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SM/83/101
Correction 1

CONTAINS CONFIDENTIAL
INFORMATION

June 9, 1983

To: Members of the Executive Board

From: The Secretary

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

The following corrections have been made in SM/83/101 (5/26/83):

Page 4, Table 3, last column, line 9: for "2.4" read "2.1"

last line: for "--" read "0.3"

Page 7, line 1: for "13 per cent" read "10 1/2 per cent"

line 7: for "nearly 4 1/2 per cent between October 1982 and January 1983"
read "nearly 4 per cent between October 1982 and March 1983"

Page 8a: Chart 1 corrected and updated to include additional information

Page 14, line 18: for "4 1/2 per cent" read "4 per cent"

line 19: for "January 1983" read "March 1983";
for "13 per cent" read "10 1/2 per cent"

Corrected pages are attached.

Att: (4)

Other Distribution:
Department Heads

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.

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

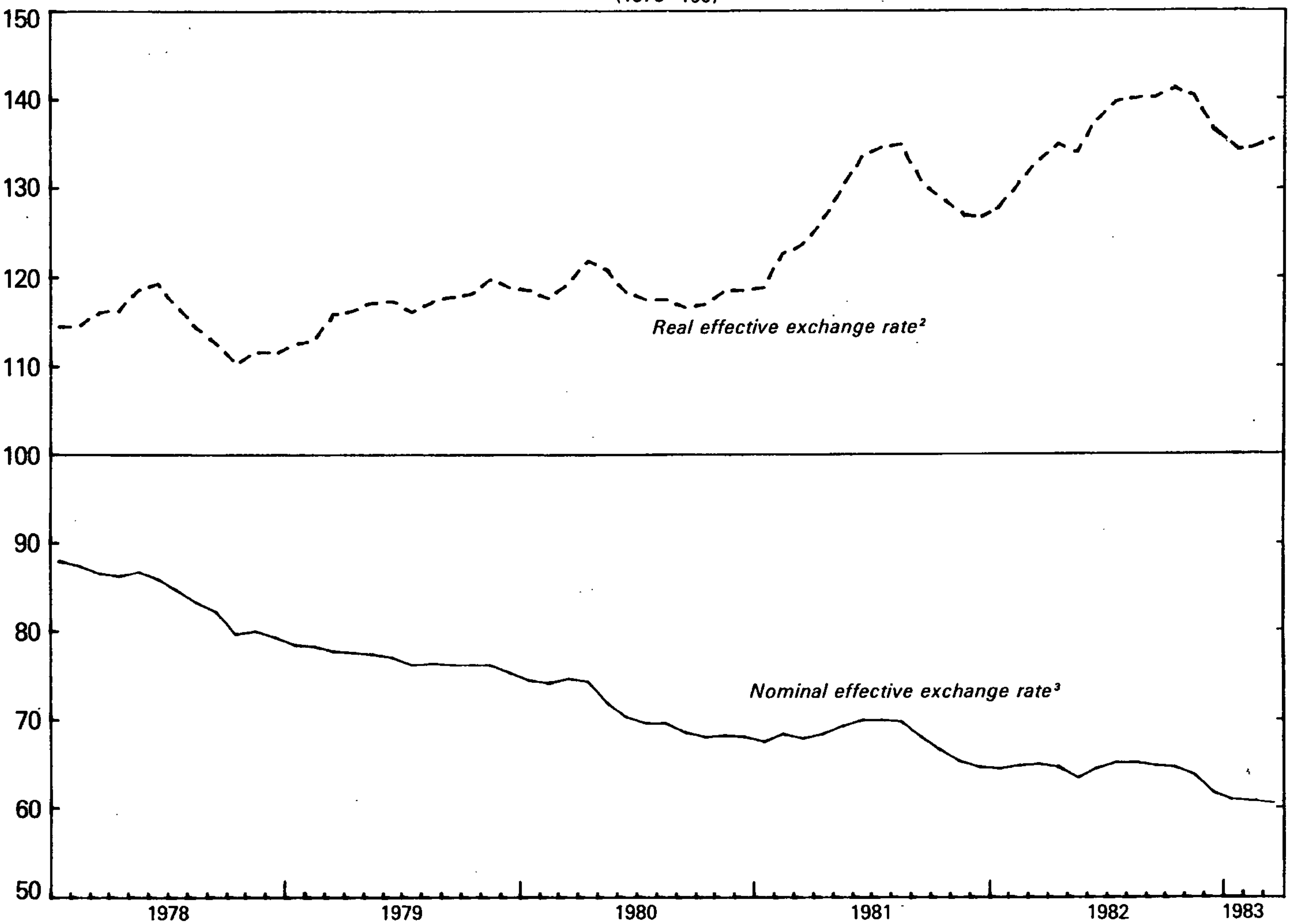
The authorities have acted on the belief that the economy can be stimulated through the expansion of domestic bank credit, and over the past six months their policies have been set on this course. In this period a number of measures have been taken to loosen the monetary controls imposed during the period 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.

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.