on foreign trade. The reform package seeks an enlargement of the tax base--in part by extending the applications of presumptive income to activities other than agriculture--the elimination of legal loopholes which have encouraged tax evasion, and flexibility in the administration of taxes so as to prevent distortions because of inflation. As regards local governments, the reform package aims at strengthening their revenue base by establishing new taxes on vehicles and raising the rates of excise taxes, and by improving tax administration, including provisions for the updating of cadastral values. The implementation of these provisions would set the stage for a substantial increase in revenue from property and land taxes, which would make it possible to cut substantially central government transfers to local governments.

The Colombian authorities pointed out that the fiscal measures already approved and those now in Congress would provide only a small additional revenue in the current year,1/ but would have a substantial impact in 1984 and following years. Nevertheless, the authorities acknowledged that additional tax efforts and curbs on expenditures might be necessary to reduce the public sector deficit to a level consistent with both the absorptive capacity of the domestic financial market and the limit imposed by the condition of prudence in external borrowing.

As regards the plans for public spending, as was noted earlier, the authorities believe that policy in this area should be geared to help promote the recovery of demand. In 1983, central government current expenditure will probably increase somewhat more than the projected growth in nominal GDP, largely owing to increasing transfer payments to the rest of the nonfinancial public sector. Wage expenditures are projected to increase roughly in line with the expected rate of inflation. Capital expenditure of the public sector has shown a strong upward trend over the past five years, rising in relation to GDP from 8 per cent in 1978 to 11 per cent in 1982. This trend is expected to

---

1/ New revenue of near Col$10 billion (less than 5 per cent of central government current receipts) is estimated, related to taxpayers response to an amnesty on interest payments for past due taxes and to a special import surcharge introduced for the purpose of raising revenue to cover reconstruction expenditures in a part of the country that was recently damaged by an earthquake.

continue in 1983 with the ratio to GDP moving up to 12 per cent, and according to the Development Plan further large increases are to be expected for the years after 1983.

4. Coffee policy

Coffee policy in Colombia has attributes of fiscal, monetary, and development policies, as it encompasses measures that affect fiscal revenue, coffee growers income, crop financing, and crop diversification programs. Colombian coffee policy and the complex system of instruments used to carry it out were described fully in the documents for the 1981 Article IV Consultation (SM/82/17, 1/26/82, and SM/82/38, 2/22/82). There has been no change in the direction and management of Colombian coffee policy over the past year, except for adjustments in the retention quota, the ad valorem tax on coffee exports, the exchange surrender requirement, and the prices paid to producers because of changing conditions at home and in coffee markets abroad.

As in the two preceding seasons, Colombia's coffee production in the 1982-83 season exceeded demand, given the export quota of Colombia under the international coffee agreement. This excess is estimated at some 2.22 million 60-kilo bags and thus the coffee stock will be up to 12.22 million bags at the start of the 1983-84 coffee year. This stock is virtually equal to the country's one-year production. The authorities explained that while this sizable stock is not yet causing serious warehousing problems, it is worrisome if only because of its depressing influence on the coffee market. The authorities explained that the financing of the coffee stock itself is not a serious problem for credit policy management, inasmuch as the coffee growers bear the brunt of the cost of carrying the stock through the retention quota system. However, the burden on the economy associated with the use of storage facilities and various financing costs are not insignificant.

Colombia has been committed to a policy of encouraging the shift from coffee farming to other crops, with the aim of bringing production in line with demand, and to the promotion of exports to countries outside the International Coffee Organization (ICO) membership. In this regard, the authorities explained that in order to prevent or minimize the impact of these sales on the operation of the ICO Agreement, a parallel agreement is being negotiated with non-ICO consumer countries. The National Federation of Coffee Growers, a semiprivate organization entrusted with the implementation of the country's coffee policy, has been carrying out a program of crop diversification in coffee farming areas. According to the Federation's estimates some 100,000 hectares now used for coffee growing will have to be shifted to other crops in order to help bring supply into line with demand, a process which will be facilitated by the increased use of modern techniques in land exploitation. An obstacle to diversification into other crops has been the lack of adequate technical assistance and marketing facilities, in contrast with the well-organized system of production and marketing assistance available to coffee growers through a wide range of services provided by the National Federation of Coffee Growers. To encourage the shift away from coffee production, the various facilities of the Federation will also be made available for other crops raised in coffee producing areas.

5. Energy policy

Domestic petroleum production amounts to approximately 150 thousand barrels a day, compared with the a domestic consumption of some 200 thousand barrels a day. The authorities stated that the Government's objective is to achieve self-sufficiency in petroleum by the end of the current decade. They indicated that although foreign companies are not finding it attractive to undertake petroleum exploration at this time because of the weakness in the world oil market, eight "association contracts" were signed recently with foreign corporations. Under these contracts, local and foreign enterprises share the risks of exploration activities. If oil is discovered, ECOPETROL (Colombia's state-owned oil enterprise) pays 50 per cent of the exploration cost and the oil extracted is distributed as follows: 20 per cent to the Government as royalty, and the remaining 80 per cent in equal parts to ECOPETROL and the foreign exploration corporation. In addition to exploration under the system of association contracts, the exploration capability of ECOPETROL has been strengthened with the creation of a special fund made possible by the drop in the price of imported oil and the rise of domestic prices of petroleum derivatives. The intention of the authorities is to maintain domestic prices constant in U.S. dollar, a level that is still somewhat below international prices.

Colombia's energy policy is also focusing on its abundant coal and natural gas resources. Two major coal exploitation projects are currently under way; the largest, the Cerrejon North, is expected to produce 15 million tons of coal by 1990, with some US$1.5 billion of a total investment project of US$3.5 billion already committed. This project includes not only the installation of mining facilities but also the construction of port facilities and a transportation system. The other project, the Cerrejon Central, is in a more advanced stage of development, and exports from this project are expected to begin this year. The natural gas reserves are mainly in the Atlantic coast region of the country, which is the area that will benefit from the infrastructure associated with the coal investment projects. The Colombian authorities are considering a number of alternatives for the exploitation of the country's natural gas resources, including the "association contract" system to attract foreign companies. Projects are currently under way for the utilization of natural gas to produce fertilizers (ammonia and urea) and methanol.

Colombia's hydroelectric power potential is enormous. The authorities said that at present only some 5 per cent of the country's hydroelectric potential is exploited, although hydroelectric production accounts for 70 per cent of the existing electricity generating capacity. At frequent intervals since 1981 electricity rationing has been necessary because of insufficient rain and technical problems in a large hydroelectric power plant (Chivor II). With the recuperation of this plant, and the completion of a new hydroelectric power plant (San Carlos) which will add 600,000 KW to the present generating capacity (4.8 million KW) by the end of 1983, there will be a surplus capacity, thereby permitting the phasing out of some thermo power plants. A major hydroelectric power project under way in the Atlantic coast region will add (when completed in 1988) over 1 million KW to the present generating capacity.

Under the present system, the prices charged for electricity vary according to the consumption levels and regions. A program is currently under way to achieve a national unification of tariffs for consumption below 400 KW a month. This process is scheduled to be completed by June 1983 and thereafter the tariffs are to be adjusted as necessary to keep pace with the rate of inflation.

6. External sector policies

The authorities said that Colombia is not subject in the short run to the rigid external constraints currently affecting many developing countries, not only because of its comfortable level of international reserves but also because of its relatively low external debt. Hence, the authorities believe that the use of some of the country's relatively large international reserves--which partly owing to the pursuit of prudent policies had been accumulating for a number of years through 1981--is fully justified under present circumstances; they remarked that even after a loss of US$740 million in 1982 the Banco de la Republica's net international reserves were US$4.9 billion, only slightly below the value of the country's imports in that year. Also, they pointed out that Colombia has pursued cautious external debt policies, and that an intensification of foreign borrowing in the current year in support of their economic strategy is reasonable. At the end of 1982, Colombia's overall external debt was estimated at close to US$10 billion, of which US$6 billion was owed by the public sector; the country's total interest payments in that year, of some US$1 billion, was equivalent to about 23 per cent of the value of exports of goods and nonfactor services in 1982; approximately one half of these debt service payments corresponded to the public sector.

The mission noted that according to its estimates, net external borrowing by the public sector of about US$1.1 billion, up from some US$800 million in 1982, would be needed to hold the loss of external reserves to no more than US$1 billion in 1983. The authorities concurred with these estimates, but they noted that they had doubts about the feasibility of reaching that level of external borrowing, given the slow pace of disbursements in the first quarter of the year. They realize that financial markets abroad have hardened and that the failure to secure foreign loans in the needed amount would result in a larger drawdown of the country's international reserves than was desirable. They remarked that a reserve loss beyond US$1 billion in

1983 would be a cause of great concern, but they noted that the combination of poor external market conditions and weak terms of trade was exerting great pressure on Colombia's balance of payments. In addition, they observed that the recent substantial depreciation of the bolivar and the sucre, together with other measures taken by the Venezuelan and Ecuadoran Governments, had put the Colombian peso under strain and had accounted for much of the accelerated loss of international reserves of the Banco de la Republica during March. These developments had triggered concerns that a roughly similar devaluation of the Colombian peso might take place soon. The authorities felt that they had succeeded in calming the situation, emphasizing that they would continue with the policy of small frequent adjustments of the exchange rate in line with domestic inflation and price developments in the main trading partner countries. The authorities told the mission that that in October 1982 the rate of monthly depreciation of the peso was increased with a view to reversing gradually the real appreciation of the peso that had occurred in the recent past. (The trade-weighted real effective exchange rate depreciated by about 4 per cent from October 1982 to March 1983, compared with an appreciation of about 10-1/2 per cent in the first three quarters of 1982).

In addition to managing the balance of payments through the flexible exchange rate policy just described, the authorities noted the use of special incentives to promote nontraditional exports and the use of restrictions to curb imports and nontrade related payments; these last mentioned restraints might vary in intensity, depending on external payments developments. The authorities also told the mission that they used the exchange control mechanisms as a means of preventing capital flight, and that trade measures were being taken to protect the domestic industry from what they regard as unfair foreign competition.

Since the latter part of 1982, the Government has taken measures that have started to reverse the import liberalization process initiated in 1980. Through the end of March 1983, more than 500 products had been shifted from the freely importable regime to the import license regime, and a few weeks later the import license regime was extended to cover about 80 per cent of all imports; the only items that are exempt from these requirements are raw food products not grown in the country, such as wheat, and parts needed for foreign products assembled in Colombia. Another recent measure tightened regulations affecting purchases of foreign exchange for travel abroad. Regarding export incentives, new products were added to the list of exports which are entitled to the tax credit certificates and higher rates of tax credit were introduced effective from January 1, 1983. In a separate action, a 5 per cent discount on premature conversion of exchange certificates--which constituted a multiple currency practice--was eliminated. A full description of all of these measures is presented in the accompanying report on Colombia's recent economic developments.

The staff representatives noted that the application of trade and exchange restrictions might seem to work in the very short run to help achieve the net international reserves target set by the authorities but the drawbacks of such an approach are very well known. As such restrictions are tightened in response to growing pressures on the balance of payments stemming from expansionary demand policies, the domestic supply and demand relationship is bound to be altered in a way that will result in distortions in resource allocations and a reversal of the progress made in slowing inflation. The authorities said that the tightening of trade restrictions by and large has been a response to the need to protect the domestic industry, which has been facing a critical situation because of changes in external circumstances, while the tightening of payment controls is expected to be temporary. They stressed that for the medium and long term they would be pursuing policies designed to eliminate the fiscal and balance of payments gaps.

Colombia's exchange system is described in the accompanying report on recent economic developments. The system entails certain restrictions on payments and transfers for international transactions arising, inter alia, from bilateral payments agreements with two Fund members, and several multiple currency practices arising from the system of tax credits for nontraditional exports, the tax on coffee export proceeds, taxes on profit remittances and other transactions, and the recently established advance deposit scheme on the purchase of foreign exchange for travel purposes. The multiple currency practice arising from the penalty on early conversion of proceeds from certain exports and invisibles has been eliminated. As in past years, the authorities are not requesting approval of the practices that are subject to Fund approval under Article VIII.

III. Staff Appraisal

The Colombian economy in 1982 continued its marked slowdown of the preceding three years and real GDP grew by a mere 1 per cent. Poor agricultural output and recessionary conditions in the industrial and private construction sectors accounted for the weak economic performance last year. In a turnaround from a cumulative surplus in excess of US$5 billion over the 1975-81 period, a balance of payments deficit of US$740 million was incurred in 1982 reflecting a further weakening in the current account and a large reduction in the net inflow of capital. The rate of inflation slowed to 24 per cent in 1982, down from near 27 per cent in 1981, and further gains were made in the early months of 1983; these developments were in part the result of a moderation of the wage increases negotiated over the past six months.

The Government is making progress in its efforts to diversify agriculture and reduce the surplus coffee production, with the effective participation of the National Coffee Growers Federation. It is also succeeding in attracting foreign concerns for the joint development of the country's oil fields with the promise of attaining self-sufficiency in petroleum by the end of the decade. At the same time, substantial investment for the exploitation of Colombia's vast natural gas and coal reserves is being undertaken, and it is encouraging that coal exports will become in a few years an important new source of foreign exchange earning for the country. Also noteworthy is the progress that Colombia is making in developing its hydroelectric power potential. The authorities have been adjusting oil prices and electric tariffs to bring them more in line with external and domestic market conditions. The staff welcomes these actions, which should contribute to the strengthening of capital formation in the energy sector.

The overall deficit of the nonfinancial public sector rose from 3.6 per cent of GDP in 1981 to 5.8 per cent in 1982 and is expected to climb to at least 6 per cent in 1983. The Colombian authorities are aware of the adverse effects of the rising deficit on the country's prospects for a sustained and sound economic growth. They believe, however, that their current expansionary fiscal stance is consistent with the objective of spurring the economy in 1983. Looking beyond the year in course, the package of fiscal measures being put forward by the Government is primarily designed to strengthen and rationalize the tax system over the medium and long term.

The immediate preoccupation of the authorities in the short-run reactivation of the economy is understandable. But seeking to bolster economic activity by an expansionary fiscal policy on the scale contemplated will result in a large increase in external indebtedness, the absorption of domestic resources at the expense of the private sector, and pressures on prices and international reserves. Thus, the staff would urge an immediate change in the direction of fiscal policy to ensure an early reduction of the public sector deficit. The implementation of fiscal measures currently under consideration would make a significant contribution to the improvement in the fiscal situation, but it is the staff's view that such measures alone will not be sufficient; they will have to be complemented with additional action on the revenue front as well as with efforts to reduce and rationalize public spending if the public sector deficit is to be brought to a manageable level. In this context, and in view of the Government's plan to raise public investment, the need to ensure effective control of current spending by decentralized agencies and local governments--which has been a major factor behind the recent deterioration in the public finances--becomes particularly urgent.

Monetary instruments are being actively used in conjunction with the expansionary fiscal policy to stimulate the economy in the current year. The liquidity of the banking system has been bolstered through the reduction of reserve requirements and the mechanism of special funds in the Banco de le Republica for extending credit at low interest rates to selected sectors. The authorities expect that these measures, besides injecting liquidity to the economy, will bring real interest rates down, a development which they believe is necessary for the reactivation of the economy. These expectations are, indeed, debatable and the staff has serious concerns about the consequences of these policies. In the staff's view, the monetary and credit measures contemplated by the authorities, combined with a large public sector financing requirement, will further weaken the balance of payments and increase the rate of inflation, which would affect confidence in the viability of the current exchange rate policy. The staff would note that lower real interest rates will not be achieved through monetary expansions; rather what is needed to achieve a reduction in such rates is a policy of fiscal restraint and monetary management that improves confidence. The staff also would wish to express its concern that the proliferation of special credit funds in the Banco de la Republica introduces an element of rigidity in monetary management, and will lead to a misallocation of scarce domestic financial resources.

The authorities have indicated that a reserve loss of up to US$1 billion would be tolerable in 1983 but that a larger loss would be worrisome. The staff views such prospects with considerable concern. A loss of US$1 billion in a year of intensive recourse to external borrowing by the public sector, and following the reserve drop of US$740 million in 1982, may involve substantial risks. Although even a reserve loss of US$1-1/2 billion in 1983 would leave the country with reserves equivalent to seven months of imports, the combination of the momentum of the reserve fall with the step-up in foreign borrowing could not but add to uncertainty and stir speculative forces. It is the staff's view that financial policies need to be adjusted without delay to slow the current loss of international reserves, keep foreign borrowing moderate, and ensure the achievement of external equilibrium in 1984. To some extent, in the short run, capital flight may be checked through a stricter control on exchange operations. But the staff would warn that controls cannot check pressures for long and reliance on them ends up with the creation of distortions and a misallocation of resources.

The Colombian authorities have reaffirmed their intention to continue with a policy of small frequent adjustments of the exchange rate, in line with external conditions and domestic inflation. Because the Colombian peso has appreciated in real terms over the last several years, the authorities have recently accelerated the pace of depreciation of the peso with the aim of reducing the extent of such overvaluation. The staff agrees with the authorities that it is necessary to re-establish Colombia's external competitiveness, and thus to facilitate the elimination of subsidies and payments restrictions; interest rate policy will need to be managed so as to avoid spurring capital flight. In view of the country's balance of payments situation and prospects, the restoration of competitiveness should be sought without delay.

The authorities reiterated that they favor the simplification of Colombia's trade and exchange systems over the medium run, and emphasized that the recent tightening of controls has been made in response to difficulties arising from the recessionary conditions abroad and the worsening of the country's terms of trade. Most of the practices in Colombia's exchange system which are subject to approval under Article VIII, sections 2 and 3, have been in effect for some time. These include multiple currency practices arising from a tax applied on the foreign exchange proceeds from coffee exports, tax credit certificates granted to nontraditional exports and applied to the amount of foreign exchange being surrendered, and taxes on profit remittances and other selected transactions. They also include exchange restrictions arising from two types of import deposit schemes, a discriminatory limit on the annual remittance of profits to countries outside the Andean group, and bilateral payment agreements with two Fund members. In March of 1983, Colombia proceeded to eliminate a multiple currency practice arising from a discount applied to the early surrender of exchange certificates from the proceeds of pearls, emeralds, and invisible exports. However, in April of this year, ceilings on the purchases of foreign exchange for travel purposes were tightened. These ceilings represent an exchange restriction, subject to Fund approval under Article VIII, Section 2. Also, an advance deposit scheme on the purchase of foreign exchange for travel purposes was established at the same time, which gives rise to a multiple currency practice, subject to Fund approval under Article VIII, Section 3. The practices just described involve significant costs in terms of the efficiency of resource use, and the continued need to resort to them cannot but raise doubts about the quality of Colombia's demand and exchange rate management. The staff urges the authorities to proceed rapidly with the removal of these practices, supported by appropriate policies as described above. The authorities are not requesting, and the staff is not recommending, Board approval of these practices.

IV. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to Colombia's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation with Colombia, in the light of the 1983 Article IV consultation with Colombia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Colombia maintains restrictions on payments and transfers for current international transactions and multiple currency practices as described in SM/83/101. The Fund hopes that the authorities will find possible the early removal of the exchange restrictions and multiple currency practices introduced recently, so as to proceed with a further 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.

Fund Relations with Colombia

Date of Membership: December 27, 1945

Status: Article XIV.

Quota: SDR 289.5 million.

Fund holdings of Colombian pesos:

As of March 31, 1983	Millions of SDRs	Per Cent of Quota
Total	57.3	19.8

Operational budget: SDR 28.3 million (March-May 1983)

Designation plan: SDR 5.1 million (March-May 1983)

SDR department:

As of March 31, 1983	Millions of SDRs	Per Cent of Allocation
Cumulative allocation	114.3	100.0
Holdings	177.4	155.2

Gold distribution: Colombia has received gold amounting to 134,364.514 fine ounces in four distributions.

Direct distribution of profits from gold sales: Colombia has received a total of US$24.9 million in the period July 1, 1976-July 1, 1980.

Exchange rate: The exchange rate for the Colombian peso is adjusted in small amounts at relatively short intervals taking into account movements in a set of indicators. Exchange surrender and foreign payments are generally effected through the medium of exchange certificates, which are traded in the official market at the official rate. Exchange certificates are also traded in the stock exchange at varying rates of discount. On May 3, 1983, the rate in the official market for the U.S. dollar, the intervention currency, was Col$75.69 per U.S. dollar.

Last consultation: The 1981 Article IV consultation discussions were completed March 10, 1982 (EBM/82/27) and the following decision was taken:

1. The Fund takes this decision relating to Colombia's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1981 Article XIV consultation with Colombia, in the light of the 1981 Article IV consultation with Colombia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Colombia maintains restriction on payments and transfers for current international transactions and multiple currency practices as described in SM/82/38. The Fund welcomes the termination of a bilateral payments arrangement with a Fund member, which is scheduled for June 1982, and hopes that the authorities will be able to proceed at an early date with a further simplification of the exchange system and with the termination of the remaining bilateral payments arrangement with a Fund member.

COLOMBIA

Area and population	
Area	1,141,748 sq. kilometers
Population (est. mid-1982)	27.9 million
Annual rate of population increase (1975-81)	2.3 per cent
GDP (1982)	SDR 35,150 million US$38,774 million Col$ 2,485 billion
GDP per capita (1982)	SDR 1,260

Origin of GDP	1979	1980	Prel. 1981	Est. 1982
		(per cent)		
Agriculture	23	23	23	22
Mining	1	1	1	1
Manufacturing	23	22	21	21
Construction	3	3	4	4
Transportation and communications	9	9	10	10
Government	7	8	8	8
Other	34	34	33	34
Ratios to GDP				
Exports of goods and services	17.5	19.0	14.4	13.3
Imports of goods and services	15.5	18.6	19.6	19.7
Current account of the balance of payments	2.0	0.4	-4.5	-5.7
Central government revenues	9.5	9.2	8.8	8.3
Central government expenditures	9.4	10.3	10.8	11.7
Public sector savings	7.4	7.0	6.1	4.4
Public sector overall surplus or deficit (-)	-0.7	-2.4	-3.6	-5.8
External public debt	12.6	12.7	14.4	15.3
Gross national savings	20.1	19.4	15.5	13.8
Gross domestic investment	18.1	19.0	20.0	19.5
Money and quasi-money (end of year) 1/	33.7	38.0	39.1	38.8
Annual changes in selected economic indicators				
Real GDP per capita	3.0	1.8	0.2	-1.2
Real GDP	5.4	4.1	2.1	1.1
GDP at current prices	30.7	32.8	25.9	25.0
Domestic expenditure (at current prices)	30.8	36.5	31.3	25.4
Investment	29.7	39.5	32.3	21.3
Consumption	31.0	35.7	31.0	26.3
GDP deflator	24.0	27.6	23.3	23.6
Cost of living (annual averages)	24.7	27.2	28.1	24.6
Central government revenues	32.1	28.7	20.6	17.8
Central government expenditures	43.5	45.7	31.7	35.4
Money and quasi-money 1/	31.6	49.5	29.8	23.9
Money	24.2	27.9	21.2	25.4
Quasi-money 1/	37.5	65.0	34.6	23.1
Net domestic bank assets 2/	19.1	42.3	30.3	33.8
Credit to public sector (net)	-5.0	2.4	5.2	11.0
Credit to private sector	24.0	38.9	28.2	20.3
Merchandise exports (f.o.b., in U.S. dollars)	9.5	22.1	-20.9	-1.7
Merchandise imports (f.o.b., in U.S. dollars)	16.8	43.5	10.7	8.7

Central government finances	1979	1980	Prel. 1981	Est. 1982
	(millions of Colombian pesos)			
Revenues	112,411	144,661	174,467	205,455
Expenditures	112,008	163,217	214,981	291,147
Current account surplus	26,358	23,398	20,652	-5,531
Overall surplus or deficit (-)	403	-18,556	-40,514	-85,692
External financing (net)	15,473	16,644	19,544	14,861
Internal financing (net)	-15,876	1,912	20,970	70,831
Balance of payments	(millions of U.S. dollars)			
Merchandise exports (f.o.b.)	3,581	4,372	3,458	3,399
Merchandise imports (f.o.b.)	-2,996	-4,300	-4,762	-5,175
Investment income (net)	-255	-211	-426	-702
Other services and transfers (net)	235	275	73	260
Balance on current and transfer account	565	136	-1,657	-2,218
Official capital (net)	520	738	1,002	838
Private capital (net)	417	184	913	834
Errors and omissions	113	243	-113	-193
Allocation of SDRs	24	24	24	--
Change in banking system net reserves (increase -)	-1,639	-1,325	-169	739

International reserve position	1981 June 30	1981 Dec. 31	1982 June 30	1982 Dec. 31
	(millions of SDRs)			
Central Bank (gross)	4,672	4,839	4,867	4,435
Central Bank (net)	4,669	4,837	4,864	4,433
Rest of banking system (net)	-1,160	-985	-1,213	-1,204

1/ Includes, in addition to narrow quasi-money, other liabilities to the private sector.

2/ In relation to the financial system's liabilities to the private sector at the beginning of the period. Excludes contra-entry of SDR allocations.