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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/97

3:00 p.m., July 1, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	M. K. Diallo, Temporary
	L. E. J. Coene, Temporary
	P. D. Péroz, Temporary
A. Donoso	J. Delgadillo, Temporary
	T. A. Connors, Temporary
M. Finaish	
T. Hirao	T. Yamashita
	J. Reddy, Temporary
R. K. Joyce	
A. Kafka	C. Robalino
	G. Grosche
G. Lovato	
	V. K. S. Nair, Temporary
	J. E. Suraisry
J. J. Polak	
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	M. Camara, Temporary
M. A. Senior	
	A. Lindø
N. Wicks	C. Taylor
	Wang E.

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present
Central Banking Department: L. M. Koenig, Deputy Director. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; M. Guitian. External Relations Department: H. P. Puentes. Fiscal Affairs Department: M. I. Blejer. IMF Institute: A. Gomez-Oliver, Participant. Legal Department: H. Elizalde, A. O. Liuksila. Research Department: M. S. Khan. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; M. E. Bonangelino, A. Caetano Filho, J. Fajgenbaum, J. Ferrán, O. Gronlie, M. E. Hardy, J. Jaramillo-Vallejo. Special Advisor to the Director of the Western Hemisphere Department: E. V. Zayas. Advisors to Executive Directors: A. A. Agah, J. R. N. Almeida, S. E. Conrado, S. El-Khouri, P. Kohnert, H.-S. Lee. Assistants to Executive Directors: H. Arias, R. Bernardo, J. Bulloch, M. B. Chatah, M. Eran, I. Fridriksson, A. Halevi, H. Kobayashi, Y. Okubo, E. Portas, D. I. S. Shaw, M. Toro.

1. VENEZUELA - 1983 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/83/96, 7/1/83) their consideration of the staff report for the 1983 Article IV consultation with Venezuela (SM/83/119, 6/7/83; and Cor. 1, 6/29/83). They also had before them a report on recent economic developments in Venezuela (SM/83/127, 6/15/83; and Cor. 1, 6/29/83).

Mr. Polak welcomed the recognition by the Venezuelan authorities of the need for major adjustment. The steps taken thus far to adjust had in part been inefficient or ill-advised and would probably not lead to a lasting solution of Venezuela's deep-seated problems.

In its appraisal, the staff had given appropriate advice on the direction and scope of policy that was needed in Venezuela, Mr. Polak continued. A general adjustment of public finances, priority attention to official investment, a reduction in current expenditure, an increase in revenue, better pricing policies in the public sector and better petroleum product pricing, restrained monetary policy, a freeing of interest rates, a firm incomes policy, unification of the exchange rate system, and far less reliance on import controls were the main elements of the comprehensive program of adjustment that the authorities would need to adopt in a timely fashion. In that regard, he had been concerned about Mr. Senior's reference to "gradual" adjustment; it would be a costly illusion for the authorities to think that they had time for a gradual approach to the problems that had been identified. Only determined, adequate, and prompt action to turn the economic situation around would be deserving of financial support from the Fund; he was in agreement with Mr. Joyce's comments on that point.

Mr. Suraisry observed that the economic and financial situation of Venezuela had been considerably weakened by a shortfall in oil receipts since 1981, and the authorities had thus found it necessary to re-examine their policy stance in the face of reduced export earnings, lower budgetary revenues, and a mounting debt service burden. A number of corrective measures had been adopted in 1982, and commendable progress had been made in reducing subsidies, strengthening the finances of the public enterprises, and restraining wage increases. However, those moves had not checked the deterioration in the fiscal and external accounts, and the authorities would need to take more drastic steps to restore confidence. The pace and size of the needed adjustment in any economy depended on the seriousness of the financial situation; in Venezuela, a strong and prompt adjustment effort was urgent.

In the area of fiscal policy, Mr. Suraisry agreed with the staff on the need for measures that would produce a lasting adjustment in the public finances. The authorities had been able to keep current spending down in 1982 and had appropriately taken strong measures to curb both current and capital spending in 1983; however, the size of the imbalances in the Venezuelan economy suggested the need for a further rationalization of expenditures. In passing, he inquired whether the World Bank had examined the public sector investment program in Venezuela and whether it saw any room for maneuver in that program over the medium term.

There appeared to be a case for raising domestic petroleum prices in order to increase government revenues, Mr. Suraisry continued. On the other hand, it might be politically difficult to increase domestic oil prices at a time when international prices were under downward pressure. Revenues from taxes therefore needed to be increased, and he noted that the authorities were working on possible changes in the tax system. At the same time the revenues of the public sector entities should be strengthened through the adoption of flexible pricing policies.

With regard to the external sector, Mr. Suraisry observed that the authorities had reacted to the deterioration in the foreign exchange situation in early 1983 by introducing a three-tiered exchange rate regime together with measures to restrain imports. Those measures might have been inevitable in the short run because of the urgency of the foreign exchange situation; however, their beneficial effects beyond the short run were questionable. The authorities apparently viewed the measures as temporary and intended to phase out import controls and restore a unified exchange rate regime in due course; it was to be hoped that their intentions would be carried out.

Venezuela's external debt situation was also cause for concern, Mr. Suraisry considered. The outstanding external debt at end 1982 had been estimated at $34 billion, or about 50 percent of GDP. Furthermore, some $11 billion of the public external debt was short term. The staff had estimated that external debt service obligations during 1983 could exceed $20 billion, a figure higher than the estimate for exports of goods and services. It was thus encouraging to note that the authorities had been seeking to reschedule their external debt obligations, and he welcomed the indications by Mr. Senior that progress was being made. Aside from debt rescheduling, however, it was obvious that the authorities would need to keep external borrowing--particularly short-term borrowing--under strict control. Finally, he was pleased that a staff mission would soon be visiting Venezuela to discuss the possible use of Fund resources. It was to be hoped that the staff and the authorities would be able to reach agreement on a program that would restore domestic and external balance in the economy.

Mr. Lindø agreed with those who felt that the situation in Venezuela was serious and demanded prompt action. While he could appreciate the constraints on policy formulation described by Mr. Senior in his statement, the situation in Venezuela was such that the cost of not taking immediate and effective action could easily become high.

The necessary steps included effective fiscal measures, particularly a reduction in the heavy subsidies on domestic consumption of oil, Mr. Lindø said. Such measures should also help the Central Bank to achieve adequate control over domestic credit. An important objective in present circumstances was to maintain the creditworthiness of the Venezuelan economy; the international community therefore had to be satisfied that appropriate policies were in place.

Mr. Kabbaj observed that, as was the case with other oil producers, Venezuela had suffered from the adverse effects of the fall in oil prices in 1982. Oil accounted for 95 percent of Venezuela's merchandise exports, and developments in the oil sector had introduced an exogenous and aggravating element into Venezuela's economic problems, with repercussions on growth, investment, inflation, and the current and capital accounts of the balance of payments.

Revenues in Venezuela had turned out to be lower in 1982 than expected, and expenditures had not been contained at the level previously envisaged, Mr. Kabbaj continued. As a result, the Government had recorded an overall deficit of 2.7 percent of GDP in 1982, compared with a surplus of 1.8 percent in 1981. Still, the deficit did not compare unfavorably with the deficits of several other countries; besides, as with other oil producers, government expenditure constituted a significant source of income and investment in the economy. The authorities were of course keenly aware of the need to keep expenditure developments under close scrutiny. In the 1983 budget, the deficit would be 2 percentage points lower than in 1982, public sector investment programs would be slowed, and inventory holdings of the public sector would be reduced. Moreover, capital expenditure would decline by about 30 percent. There was, however, a need to further curtail current expenditure, which was slated to increase in 1983.

The authorities had already taken a series of measures aimed at reducing subsidies and raising gasoline and other key prices to bring them more in line with market prices, Mr. Kabbaj observed. A mandatory price freeze had been imposed earlier in 1983, and a resolution had been adopted that required a 30-day advance notice before the prices of certain items could be raised. There had also been considerable moderation in wage increases; in fact, the Government had offered its employees only a small wage increase for the period up to 1985. Inflation had been reduced significantly in 1982; however, for 1983, the Government was predicting a rate of inflation close to 20 percent, which would reflect earlier selective price increases. Further steps would have to be taken to reduce inflation in line with the austerity measures that were clearly necessary to correct the widespread imbalances in the economy.

The authorities had also been taking measures aimed at strengthening the finances of the public enterprises, with a view to making them more efficient and cost conscious, Mr. Kabbaj remarked. Subsidies had been reduced, and utility rates had been raised significantly. However, despite those improvements, further measures would need to be taken to make the public enterprises self-sufficient and viable market entities.

On the external side, the balance of payments had come under severe pressure in 1982, Mr. Kabbaj said. The fall in export receipts, the rise in international interest rates, and other exogenous factors had eroded confidence and had resulted in capital outflows and considerable difficulties with debt payments and access to capital markets. The authorities had responded to the crisis by imposing direct import restrictions and a three-tiered exchange rate regime. According to the staff report, there had been delays in establishing the machinery that was to administer the new exchange system; further explanations by the staff of the probable causes for the delay would be appreciated. With regard to the external debt, a drastic readjustment in the structure toward longer maturities was necessary.

As acknowledged by Mr. Senior in his statement, there was a clear need for overall and comprehensive adjustment in Venezuela, Mr. Kabbaj commented. In that regard, the staff's suggestions seemed to be well taken. The authorities had begun to take steps to address the main problems and had already adopted serious measures in a number of areas, which showed their determination to redress some of the imbalances. He agreed with others that the issue at hand was not so much the necessity of adopting a program--that was understood--as it was the extent and pace of the required adjustment. In the present uncertain domestic and external environment, a more gradual approach was in his view preferable. Still, the authorities were aware of the validity of the staff's main arguments and would no doubt regularly hold consultations with the staff with a view to monitoring developments. He looked forward to the current negotiations on an adjustment program.

Mr. Coene stated that he was in full agreement with the staff's appraisal of the Venezuelan economy. The adjustment efforts undertaken by the authorities so far had been too timid to permit the economy to adjust to the new external situation before the exhaustion of its financial resources. Early, strong action was therefore necessary to avoid a considerable worsening of the imbalances. Greater fiscal and monetary restraint were of course necessary to keep domestic demand in check, but exchange rate action should play the central role in the medium-term adjustment of the Venezuelan economy.

The diversification of the economy through the expansion of the non-oil sector was also essential if Venezuela was to obtain a broader export base and achieve a more sustainable debt situation, Mr. Coene considered. Such diversification would be possible only through better relative pricing than at present. A more realistic exchange rate would also prove more efficient than the present system of import controls in promoting import substitution. The exchange rate system introduced by the authorities in February 1983 was rather symbolic and only marginally efficient, since more than 90 percent of export receipts continued to be channeled through the so-called preferential markets. Moreover, the three-tiered system introduced additional distortions that ran counter to the long-term objectives of the country.

For the short term, Mr. Coene agreed with Mr. Senior that an exchange rate adjustment would have no effect on export earnings from petroleum, but it might have a large fiscal effect, since the bolivar counterpart of the present level of export earnings from petroleum would increase in line with the exchange rate adjustment and might thus provide higher fiscal revenues, thus helping to keep public investment at required levels. In the circumstances, he urged the authorities to take more decisive action on the exchange rate to maintain adequate growth in the Venezuelan economy. Since it was difficult at the moment to evaluate the appropriate level of the exchange rate, it might be more useful to rely on market forces for its determination. Finally, with regard to the use of Fund resources by Venezuela, he associated himself with the remarks by Mr. Joyce.

The Associate Director of the Western Hemisphere Department noted in response to a question by Mr. Joyce that the staff had not indicated a projection for output growth in its report. The general view of the staff was that no growth was likely in nonpetroleum real GDP, although much depended on the policies implemented and the availability of imported inputs. It was clear that there would need to be considerable restraint on imports in the near future; however, to the extent that imports were not governed by the price mechanism, there might be shortages and disruptions of production.

Recalling a query by Miss Le Lorier about whether the floating rate was a reliable indicator of where the exchange rate might go, the Associate Director observed, first, that the direction of the exchange rate in the end would depend on broad macroeconomic policies; however, as matters stood at present, it was not clear that the free market rate was a reliable indicator. The market was thin, and the level of receipts tended to argue in favor of preferential rates. With a unified market--say, a floating rate--the situation would be different. Of course, the results might also be affected by the degree to which import controls were applied.

With regard to the authorities' balance of payments projections reported in the staff paper, the Associate Director noted that the staff had expressed some concern that the authorities were perhaps undertaking commitments that they might not be able to maintain, given the other policies in place. It was possible that the current account position--a function of available reserves and financing--might be quite strong; however, if the basic macroeconomic policies were not functioning appropriately, a good deal of inflation could be produced, and adjustment might not take place in an orderly and sustained fashion.

Regarding comments on the feasible pace of adjustment in Venezuela, the Associate Director observed that, if the authorities decided upon a truly gradual adjustment, they would have to be prepared to pay a price in terms of inflation, a weak balance of payments, and a slowdown in private investment. In that respect, the economy did not appear to offer much scope for gradual adjustment.

Responding to questions on World Bank involvement in Venezuela, the Associate Director noted that a recent World Bank mission had examined a number of sectors of the economy; however, the results of the examination were not yet available. Finally, the delays in implementing the new exchange system had presumably been due to the complicated nature of that system and the difficulties the authorities had encountered in attempting to make it work.

The Deputy Director from the Exchange and Trade Relations Department considered that the Venezuelan consultation had been a good example of the exercise of surveillance. The consultation discussions had been held on schedule, the papers had been presented promptly to the Executive Board, and Board consideration was taking place in advance of the next mission to Venezuela for negotiations on a Fund program.

Mr. Senior agreed that Venezuela was currently facing serious financial difficulties and that there was an urgent need for determined action to redress them. His authorities were cognizant of the problems and had been making a great effort to tackle them. While some might consider their actions insufficient, it could not be said that the measures adopted had been insignificant. The Venezuelan authorities were committed to intensifying their adjustment efforts in 1983 and beyond, and they believed that realistic adjustment should and could be carried out in a period of three years, so that the economy would gradually attain equilibrium by 1985.

The gradual approach to adjustment advocated by the Venezuelan authorities did not mean that the adjustment should be "slow," Mr. Senior continued. On the other hand, the adjustment process could not be compressed into one year using a "shock" approach. Anything but gradual adjustment would not be appropriate or realistic for the economy and could even be self-defeating. A gradual approach to adjustment would give some flexibility to the policy options available to the Venezuelan authorities, but it would also demand the fulfillment of certain requirements. The most important of those was the rescheduling of external debt under favorable conditions. The authorities had been working toward that end for some time, and it was to be hoped that their negotiations would produce a favorable outcome.

Responding to questions raised by his colleagues, Mr. Senior recalled that there had been some interest in the expected growth rate for 1983. According to Venezuelan estimates, the program for 1983 should result in a decline in real GDP of 1.3 percent, which implied a reduction of 4.2 percent in real per capita income and a similar reduction in private consumption. At the same time, it was estimated that the unemployment rate would rise to about 15 percent, which was cause for concern, especially since there were no unemployment benefits in Venezuela.

Exchange rate policy in Venezuela should be viewed in light of the country's specific circumstances as an oil exporter, Mr. Senior said. In general, devaluation was geared to changing relative prices in such a way that an incentive was created to promote exports and a penalty was imposed on imports; a devaluation affected the price of tradables against nontradables. However, it was doubtful that a large general depreciation of the bolívar would have significant effects on total exports, especially in the short term. As he had earlier indicated, oil exports represented 95 percent of Venezuela's total exports; oil production was wholly controlled by the Government and did not depend to a great extent on narrow profitability considerations. Indeed, there were other well-known factors that regulated or limited Venezuela's production level and even its production potential. In the circumstances, a large devaluation would affect mainly the production of non-oil exports and import substitution. On the other hand, it could have a significant effect on imports by increaseing their price in terms of local currency and, if left unchecked, could give rise to price increases not only for imports but even for locally produced items. Experience had shown that such price increases could even be reinforced by speculative price movements that went well beyond what could reasonably be attributed to the change in local currency prices or in relative prices. In that context, it was not surprising that the authorities had opted for a controlled multiple exchange rate system, even though they were firm believers in a free unitary system.

Still, the three-tiered regime was to be only temporary, Mr. Senior remarked, and the unification of exchange rates was one of the priorities of the Venezuelan authorities. Until then, the system would allow for the benefits of a general devaluation--namely, to increase non-oil exports and import substitution, because those products would be liquidated at the free exchange rate--while minimizing the negative effects, such as the risk of a generalized inflation, that could rekindle the pressures for large wage increases. For that reason, the authorities had chosen to adopt a system of administered prices in conjunction with the multiple exchange rate system. In their view, the administered prices were required to ensure that real wages were not unduly eroded. However, the administered price system was also temporary, until other demand management policies took effect; it was expected that, by 1985, the price system would be mostly free.

The Chairman made the following summing up:

Executive Directors observed that Venezuela was facing a major task of adjustment. Foreign earnings had declined substantially, and there was an urgent need for measures to bring domestic expenditure into line with a lower level of real income and to cope with the large external debt. At the same time, policies had to be directed to laying the bases for recovery of the economy.

Most Directors expressed concern about the policy response thus far to the weakening of the economic situation. There had been too much reliance on financing in the past, they said; the measures that had been introduced more recently did not address effectively the problems confronting the economy. Many Directors noted that the failure to respond boldly enough to the situation had already been costly to the country. They felt that the time for an ad hoc and gradual adjustment policy had run out. Unless policies were strengthened urgently and markedly and were modified considerably, there were serious risks that confidence would be further eroded, capital formation would be reduced, inflation would rise, and the external constraints would become more severe. The Board discussion revealed a broad consensus that major and speedy remedial actions were needed on a number of fronts. In expressing their views, Directors were keenly aware of Venezuela's current political and social circumstances.

Directors emphasized that broad-based measures to correct the imbalance in the public finances were of critical importance. There was a need to exercise restraint over public current expenditure and to rationalize public investment expenditure. There also was a need to raise public revenues; the existing low tax burden should afford room for maneuver in that respect. Directors stressed that removal of the large implicit subsidy on the domestic consumption of petroleum products would be a particularly efficient means of raising revenue since it would also increase the country's export potential, and they added that other public sector price adjustments warranted consideration. Directors also noted that measures to broaden the tax system, which had been examined with the assistance of technical missions from the Fund, should be given priority in the establishment of an adequate and sufficiently diversified revenue base.

Directors emphasized that Venezuela confronted a major external debt problem; thus, it was essential that fiscal policy limit the growth of debt. They observed that Venezuela would need to refinance its maturing external debt, particularly in view of its short maturity structure, and that such refinancing would be facilitated if the country were to adopt a convincing package of adjustment measures to which the Fund could lend its financial support. Directors noted the importance of Venezuela taking the actions necessary to restore its international creditworthiness.

Directors observed that a policy of credit restraint would be required to complement the improvement in fiscal policy. Credit policy should be directed to the attainment of reasonably stable prices and to the protection of the balance of payments. Given the balance of payments and fiscal pressures on financial resources, the action recently taken by the Central Bank of Venezuela to lower its rediscount rate was viewed as a disturbing development that should be reversed.

The feeling was clearly expressed that the application of price controls was not a substitute for demand policy in the search for a satisfactory price performance. Such controls threatened to create distortions and to frustrate adjustment in a situation in which there was a need for changes in cost-price relationships; indeed, the diversification of the economy depended on prices being allowed to adjust to reflect the new exchange market situation. At the same time, it was considered important that, to avoid setting off an inflationary spiral and damaging employment, wages should not reflect corrective price changes. In that context, the prudent wage policy followed by the Government thus far was noted and welcomed.

Directors were concerned that Venezuela's exchange and trade policies were not helping the country to adjust. The multitier exchange rate system was obviously cumbersome, they said, and a simplification of the system was very much needed. Directors stressed the importance of re-establishing a realistic unified exchange rate as soon as possible and noted that market forces should be allowed to play an important role in the determination of the exchange rate to assure balance of payments adjustment and to assist in the creation of the conditions for renewed economic growth. I note, in this regard, the indication of the authorities that transactions will be transferred away from the most preferential exchange rate toward the exchange rate of Bs 6 per U.S. dollar and the free market.

A number of Directors regretted the introduction of import controls in Venezuela and noted that such restraints needed to be accompanied by demand measures if inflation was to be controlled. They urged an early return to the trade liberalization policies that had been interrupted in 1982, observing that such a course of action was in Venezuela's self-interest.

Directors hoped that the forthcoming discussions on use of Fund resources would lead to the early adoption of a decisive program that should assure rapid progress toward a sustainable balance of payments.

In conclusion, Directors drew attention to Venezuela's strong resource base and to the economy's favorable growth prospects in the medium to longer run. With appropriate adjustment measures, they said, the country should be able to achieve its growth potential. Directors commended Venezuela for its participation in cooperative international efforts to assist other countries.

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

2. COLOMBIA - 1983 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Colombia (SM/83/101, 5/26/83; and Cor. 1, 6/9/83). They also had before them a report on recent economic developments in Colombia (SM/83/134, 6/23/83).

The Special Advisor to the Director of the Western Hemisphere Department, leader of the mission, observed that the staff had been informed by the Minister of Finance of Colombia that Congress had approved the fiscal reform package described in the staff report for the 1983 Article IV consultation. The Minister had reported that, in addition, Congress had granted the executive power necessary to reform the national tax system, a move that the authorities intended to undertake before the end of 1983. The new measures were expected to result in an increase in the elasticity of the tax system and should produce a significant improvement in revenue in 1984.

Mr. Kafka made the following statement:

There is, I believe, no disagreement between my Colombian authorities and the staff over the medium-term program that Colombia requires. The medium-term program places emphasis on structural reform, particularly with respect to the fiscal and financial systems. As regards the former, progress is particularly urgent also from the short-term point of view. A far-reaching reform package, originally enacted under emergency legislation and rejected by the Supreme Court on jurisdictional grounds, was adopted by Congress in its entirety last week and has been sanctioned by the President. In a full year, it alone is expected to yield 3 percent of GDP in increased revenues. The reform proposals are correctly described in the consultation report. In addition, however, the Congress has voted the executive far-reaching powers to reform the indirect tax system generally with a view to an early establishment of a value-added tax. The authorities are also proceeding to establish improvements in spending control, and a bill to that effect is expected to be passed within 90 days. Other parts of the medium-term program with its emphasis on the promotion of exports, agriculture, and low-cost housing are well described by the paper and do not require further comment from me.

Before turning to short-term policies, the locus of divergencies between Colombia and the staff, I would like to record some recent economic developments. In particular, I would like to stress the dramatic reduction from over $200 million to less than $60 million of monthly reserve losses after April and more recent information which indicates that this loss almost completely stopped in June. Also, the parallel market rate has recently fallen by 20 percent, and prevailing circumstances leave no doubt that this result reflects a restoration of confidence, due in large part to the dramatic reduction in the 12-month rate of inflation. The latter was 27 percent a year ago and is now--from results for the first three weeks of June--down to just over 20 percent, the goal that the authorities had set themselves for the year as a whole. Their further goal of reducing inflation to an annual rate of 14 percent in 1984 thus seems well in sight. Contrary to the expectations stated by the staff, the exchange restrictions--which are, of course, intended to be temporary--have, therefore, not prevented substantial gains against inflation. There is every prospect that there will be a continuation and possibly reinforcement in 1984 of the noninflationary recovery in GNP growth.

Let us now turn to short-term policies. The basic disagreement between the staff and the authorities refers to the stimulative policies employed in the current year. If the stimulative policies were medium-term policies, the staff would be quite right in expressing fears; but the policy is envisaged as one of limited duration. Colombia has, after all, already taken the most essential and difficult step to assure sustainable growth in the context of a reduced rate of inflation through the fiscal reform. And Colombia disposes of a considerable cushion in its high reserves, as the staff recognizes. I should perhaps mention that these reserves, even in the face of a loss of $1 billion in 1983, which now seems quite a reasonable forecast, will still represent over one third of the gross external debt. Again, contrary to the staff's affirmations, such a reserve level is not likely to excite great fears among Colombia's actual and potential creditors, in view of the careful policy on borrowing that Colombia has traditionally pursued, and the combination of fiscal restraint inherent in the package that has just been approved. The rate of devaluation in relation to the U.S. dollar, now 25 percent and therefore much above the rate of inflation of 20 percent in Colombia--though U.S. dollar prices are still rising by over 4 percent a year--suggests that Colombia is devaluing in real terms by over 9 percent a year plus or minus any devaluation of the U.S. dollar in relation to other currencies. The competitiveness of the Colombian economy should thus be improving considerably. Another fact recgnized by the staff that should be helpful to Colombia, is its careful wage policy, which has been keeping nominal wage increases below the rate of inflation. It would be a pity and quite unjustified if the confidence of the international financial community in Colombia were to be prejudiced by statements contained in the papers which might somehow find their way outside the official circuit, and which might prove to overstress the negative side. The need for caution can be exemplified by the statement appearing on page 13 of the consultation report, that total interest payments for 1982 amounted to $1 billion, or 23 percent of the value of exports; not mentioned there is that these are gross interest payments, whereas net interest payments represented less than $600 million, or 13 percent of exports of goods and services, according to Table 77 on page 146 of SM/83/134.

I have little to add to what is said by the staff on sectoral policies. But the decisive move of the Colombian authorities to encourage a shift away from coffee to other crops and their success in engaging the Coffee Federation with its outstanding infrastructure in this process in the coffee growing regions, together with the policies pursued in the energy sector, designed both to develop the resources of that sector and to economize on the use of oil in particular, deserve much credit.

Mr. Senior remarked that, against the background of a difficult external environment--both within the region and worldwide--the Colombian economy had registered low rates of growth in 1982, while the overall balance of payments had shifted from surplus to deficit for the first time in several years. That weakening of the balance of payments had been accompanied by a slowdown in the rate of inflation (from 27 percent to 24 percent), which was a positive development, considering that entrenched inflationary expectations had for several years prevented any decline in price increases. Notwithstanding the weakening of economic conditions, the Colombian authorities had continued to diversify the economy, particularly in the agricultural and energy sectors. Especially welcome was the substantial investment that had taken place in the energy sector to develop sources of energy other than oil.

He tended to agree with the authorities that, in current circumstances, the reactivation of the economy and a further slowdown in the rate of inflation should continue to be the primary objectives of economic policy, Mr. Senior continued. Fiscal policy should play a complementary role, with investment expenditure focused on recovery in the agricultural sector. On the revenue side, he welcomed the recently adopted package of measures designed to enhance the proceeds from the tax system for the Central Government and local governments. Those measures, in conjunction with expenditure control, should contribute to the maintenance of a relatively small overall deficit in the nonfinancial public sector. As for monetary and exchange rate policies, he tended to believe, unlike the staff, that the measures already adopted by the authorities were not at present having any significant adverse effect on the balance of payments or on the rate of inflation. Indeed, it was satisfying to note from Mr. Kafka's statement that the rate of inflation had continued to slow down during the year.

He agreed with the authorities that the fiscal measures adopted, in combination with prudent external debt policies and a comfortable level of international reserves, should give them sufficient room for maneuver to achieve their desired objectives and should not be cause for concern, Mr. Senior stated. It appeared that confidence was again beginning to build, as evidenced in recent weeks by the slowdown or cessation in the loss in international reserves. It was to be hoped that unduly negative comments in the staff report would not undermine that confidence.

Mr. Polak said that it was refreshing to be able to discuss a country with such a long record of positive growth as that registered by Colombia. Also gratifying was the reduced rate of inflation--which had been facilitated by a moderate wage policy--and the high level of reserves, which gave the Colombian authorities some room for maneuver. In that regard, he could understand the desire of the authorities to use their room for maneuver, in a situation that they considered politically unbearable, to stimulate the economy through more expansionary fiscal and monetary policies. Their desire was all the more reasonable, since such policies would be combined with a far-reaching fiscal package for the medium term that would apparently produce increased revenues of some 3 percent of GDP. However, he had reservations about the content of the expansionary package and possibly its size. The staff had criticized the proposed expansion on both counts, and he had the impression that, even though the staff was implying that the Government's preoccupation with reactivation was understandable, it objected to the entire package. The staff had argued that the expansionary fiscal policy on the scale contemplated would lead to crowding out, with domestic resources absorbed by the public sector at the expense of the private sector. While such a development was possible, he had found no evidence in the paper to support the staff's conclusions. The staff had also suggested that expansion would place pressure on international reserves, a development that the authorities considered inevitable but, up to a certain limit, acceptable.

His own concerns were related to the composition of the various measures contemplated and to the fact that some needed measures were missing, Mr. Polak continued. The Government had allowed the peso to become overvalued, and the recent correction of that overvaluation had been insufficient. Moreover, in lieu of competition--which the authorities had previously been inviting--a wide range of highly undesirable restrictions had been introduced as a kind of substitute for an appropriate exchange rate.

On the monetary side, expansion was taking the form of subsidized sectoral interest rates, Mr. Polak observed. Such rates had been an unfortunate element in Colombian policy in the 1970s and, after being almost entirely eliminated, were now being reintroduced. It was illusory to believe that monetary policy by itself could be used to lower real interest rates in Colombia below the level applying worldwide unless the authorities were prepared to accept a large capital flight. The interest rate measures taken by the authorities had in fact produced symptoms of capital flight, and the capital controls--another undesirable element--had not been particularly effective. Given that Colombia had begun in recent years to move away from such restrictions after a long history of relying heavily on them, he found it particularly regrettable that the restrictions had been reintroduced, essentially for cyclical reasons.

On the positive side, there were some encouraging elements in the staff report on structural developments in Colombia, Mr. Polak remarked. In particular, he welcomed the fact that the resources of the powerful Coffee Federation had been marshaled to encourage diversification by coffee farmers to other crops. Some welcome measures had also been taken in the energy sector.

Mr. Connors stated that he was in broad agreement with the staff's analysis and could support the proposed decision. In its appraisal, the staff had correctly stressed the danger of following expansionary policies in Colombia at present. While it was understandable that the authorities might wish to stimulate economic activity, he was concerned that their efforts could entail considerable risks in the present international environment. It would seem prudent not to underestimate the possible effects of expansionary domestic policies on the balance of payments, the reserve position, and the exchange rate. Hence, because he shared the fears of the staff, he urged the authorities to reverse the expansionary stance of fiscal policy. There was a need to increase fiscal revenues and to reduce and rationalize public spending; in that regard, he welcomed the most recent fiscal measures adopted.

Also worrying was the expansionary monetary policy in Colombia, Mr. Connors continued. Like Mr. Polak, he wondered whether the authorities would be able to control real interest rates. By following an expansionary monetary policy, the authorities were risking capital flight and unmanageable pressures on the exchange rate. While international reserves were currently at a comfortable level in relation to imports, it was not clear that such a ratio was the best indicator of a safe position in present international circumstances. A large reserve loss could endanger confidence, and capital flight could potentially erode reserves far more rapidly than import payments. Moreover, available external financing could disappear quickly. He had noted from Mr. Kafka's statement that signs of renewed confidence had recently emerged, but he believed that the authorities would do better to err on the side of caution.

Commenting on exchange rate policy, Mr. Connors considered that the authorities should emphasize the maintenance of competitiveness. Of course, exchange rate policy must be supported by more restrained domestic financial policies, and he urged the authorities not to rely on inefficient trade and exchange controls in an effort to protect the balance of payments. In sum, he would suggest that the authorities act quickly to reverse the expansionary policies that they had been following. The present economic and financial situation in Colombia appeared brighter than that in many other countries, and the authorities should not risk a deterioration in that situation by pursuing expansionary policies.

Mr. Taylor observed that, through careful and consistent economic policies, Colombia had come to be regarded as one of the most creditworthy countries in the Latin American region. Such a reputation was particularly helpful at a time when the international banking community was less willing than in the past to extend credit. It would be unfortunate if Colombia's good reputation were put at risk through the postponement of necessary adjustment measures; hence, he urged the authorities to adopt the recommendations in the staff appraisal. The staff had correctly advised the authorities to change the direction of their fiscal policy so as to secure an early reduction in the public sector deficit, expected to reach 6 percent of GDP in 1983. In passing, he wondered whether that projection had been based on the package of fiscal measures recently adopted. The absence of a clear framework of forecasts or projections for the main economic aggregates in 1983 made it difficult to get a clear sense of the likely development of the economic situation in Colombia during the year. That lack of clarity--which might be translated as overoptimism in the short-term forecasts--could damage confidence if it were widely communicated.

He understood the authorities' desire to stimulate the economy, given that real GDP had risen by only 1 percent in 1982, Mr. Taylor continued. Nevertheless, the expansionary policy risked severe balance of payments problems, which could in turn jeopardize the longer-term potential of the economy. Sufficient external financing--on which the authorities were relying heavily--was by no means assured, and he would be interested in hearing whether any thought had been given to contingency plans for cutting public expenditure if the external financing did not materialize.

The authorities had put forward a package of major fiscal reforms, Mr. Taylor noted, but the relevant measures would not have much effect for some time. Once implemented, however, they would undoubtedly make a significant contribution to a reduction in the budget deficit. It was to be hoped that some of those measures could be brought to bear during 1983.

On monetary policy, Mr. Taylor agreed with the staff and others that the present stance risked a reinforcement of pressures on both the level of domestic prices and the balance of payments. It was of course reassuring to note that the Central Bank was prepared to make adjustments as warranted; in that regard, it would be important carefully to monitor developments in inflation and the balance of payments in preparation for such adjustments.

Colombia's medium-term prospects on the supply side seemed good, Mr. Taylor considered. The current program of crop diversification was sensible, and the intention to make the economy self-sufficient in gasoline by 1990 and the planned increase in hydroelectric power in 1984 were welcome. It would be interesting to know whether the staff saw any scope for inward investment, particuarly direct investment, to aid those developments. Tapping foreign investment resources without adding a debt financing burden to the balance of payments would be helpful; unfortunately, the existence of exchange controls could deter potential investors. While such controls might be used to stem capital flight in the short run, they could be counterproductive over the longer term. Similarly, he hoped that the recent tightening of trade restrictions--which had probably been necessary to protect domestic industry--would be only a temporary expedient.

The decision to accelerate the pace of depreciation of the peso against the U.S. dollar was welcome, especially since the peso had appreciated in real terms in the first nine months of 1982, Mr. Taylor remarked. The depreciation should help the country's competitiveness, although the sharp devaluations in the currencies of neighboring economies, combined with the risk of resurgence of inflation at home, would place the peso under renewed strain. He wondered whether the authorities were considering possibly stepping up the rate of depreciation further as a way of dampening speculative pressures and protecting reserves.

Given the authorities' intention to finance the fiscal deficit in large part by running down reserves and increasing foreign borrowing in 1983, it would be interesting to know the staff's estimate of Colombia's short-term debt in relation to its reserves, Mr. Taylor said. Reserves had fallen sharply to just over $3 billion at end-April 1983 from more than $4 billion at the end of 1982. The loss of $1 billion or so in one quarter was equivalent to the authorities' projection for the year as a whole. While the pace might have slowed of late--as indicated by Mr. Kafka--it was unclear whether a new trend was being set. Hence, the prospect of a further fall in reserves, failing the required level of banking finances, was worrying.

As with other aggregates, greater quantitative precision by the staff about the forecasts for the balance of payments in 1983 would have been appreciated, Mr. Taylor commented. The 13 percent ratio of net interest payments to exports might not have been worrying in 1982, but the situation could become worse by the end of 1983 if present trends in reserves and foreign borrowing continued. Finally, in view of the authorities' economic goals and the staff's advice, he hoped that it would be possible to conduct future Article IV consultations on a 12-month cycle.

Mr. Delgadillo remarked that, following six years of good performance, the situation in Colombia had deteriorated in 1982, with reductions in the pace of economic growth and in the level of international reserves together with some reversal in the import liberalization process initiated in 1980. The various domestic and external factors that had led to the current situation had been well described in the staff paper; the real issue was the appropriateness of the approach that the Colombian authorities were developing to deal with the problems.

The primary objective of the authorities was to reactivate the economy through a combination of expansionary fiscal and monetary policies, together with additional restrictions on the external side, Mr. Delgadillo continued. The authorities had, at the same time, made clear their intention to intensify borrowing from external financial sources to avoid a sharp reduction in their current international reserves. They considered the program to be feasible, given the margin for maneuver available to them as a consequence of prudent past policies that had led to an accumulation of international reserves without excessive recourse to foreign financing.

The implementation of an expansionary fiscal policy implied a further increase in the overall public sector deficit--already projected to exceed 6 percent of GDP in 1983--which would need to be financed with foreign resources, Mr. Delgadillo remarked. However, since expanded foreign financing was not yet assured, the authorities should bear in mind the dangers that could arise from a growing deficit, such as constraints on domestic bank financing to the private sector, a large balance of payments deficit, and domestic price pressures.

In fiscal policy, Mr. Delgadillo wondered whether the projected increase in public sector wage expenditures--in line with the expected rate of inflation--would not induce the same type of increases for private wages, which could become inconsistent with the level of real wages required to avoid unemployment in an economy experiencing low rates of growth. On the monetary side, he agreed with the staff that a relaxation of monetary policy--while it might produce some short-run stimulation of activity--would involve additional pressures on the balance of payments and on domestic prices. Also, the practice of granting credits at subsidized interest rates could be difficult to redress in future, and he wondered whether further cuts in interest rates might not adversely affect the behavior of domestic savings.

In general, Mr. Delgadillo observed, the intensification of foreign borrowing could be viewed as a reasonable short-term measure if kept within appropriate limits and provided that financing was assured before expenditures were undertaken. Less appropriate were the measures that had begun to reverse the liberalization of imports.

For the medium term, he welcomed the priority to be given to fiscal reforms designed to improve and strengthen the financial situation of the public sector, through enlarging the tax base, eliminating legal loopholes that had encouraged tax evasion, and adding greater flexibility in the administration of taxes, Mr. Delgadillo said. A reduction of public expenditures might be necessary to bring the public sector deficit to a level consistent with both the absorptive capacity of the domestic financial market and the limit imposed by prudent external borrowing. Finally, he commended the Colombian authorities for the progress already made in diversifying agricultural production and reducing surplus coffee production. Also welcome were the new oil, coal, and hydroelectric investments, which should contribute to strengthening capital formation in the energy sector.

The Special Advisor to the Director of the Western Hemisphere Department remarked that the package of fiscal measures recently adopted was not expected to have much effect on the projections for the fiscal deficit in 1983. However, if the authorities were unable to obtain foreign financing for investment, they were likely to make reductions in investment and might reduce the fiscal deficit below the expected level of 6 percent of GDP. On the other hand, the authorities had indicated that, particularly in the energy sector, prospects for direct investment of the sort that would not increase the deficit were good.

With regard to estimates of the ratio of short-term debt to reserves by the end of 1983, the Special Advisor indicated that available information was unclear. Suppliers' credits were estimated to be about $1.5 billion of the total debt of the public and private sector of about $10 billion. In addition, there were a number of other short-term debts that could total approximately $3 billion. However, those were only estimates, and they were based on information that might not be reliable. It was also difficult to be precise about the balance of payments projections for 1983 because so much depended upon conditions in the world economy and on the future impact of the expansionary policies being pursued in Colombia. Still, the staff considered that the estimates that it had provided were reasonable.

The staff representative from the Exchange and Trade Relations Department recalled that a number of Directors had touched upon the general question of the appropriateness of expansionary policy in Colombia. One of the authorities' important objectives was a sound and sustained recovery, but the proper approach to achieving that end was a matter of judgment. In that connection, the experience of the past few years, when the public sector had incurred progressively larger deficits, was of some interest. Inflation had not risen much but had remained at a rate well above 20 per cent a year. Growth in the economy had declined over the period to the current rate of almost zero. At the same time, the deficit in the current account of the balance of payments had been on the rise, necessitating recourse to foreign borrowing, yet international reserves had begun to fall. What was interesting about the current situation was that, unlike a number of other members that no longer had reserves or access to foreign financing, Colombia had some room to make a policy choice. It appeared to the staff that there was sufficient evidence to show that the attempt to help the economy to recover by lowering real interest rates through monetary expansion would not work; there were also many examples in the world of the failure to increase growth rates on a sustained basis through pure expansions in expenditure. In the circumstances, the staff was advising the Colombian authorities that, given the international environment and the risk of a quick exhaustion of the large stock of international reserves, the appropriate policy choice should be a cautious one.

Mr. Kafka remarked that it was clear from the discussion that very different judgments could be made about a country with relatively high reserves that decided to use its room for maneuver for stimulative policies. Some would suggest that those policies were excessive, while others would look upon them as approximately correct or perhaps even insufficient. In his view, too few of his colleagues had stressed that the reserve loss in Colombia had ceased and that the prospective reserve level at the end of 1983 would still allow Colombia to cover one third of its total gross debts, which represented a considerable margin of safety. Finally, in response to Mr. Polak's thoughtful comments on the nature of the stimulative program and its partial reliance on restrictions, he hoped that Colombia's approach would be judged with due regard to the fact that reliance on restrictions was by no means unique to that country.

The Chairman made the following summing up:

> In concluding the 1983 Article IV consultation with Colombia, Directors noted the country's relatively strong external position in the face of weak foreign demand for its main exports and of reduced capital flows into the region. It was observed that domestic inflation appeared to be on the decline and that economic growth had remained positive in 1982, although its pace had declined.
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> Directors took note of the Colombian authorities' objective of reactivating the economy in 1983 through a more active recourse to foreign borrowing and a prudent use of the country's international reserves. While some Directors expressed support for the short-term policy objectives of the authorities, others emphasized the dangers of such an approach, taking into account the present external environment and the need to maintain confidence in the currency.

Concern was expressed by some Directors about the magnitude and the content of the contemplated anticyclical action. A number of Directors viewed the package of fiscal measures recently passed by Congress as a major step in the right direction; it was noted in particular that, on a full-year basis, the new tax package would yield revenues equivalent to approximately 3 percent of GDP.

Concern was also expressed about the considerable relaxation of monetary controls and the granting of credit lines at subsidized rates. Directors remarked that efforts by the authorities to reduce interest rates in the formal financial sector below market levels would likely spur capital flight.

Directors took note of the real appreciation of the Colombian peso during recent years and welcomed the authorities' decision to accelerate the pace of the depreciation of the peso with the intention of improving the country's competitive position. However, successful implementation of Colombia's exchange rate policy was seen by a number of Directors to be crucially dependent on the pursuit of realistic interest rate policies and appropriate demand policies. The increased reliance by Colombia on exchange and trade controls as a means of protecting the balance of payments was noted with regret. Such a course of action would, in the view of several Directors, introduce distortions in resource allocation, exert renewed pressures on domestic prices, and ultimately weaken the external sector. Directors welcomed the authorities' intention of simplifying Colombia's exchange and trade system over the medium run and encouraged them to proceed as rapidly as possible toward that end.

Directors also noted the relatively comfortable external debt position of Colombia at a time of sizable external debt difficulties in most countries of the region. While a moderate increase in foreign borrowing might be acceptable in present circumstances, they said, the authorities should be encouraged not to delay unduly the adoption of measures needed to raise domestic savings and bolster private sector confidence.

Finally, Executive Directors welcomed the slowdown in the rate of domestic price increases. In that regard, they considered that the authorities deserved commendation for having followed prudent and restrained wage polices; the continued pursuit of such policies was viewed as an essential ingredient in further reducing inflationary pressures and contributing to employment growth.

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

The Executive Board then adopted the following decision:

Decision Concluding 1983 Article XIV Consultation

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.

Decision No. 7458-(83/97), adopted
July 1, 1983

APPROVED: December 7, 1983

LEO VAN HOUTVEN
Secretary