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January 26, 1982

To: Members of the Executive Board  
From: The Secretary  
Subject: Colombia - Staff Report for the 1981 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1981 Article IV consultation with Colombia. A draft decision appears on page 16.

This subject has been tentatively scheduled for discussion on Wednesday, March 10, 1982.

Att: (1)

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Department Heads

INTERNATIONAL MONETARY FUND

COLOMBIA

Staff Report for the 1981 Article IV Consultation

Prepared by the Staff Representatives for the  
1981 Consultation with Colombia

Approved by E. Walter Robichek and Manuel Guitian

January 25, 1982

The 1981 consultation discussions with Colombia were held in Bogota from November 30 to December 10, 1981.<sup>1/</sup> The principal representatives of Colombia in these discussions were the Minister of Finance; the Director of the National Planning Department; the Acting Minister of Labor; the General Manager and Deputy Manager of the Banco de la Republica; and the Advisors to the Monetary Board. The staff representatives were Linda M. Koenig (Head-WHD), Jorge Bonvicini and Antonio Caetano (both WHD), Alberto Pera (EP-ETR), Lorenzo Perez (ETR), and Rosaleen S. Gray (Secretary-WHD).

I. Background

Colombia's economic situation in 1981 was characterized by a moderate decline in the rate of real economic growth, a small balance of payments surplus after five years of large reserve gains, and a continuation of inflation at a 26-1/2 per cent annual rate.

The expansion in GDP at constant prices is estimated to have amounted to between 3 and 3-1/2 per cent. This was the third consecutive year of decline in the real growth rate from the peak of 9 per cent registered in 1978, a year of unusually strong agricultural performance; real output is estimated to have grown by approximately 5 per cent in 1979 and 4 per cent in 1980. The moderate decline in growth in 1981 was due to a contraction in manufacturing output and to slower growth in commerce; agricultural output, in contrast, expanded more strongly in 1981 than in 1980 (Table 1).

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

Table 1. Colombia: Economic Indicators

(In per cent)

	1977	1978	1979	Prel. 1980	Est. 1981
Change in GDP at constant prices	4.8	9.0	5.1	4.0	3.0-3.5
Change in GDP at current prices	34.0	27.4	30.2	29.7	30.6
Change in agricultural value added (at constant prices)	2.3	10.3	4.3	2.5	3.2
Change in industrial value added (at constant prices)	4.1	8.5	4.6	2.6	-1.5
Change in consumer price index (Dec.-Dec.)	29.3	17.8	29.8	26.5	26.7
Change in index of nonfood prices (Dec.-Dec.)	21.0	27.0	27.1	27.7	24.8
Unemployment rate (as of each September)	9.4	9.2	8.9	9.1	8.1

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

After registering a surplus of US\$1.3 billion in 1980 and a cumulative surplus of US\$4.6 billion over the 1976-80 period, Colombia's balance of payments produced a much smaller surplus of US\$170 million in 1981 mainly as a consequence of a decline in coffee exports, precipitated by the fall of world prices. The growth of nontraditional exports leveled off, while imports expanded by some 12 per cent. Principally on account of the fall in exports, the deficit on current account of Colombia's balance of payments widened from 0.6 per cent to 4.7 per cent of Colombia's gross domestic product. This deficit was fully financed by net capital inflow, over half of which represented direct investment and net borrowing by the private sector (Table 2).

Table 2. Colombia: Balance of Payments  
(In billions of U.S. dollars)

	1977	1978	1979	Prel. 1980	Est. 1981
<u>Current account</u>	<u>0.4</u>	<u>0.4</u>	<u>0.6</u>	<u>-0.2</u>	<u>-1.7</u>
Exports	2.7	3.3	3.6	4.4	3.8
Of which: coffee	(1.6)	(1.9)	(2.1)	(2.3)	(1.6)
Imports	-2.0	-2.6	-3.0	-4.3	-4.9
Services and transfers (net)	-0.3	-0.3	--	-0.3	-0.6
<u>Capital account</u>	<u>--</u>	<u>0.2</u>	<u>0.9</u>	<u>1.4</u>	<u>1.9</u>
Private	-0.2	0.1	0.4	0.6	1.1
Long-term (net)	(-0.1)	(0.1)	(0.6)	(0.5)	(0.6)
Short-term (net)	(-0.1)	(--)	(-0.2)	(0.1)	(0.5)
Public, long-term (net)	0.2	0.1	0.5	0.8	0.8
<u>Errors and omissions (net)</u> <u>and SDR allocations</u>	<u>0.2</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>--</u>
<u>Overall surplus or deficit (-)</u>	<u>0.6</u>	<u>0.6</u>	<u>1.6</u>	<u>1.3</u>	<u>0.2</u>
<u>Memorandum item</u>					
Current account as a percentage of GDP	2.0	1.6	2.0	-0.6	-4.7

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

Inflation, as measured by the rise in the cost of living index, continued at a 26-1/2 per cent annual rate during 1981, a phenomenon attributable in substantial degree to ingrained inflationary expectations and to the high degree of indexation in the economy.

Fiscal policy was relatively conservative. The overall deficit of the nonfinancial public sector rose from 0.8 per cent to 1.6 per cent of GDP entirely on account of an expansion in public investment. Public savings declined marginally to 5.1 per cent of GDP, the fall in coffee export tax receipts being offset by higher collections of indirect taxes and larger transfers of profits of the Banco de la Republica, and current spending rising moderately in relation to GDP. As in the recent past, the entire public sector deficit was financed from abroad but, in contrast to what occurred in the two preceding years, there was no large net buildup of public sector deposits in the Banco de la Republica (Table 3).

Table 3. Colombia: Public Sector Operations

(As per cent of GDP)

	1977	1978	1979	1980	Est. 1981
<u>Current revenues</u>	<u>14.0</u>	<u>16.0</u>	<u>16.4</u>	<u>17.4</u>	<u>17.7</u>
Of which: taxes	(8.3)	(8.5)	(8.1)	(8.3)	(7.9)
<u>Current expenditure</u>	<u>9.9</u>	<u>11.5</u>	<u>11.7</u>	<u>12.1</u>	<u>12.6</u>
Of which: transfers	(2.7)	(3.3)	(3.5)	(3.9)	(4.1)
<u>Current account surplus or deficit (-)</u>	<u>4.1</u>	<u>4.5</u>	<u>4.7</u>	<u>5.3</u>	<u>5.1</u>
<u>Capital expenditure</u>	<u>4.5</u>	<u>4.7</u>	<u>5.1</u>	<u>6.1</u>	<u>6.7</u>
<u>Overall surplus or deficit (-)</u>	<u>-0.4</u>	<u>-0.2</u>	<u>-0.4</u>	<u>-0.8</u>	<u>-1.6</u>
External financing (net)	0.6	0.4	1.9	1.5	1.5
Internal financing (net)	-0.2	-0.2	-1.5	-0.7	0.1
Of which: Banco de la Republica (net)	(-0.3)	(-0.3)	(-1.9)	(-0.6)	(--)

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

Through the use of a number of fiscal and quasi-fiscal instruments the authorities cushioned the impact of the sharp decline in the value of coffee exports on coffee producers' incomes; these were allowed to expand in nominal terms by an estimated 20 per cent, for a real decline of only 6 per cent.

With the disappearance of the public sector's internal surplus, the Banco de la Republica's net domestic assets declined by only 6 per cent in relation to its starting stock of liabilities to the private sector, in contrast with contractions of 53 per cent in 1979 and 29 per cent in 1980. In addition, there was no net placement of Banco de la Republica bonds in the private market whereas, in 1979 and 1980, the Bank had captured large amounts of funds via an aggressive open market policy. Almost the entire increase in the resources of the financial system was thus made available to the private sector (Table 4).

Table 1. Colombia: Summary Accounts of the Financial System

(Percentage change over preceding 12 months)<sup>1/</sup>

	December				June	Est. Dec,
	1977	1978	1979	1980	1981	1981
<u>Net international reserves</u>	<u>17.2</u>	<u>9.6</u>	<u>15.4</u>	<u>10.9</u>	<u>5.9</u>	<u>0.9</u>
<u>Net domestic assets</u>	<u>21.0</u>	<u>21.9</u>	<u>16.8</u>	<u>37.6</u>	<u>33.2</u>	<u>26.2</u>
Central Administration (net)	-1.3	-2.9	-7.3	-2.2	-1.7	-0.1
Rest of public sector (net)	3.9	-2.7	-1.5	-0.9	-0.6	0.1
Official capital and surplus	-1.7	-1.6	-1.2	-2.2	-1.6	-1.5
Private sector	24.5	24.9	24.0	38.9	35.1	27.2
Interbank float and unclassified assets (net)	-4.4	2.6	2.8	4.0	2.0	0.5
<u>SDR allocation and valuation adjustment</u>	<u>--</u>	<u>-1.0</u>	<u>-0.4</u>	<u>-2.4</u>	<u>-2.9</u>	<u>-2.2</u>
<u>Medium- and long-term foreign liabilities</u>	<u>0.6</u>	<u>1.3</u>	<u>1.0</u>	<u>1.4</u>	<u>0.8</u>	<u>0.4</u>
<u>Liabilities to the private sector</u>	<u>37.6</u>	<u>31.2</u>	<u>31.6</u>	<u>49.5</u>	<u>41.2</u>	<u>28.9</u>
Broad money supply (M-2)	26.0	27.9	18.2	33.7	34.1	27.8
Narrow money supply (M-1)	(14.3)	(13.5)	(10.7)	(11.6)	(9.5)	(7.6)
Quasi-money	(11.7)	(14.4)	(7.5)	(22.1)	(24.6)	(20.2)
Bonds and certificates	4.1	0.5	3.9	4.9	2.6	-0.1
Advance import deposits	2.6	0.3	1.4	0.7	0.1	-0.1
Other liabilities	4.9	2.5	8.1	10.2	4.4	1.3
(End of period, as per cent of GDP)						
<u>Memorandum item</u>						
<u>Liabilities to the private sector</u>	32.3	33.2	33.6	38.7	38.1	38.2

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

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

In the course of 1981, the authorities continued to make more efficient the workings of Colombia's import control system. However, given the recessionary conditions in the industrial sector, the easing of requirements for the granting of import licenses, which had contributed to a sharp increase in imports in 1980, was not carried further and some retrenchment in fact occurred in the granting of licenses for imports of automobiles, steel, textiles, and clothing, products particularly hard hit by the fall in demand.

Continuing the policy of the preceding three years, the authorities depreciated the peso in terms of the U.S. dollar roughly in line with relative inflation rates in Colombia and the United States, but whereas this policy had broadly stabilized the real effective value of the peso over 1978-80, in the first eight months of 1981 it led to its real effective appreciation by 16-1/2 per cent. After midyear, the authorities began depreciating the peso somewhat more rapidly than in the preceding months, and this increase in the rate of depreciation, added to some weakening of the dollar on world markets, caused the peso to depreciate in real effective terms by an estimated 5-1/2 per cent between end-August and end-October (Chart 1).

## II. Report on Discussions

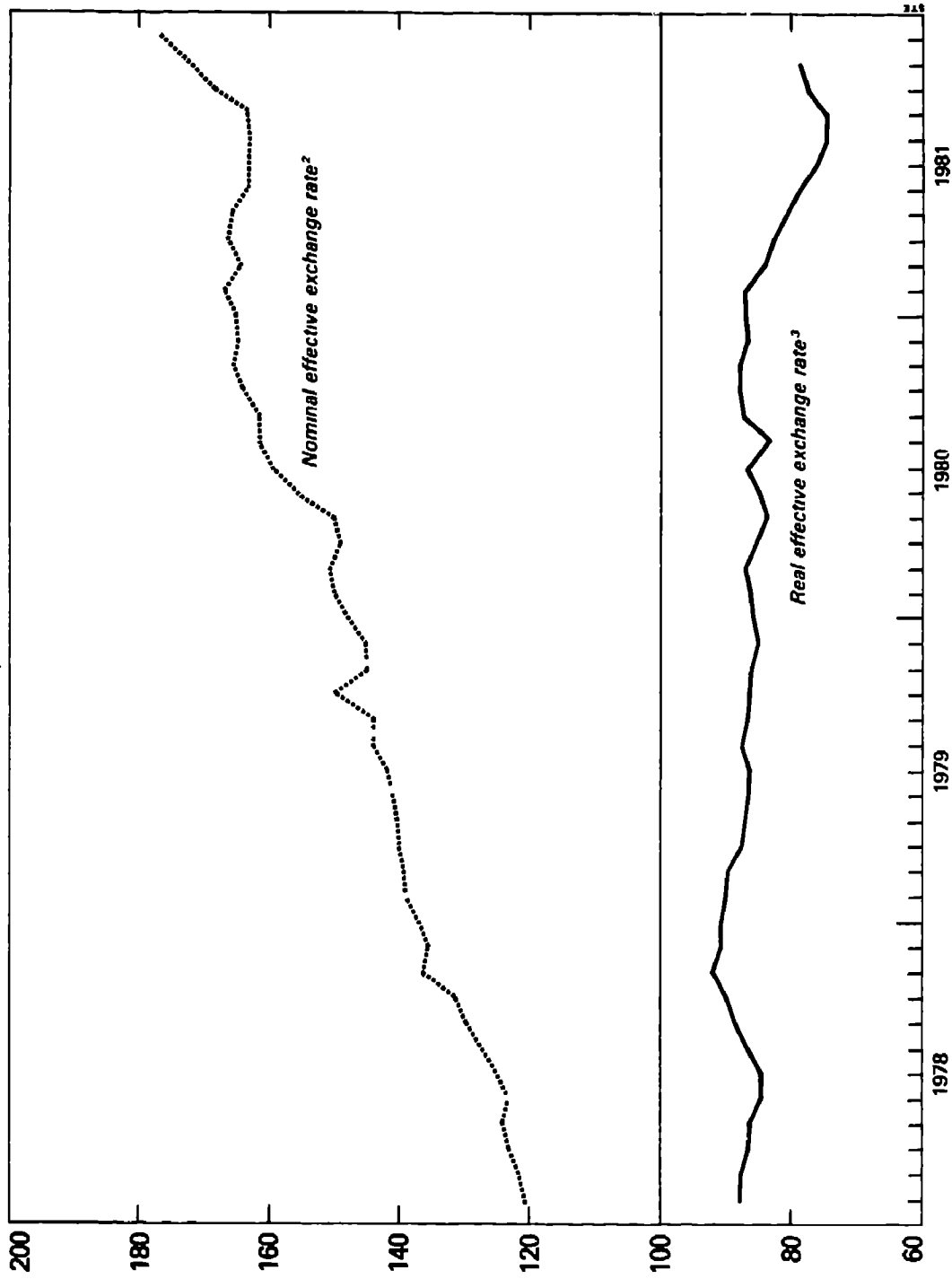
### 1. General aims and strategy of economic policy

The authorities began the discussions by stating that economic policy in 1981 had as in the past been guided by the twin goals of growth and stabilization. They believed that the year 1981 was most properly viewed as representing the end of the economic cycle which began in 1976 with the sharp increase in world coffee prices. In response to this rise, the Government had sharply curtailed its investment spending in order not to exacerbate inflationary pressures. In mid-1979, it had become clear that the coffee boom was over and, under the National Integration Plan, the Government had begun increasing its investment spending with the dual objectives of removing production bottlenecks and propping up domestic demand to compensate for the decline in coffee earnings. In addition, monetary policy had been moderately relaxed, and the fall in coffee growers' incomes had been cushioned through domestic pricing policy. The authorities believed that the moderate easing in demand management over 1980-81 represented the maximum compatible with the containment of inflation; it was doubtful that any further easing would have produced a higher rate of real GDP growth, whereas it almost certainly would have led to an acceleration in the rate of price increase.

### 2. Fiscal policy

The mildly countercyclical management of fiscal policy was a key-note of the authorities' demand management in 1981. For the second consecutive year, public investment was increased substantially in relation

CHART I  
COLOMBIA  
EFFECTIVE EXCHANGE RATE INDICES<sup>1</sup>  
(1975 = 100)



Source: Banco de la República and Fund staff estimates

1/ In Colombian pesos per unit of foreign exchange

2/ Adjusted by exchange rate movements in Colombia's 18 major trading partners

3/ Adjusted by exchange rate and price movements in Colombia's 18 major trading partners



to GDP; however, while in 1980 over half of the increase in the investment ratio was covered by a rise in public sector savings, in 1981, as savings declined marginally, growth in investment caused the overall deficit of the nonfinancial public sector to increase from 0.8 per cent to 1.6 per cent of GDP.

In line with the Government's investment strategy, approximately half of public investment was made in the social sectors and regional development and one third in energy and economic infrastructure--particularly electric power generation, petroleum exploration, and transport. Public investment in activities directly related to the production of goods was minimal and limited to the agricultural sector.

The slight decline in the public sector savings ratio in 1981 was due to the slower growth of current revenue together with the continued moderate increase in current spending. Public enterprise earnings on account of net sales of goods and services and social security contributions rose roughly in line with GDP, but Central Government tax receipts fell strongly on account of the sluggish performance of income tax revenue and, to a lesser extent, the fall in collections of the coffee export tax. The authorities expressed concern with the poor performance of income taxes and with the fact that the Government was becoming increasingly dependent on transfers of Banco de la Republica profits on account of exchange operations and interest earned on international reserves--revenue sources which could not be expected to grow in line with GDP. If a real decline in revenue was to be avoided in the future, steps would have to be taken to reverse the declining trend of income tax collections, trend the authorities attributed mainly to tax evasion. For this purpose, draft legislation to facilitate a streamlining of the tax administration system had been introduced into Congress.

Beyond this, the authorities did not think that much room existed for increasing real tax revenue. Rather they placed their hopes on a rationalization of the system of transfers to local governments. In recent years, while government salaries and outlays for purchases of goods and services grew roughly in line with GDP, transfers increased steadily as a consequence of a complicated system of tax earmarking to cover expenditure for education, social services, and general administration. A major study carried out over the past two years by the Commission on Inter-Governmental Finances showed that there was considerable scope for increasing public saving by reducing tax earmarking and generally improving control over the spending policies of local governments. In November 1981, various legislative proposals based on the recommendations of this Commission, among them bills to reduce over time government funding of national universities and to eliminate earmarking of nonrecurrent revenues, were introduced in Congress, and some of this legislation was approved before Congress adjourned in December.

After increasing strongly in 1979 as the result of corrective price adjustments, public enterprise revenue from sales of goods and services remained constant in relation to GDP over 1980-81 as prices were moved broadly in line with production costs. Prices of petroleum derivatives were increased in early December 1981 for the first time in 13 months; the increase brought them marginally above (in U.S. dollar terms) the levels achieved in late October 1980. (For example, regular gasoline and diesel were raised to US\$0.93 per gallon each; in October 1980 each cost US\$0.89.) By contrast, electric power rates have been increased every month roughly in line with the rate of inflation--and somewhat more rapidly in the case of large scale residential users--and peak-load pricing was introduced a few months ago. Water rates also are being increased gradually.

The authorities told the mission that their general goal was to continue increasing public sector prices and tariffs in real terms to reflect opportunity cost and to generate resources to finance needed investments. However, the size and timing of increases had to be calibrated to avoid adding to price pressures in times of high inflation and thereby raising inflationary expectations. For example, the decision not to move petroleum derivative prices until late in 1981 had been taken because food shortages due to bad weather had caused inflation to accelerate earlier in the year. Once inflation had declined, the increases were carried out.

In the context of the discussion of fiscal policy, the mission asked the authorities to explain their stance regarding foreign borrowing by the public sector. During 1979-80, in view of the time lag between the decision to accelerate public investment and the negotiation of loans from suppliers and official lenders, the Government had engaged in general purpose borrowing from foreign banks in part to cover foreign debt amortization and in part to finance investment outlays. However, general purpose borrowing abroad would be strictly limited in the future. Except for one general purpose loan of US\$200 million, recourse to foreign commercial bank loans would be restricted in 1982 to borrowings by state enterprises to finance specific investment projects; moreover, to help ensure that the projects to be financed, and the borrowing entities, were financially sound, the Government of Colombia would not guarantee these loan operations.

### 3. Coffee policy

The management of a complex system of instruments, including the price at which coffee export proceeds are surrendered to the Banco de la Republica, the "retention quota" which assigns a part of coffee exports to the National Federation of Coffee Growers, and the domestic support price, is an important complement of fiscal policy in Colombia. "Coffee policy" is developed jointly by the Government and the coffee growers--represented by the National Federation of Coffee Growers--and has as its aim the stabilization of coffee growers' income at a level

consistent with the long-run price of coffee in the world market. During the period of the coffee "boom," in 1976-78, about one third of increased coffee earnings was channeled, mainly via the retention quota, to the National Coffee Fund, managed by the Federation. A part of these funds was used for infrastructure investment in coffee growing areas and a part was invested abroad and in Banco de la Republica bonds. Taxation was used to a lesser extent to sterilize coffee income; in fact, the ad valorem tax on coffee exports was reduced progressively between 1974 and 1978.

In response to the sharp fall in world coffee prices in 1980 and 1981, the authorities lowered the coffee surrender price and the retention quota, while further reducing the ad valorem export tax. These actions permitted the Fund, while increasing its stocks of coffee, to raise the domestic purchase price of coffee in peso terms, thus limiting the fall in real income of coffee growers to around 6 per cent in each of the two years.

Colombia is a member of the International Coffee Agreement and both the Government and the Federation strongly advocate a decline in world coffee production with a view to stabilizing prices at the present level. This advocacy is based on the belief that world coffee demand is highly price-inelastic and that the release of current output into world markets would lead to a steep drop in export earnings. In accordance with Colombia's export quota under the ICA, the National Coffee Fund in 1981 increased its stock of coffee by 3 million bags out of a total production of 14 million; this increase was financed with the proceeds of the retention quota and with funds held by the Federation abroad. It is likely that observance of Colombia's quota will create the need for a similar increase in coffee stocks again in 1982. In order to enable the National Coffee Fund to finance this increase in stocks in a noninflationary manner, and to link domestic pricing policy more closely to world market developments, the authorities have reached an agreement with the Executive Committee of the National Federation of Coffee Growers whereby the domestic coffee price will be raised only when Colombia's export quota under the International Coffee Agreement is increased.

#### 4. Monetary policy

Monetary policy in 1981 must be viewed against the background of the major steps taken in early 1980 to reduce official intervention in the process of financial intermediation and thereby strengthen the formal financial system. In 1976 and 1977 the introduction of a 100 per cent marginal reserve requirement on bank sight deposits, prior import deposits and a penalty on immediate conversion of exchange proceeds from coffee exports and invisibles reduced net credit expansion by financial intermediaries. By mid-1978, however, it became clear that these measures, adopted in the wake of the coffee "boom," had produced

considerable financial disintermediation. The authorities, therefore, began moving gradually and cautiously to reduce the degree of monetary restrictiveness.<sup>1/</sup>

In 1980, the authorities took bolder steps to liberalize controls over the operations of the financial system, reducing the marginal reserve requirement on sight deposits to 50 and subsequently 45 per cent, and abolishing the penalty for immediate conversion of coffee export proceeds. More important still, interest rate ceilings were lifted from commercial and investment bank certificates of deposit of 90 days or more. These actions had the effect of attracting funds back to the formal financial system on a massive scale. Over the course of 1980 bank liabilities to the private sector rose by 50 per cent (compared with an average increase of 32 per cent per annum in the two preceding years), and nearly 80 per cent of this increase in financial savings was relent to the private sector. Credit to the private sector thus expanded by 48 per cent over the course of 1980 whereas it had risen by 29 per cent the previous year. The process of reintermediation in response to these actions seems to have been substantially completed by the end of 1980, and in 1981 financial system liabilities to the private sector grew roughly in line with nominal GDP. With the public sector making virtually no net use of domestic credit, the financial system was able to expand credit to the private sector by an estimated 35 per cent of the outstanding credit stock.

The major change in monetary policy in 1981 was the abandonment of the aggressive open market policy which the Banco de la Republica had pursued during the preceding one and one half years. With a view to setting the stage for the relaxation of reserve requirements and to compensating for the leveling off of private sector holdings of exchange certificates and import deposits, the Banco de la Republica began in late 1979 to place short-term bonds (Titulos de Participacion) on a major scale. In early 1981, believing that the need for incremental placements had passed, efforts to compete aggressively with other interest paying instruments were abandoned. As a result of this change in policy the stock of Banco de la Republica paper in the hands of the public declined over the course of 1981, while bank certificates of deposit grew well in excess of the rise in nominal GDP.

As it has been since 1975, when interest rates on bank credit operations effectively were freed, the level of interest rates has continued to be a matter of controversy in Colombia this year. The yield on certificates of deposit averaged 37 per cent in 1981; while no statistics exist on effective interest rates on the lending side, the general impression is that such rates averaged 45 per cent or more. The real rates equivalent to these nominal rates are about 8 per cent on the deposit side and 14 per cent on the lending side. The authorities told the mission that they believed that the spread between average

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<sup>1/</sup> See the staff reports on the 1977 and 1979 Article IV consultations with Colombia, SM/78/14 and SM/80/34.

deposit and lending rates had widened in 1981 as a consequence of lack of competition in the banking industry and the banks' lack of experience in operating in an environment of free interest rates on term deposits. For their part, the banks argue that the present lending rates are dictated by their average cost of funds.

The change in the Banco de la Republica's open market policy, the rapid growth of bank certificates of deposit as compared with that of narrow money, and the easing of the marginal reserve requirement on sight deposits, all had the effect of reducing the share of the Banco de la Republica in total financial system credit in 1981. In the expectation that the public sector would continue to abstain from use of net bank credit in 1982, the authorities indicated that they would like, if possible without endangering their stabilization objectives, to continue reducing this share in 1982 with a view to increasing the resources available to the rest of the financial system and thus contributing to some decline in interest rates on loans.

#### 5. Wage policy

Private sector wages and salaries in Colombia are determined mainly through collective bargaining. Colombian law provides for compulsory arbitration whenever a strike lasts beyond 40 days, but most labor conflicts are resolved before this stage is reached. Official wage policy, therefore, is limited mainly to determination of the increase in government salaries and to the setting of the minimum wages for urban and rural workers. (The latter are set by a Tripartite Commission in which government representatives participate.) The increases granted in government salaries and in the minimum wage for urban workers at the start of 1981 were both 26-1/2 per cent, equal to the December-to-December cost of living increase; a similar policy had been followed in 1980. The authorities were not in a position to predict what the increases for 1982 would be but it appeared that they again would be equal to, or marginally above, the rate of cost of living increase between December 1980 and December 1981 (estimated at 26-27 per cent).<sup>1/</sup> The authorities did not believe that it was politically feasible to hold official wage and salary increases below the rate of inflation, although they recognized that the virtual indexation of remunerations made it difficult to achieve major gains in the fight against inflation from one year to the next.

The mission was told that collective bargaining settlements in 1981 provided wage increases of approximately 30 per cent, compared with an average of 29 per cent in 1980. The number of labor conflicts increased, but only because most labor negotiations take place in odd-numbered years.

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<sup>1/</sup> On December 16, new minimum wages were approved, to take effect January 1. The minimum wage for urban workers was raised by 30 per cent. On December 30, the Government announced salary increases ranging from 26 to 30 per cent for its employees.

## 6. Energy policies

Petroleum supplies the bulk of Colombia's present energy requirements. The steady decline in petroleum production over the last decade and rapid growth in consumption of petroleum derivatives has caused Colombia, a net petroleum exporter until 1976, to lose self-sufficiency. In 1981 Colombia had to import about 30 per cent of its total petroleum requirements, at a total cost of US\$600 million. The authorities' policies in the energy field aim at slowing down the growth of consumption by raising petroleum derivative prices gradually to reflect their opportunity cost, and developing other sources of energy by means of large scale private and public investments.

The authorities' petroleum pricing policy has been described above. Since 1980, this policy has succeeded in slowing the growth of domestic consumption of petroleum derivatives; at the same time, increased exploration outlays by ECOPETROL, the state petroleum enterprise, and by foreign companies have led to a moderate increase in crude production after several consecutive years of decline. New finds in the north-eastern part of Colombia reportedly will boost petroleum output in 1982 by 13,000 barrels per day, or 10 per cent, and may restore Colombia's self-sufficiency in petroleum by mid-decade.

The authorities' long-run energy strategy, however, aims at reducing the weight of petroleum in the energy balance in favor of hydroelectric power and coal, two areas in which Colombia has an immense potential. Investments now under way will raise hydroelectric generating capacity from 4.2 million kw to 12 million kw by the end of the decade. Also by 1990, development of large scale coal deposits under a mixed venture arrangement with a major multinational corporation is expected to boost the production of coal from the present 5.5 million metric tons to 30 million metric tons, an estimated 18 million metric tons of which--US\$1 billion at 1981 prices--would be available for export.

## 7. External sector policies

The regulations governing trade and exchange operations in Colombia are highly complex. The liberalization of exchange and trade policies has been a long-standing goal of the authorities and one which they were in a position to pursue beginning in 1976, when the balance of payments moved strongly into surplus. Beginning in that year, trade restrictions were slowly reduced, but the apparatus for import approval was largely left intact. In 1979 and in the first half of 1980, the pace of trade liberalization gained momentum as a large number of goods was removed from the list of products requiring import licenses, import duties were lowered by an average of 3 percentage points and, most importantly, approval for goods still subject to licensing was granted more freely.

However, beginning in 1981, the decline in the rate of growth of industrial activity led to some retrenchment in the granting of import licenses for products competing with those produced locally; for example, the granting of licenses for motor vehicles costing US\$5,000 or less was prohibited entirely, and approvals for imports of finished clothing, textiles, and steel reportedly were obtained with much greater difficulty than in 1980.

The authorities told the mission that they believed that the high degree of protection by means of quantitative restrictions and duties had prejudiced the development of the export sector and the economy in general; therefore their goal continues to be import liberalization. Liberalization was more difficult, however, in the present recessionary conditions facing the traditional manufacturing sector. Under such conditions the interests of producers in the domestic market and exporters clearly diverge and the conflict can only be resolved through the political process. Meanwhile, while over the past decade the level of export subsidies was progressively reduced, in late 1981 subsidies were reintroduced or increased for certain products experiencing a slowdown in foreign demand, e.g., fresh vegetables, flowers, cacao, t: ad hides, cotton, and textiles.

As is mentioned above, the real effective exchange rate of the peso appreciated by 16-1/2 per cent during the first eight months of 1981 after three years of substantial stability. This appreciation was mainly the consequence of the rise of the U.S. dollar in world currency markets. After midyear, the authorities accelerated moderately the rate of depreciation of the peso, policy which, together with some weakening of the dollar in world markets, had the effect of reversing part of the appreciation which occurred earlier in the year.

The authorities told the mission that they saw a clear relationship between exchange rate policy and trade policy. To encourage domestic production, it was important to keep the real exchange rate broadly stable over the longer run. But a faster nominal depreciation of the peso to redress the real appreciation of the recent past (and that registered over 1976-77) would fail in its goal of affecting the real exchange rate unless accompanied by more rapid import liberalization. In the present climate, the scope for increasing the rate of depreciation was, therefore, limited.

Those aspects of Colombia's exchange system which are subject to Fund approval under Article VIII are detailed in Appendix IV of the report on Recent Economic Developments (to be issued shortly). Currently, the system entails few restrictions on payments and transfers for international transactions but there are several multiple currency practices of some economic significance--in particular those which arise from the system of tax credits for nontraditional exports and from the penalty on immediate conversion of proceeds from exports of invisibles. The authorities pointed out that the practices subject to approval under Article VIII had been in effect for some time, stressing that none had

been adopted to defend the balance of payments. They believed that over the medium run a simplification of Colombia's exchange system would be highly desirable. As in past years, they are not requesting Fund approval of these practices. Effective June 1982 a bilateral payments arrangement with Yugoslavia is scheduled to be terminated, leaving only one with a Fund member, i.e., Romania.<sup>1/</sup>

### III. Staff Appraisal

After several years of strong economic expansion, Colombia's rate of real output growth declined moderately in 1981 for the third consecutive year. The balance of payments produced a small surplus after five years of very substantial reserve gains, the decline in the surplus reflecting a sharp fall in coffee exports and the leveling off of other exports. Inflation continued at the 1980 rate of 26-1/2 per cent. The persistence of inflation in the presence of weak domestic and external demand can be explained primarily by the entrenchment of inflationary expectations and by the high degree of indexation in the economy.

Fiscal policy in 1981 was relatively cautious. The overall deficit of the nonfinancial public sector rose from 0.8 per cent to 1.6 per cent of GDP on the strength of an increase in public investment, while public savings declined marginally in relation to GDP. The staff, however, shares the authorities' concern that the sluggish performance of direct tax revenue and the continuing rise in current outlays may prejudice the Government's investment efforts in the future if corrective action is not taken, and therefore welcomes efforts to improve tax administration and reduce the scope of nondiscretionary transfers to local governments. It also welcomes the authorities' intention to raise in real terms the prices of petroleum derivatives, electric power, and other goods and services produced by the public sector to generate more resources for investment.

The use of the instruments of coffee policy in 1981 cushioned the decline in coffee growers' real income caused by low world prices and export cuts mandated by Colombia's participation in the International Coffee Agreement. The policy which the authorities have announced for 1982, in consensus with the National Federation of Coffee Growers, of moving domestic coffee prices on the basis of changes in Colombia's export quota, appears consistent with the goals of ensuring that transitory changes in world coffee prices are not passed on to producers and that any additional stock accumulation is financed out of the value of coffee exports.

The steps taken in 1980 to reduce government intervention in the process of financial intermediation--the reduction of the 100 per cent reserve requirement on sight deposits and the freeing of interest rates

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<sup>1/</sup> Colombia also maintains bilateral payments arrangements with Hungary and Poland.



on bank deposits--produced a strong reflux of funds to Colombia's formal financial system. In 1981, the public sector's continued avoidance of recourse to domestic bank credit and the change in the Banco de la Republica's open market policy made the bulk of the growth in private savings through the financial system available for relending to the private sector. The staff welcomes these actions and hopes that circumstances will permit the further gradual lowering of reserve requirements and the reduction of prior import deposits and other nonmonetary liabilities of the Banco de la Republica in the future. Such actions should over time help to reduce the spread between deposit and lending rates by reducing intermediation costs.

Although the staff recognizes that some progress has been made toward the removal of import barriers, it concurs with the authorities that a quicker pace of import liberalization would have beneficial effects for the competitiveness of industry and agriculture, and for the growth rate of the economy in general. While recognizing the constraints to reducing protection in a period of recession, the staff would encourage the authorities to press forward in this area. The staff welcomes the exchange rate policy pursued since mid-1981 and would emphasize the importance of continuing to move the exchange rate to compensate for the differential between inflation rates in Colombia and abroad.

The authorities have indicated that they favor simplification of Colombia's trade and exchange systems over the medium run. The practices entailed in Colombia's exchange system which are subject to approval under Article VIII, Sections 2 and 3 have been in effect for some time, and were not adopted in order to defend the balance of payments. Hence, the authorities are not requesting 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 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 restrictions on payments and transfers for current international transactions and multiple currency practices as described in SM/82/. 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.

Fund Relations with Colombia

Status: Article XIV.

Quota: SDR 289.5 million.

Fund holdings of Colombian pesos:	<u>As of December 31, 1981</u>	<u>Millions of SDRs</u>	<u>Per Cent of Quota</u>
Total		137.8	47.6

SDR department:	<u>As of December 31, 1981</u>	<u>Millions of SDRs</u>	<u>Per Cent of Net Cumulative Allocation</u>
Cumulative allocation		114.3	100.0
Holdings		(119.3)	(104.4)

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 issued against proceeds from emeralds and invisibles are subject to a discount (5 per cent on December 31, 1981) if redeemed at the banking system before a 120-day waiting period is over. Exchange certificates are also traded in the stock exchange at varying rates of discount. On December 31, 1981, the rate in the official market for the U.S. dollar, the intervention currency, was Col\$59.07 per U.S. dollar.

Gold distribution: Colombia has received gold amounting to 134,365 fine ounces of gold.

Direct distribution of profits from gold sales: Colombia has received a total of US\$24.9 million.

Last consultation: The staff report for the 1979 Article XIV consultation with Colombia (SM/80/34, 1/29/80 and Cor. 1-4, 2/12/80, 2/15/80, 2/25/80, 2/29/80) was considered by the Executive Board at EBM/80/30 (2/27/80).

Colombia--Basic Data

Area and population

Area	1,141,748 sq. kilometers
Population (est. mid-1981)	27.3 million
Annual rate of population increase (1975-81)	2.3 per cent

<u>GDP per capita (est. 1981)</u>	SDR 1,152
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Origin of GDP (est. 1981) (per cent)

Agriculture	23
Mining	1
Manufacturing	18
Construction	3
Other	55

Ratios to GDP (est. 1981)

Exports of goods and services	15.0
Imports of goods and services	19.7
Central government revenues	10.6
Central government expenditures	11.3
External public debt (end of June)	12.5
Saving	21.5
Investment	26.2
Money and quasi-money (end of year)	29.5

Annual changes in selected economic indicators

	1978	1979	1980	Est. 1981
		(per cent)		
Real GDP per capita	6.5	2.7	1.7	0.9
Real GDP	9.0	5.1	4.0	3.2
GDP at current prices	27.4	30.2	29.7	30.6
Domestic expenditures (at current prices)	29.0	30.3	34.2	35.3
Investment	23.5	25.2	46.7	38.0
Consumption	30.7	31.8	30.6	34.4
GDP deflator	16.9	23.9	24.7	26.5
Cost of living (annual averages)	17.1	24.7	27.2	28.1
Central government revenues	36.1	31.1	43.3	31.6
Central government expenditures	36.2	43.5	45.7	40.3
Money and quasi-money	31.2	31.6	49.5	28.9
Money	30.3	24.2	27.9	21.2
Quasi-money <sup>1/</sup>	31.9	37.5	65.0	33.1
Net domestic bank assets <sup>2/</sup>	21.9	16.8	37.6	26.2
Credit to public sector (net)	-4.0	-8.8	-3.1	--
Credit to private sector	24.9	24.0	38.9	27.2
Merchandise exports (f.o.b., in U.S. dollars)	19.9	9.5	23.7	-15.2
Merchandise imports (f.o.b., in U.S. dollars)	29.6	16.9	44.6	12.0

<u>Central government finances</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>Est. 1981</u>
	<u>(millions of Colombian pesos)</u>			
Revenues	86,894	113,942	163,229	214,760
Expenditures	78,051	112,008	163,217	229,040
Current account surplus	25,537	27,889	41,966	54,310
Overall surplus or deficit (-)	8,843	1,934	12	-14,280
External financing (net)	-2,193	15,473	16,644	14,713
Internal financing (net)	-6,650	-17,407	-16,656	-433
<u>Balance of payments</u>	<u>(millions of U.S. dollars)</u>			
Merchandise exports (f.o.b.)	3,270	3,581	4,428	3,755
Merchandise imports (f.o.b.)	-2,564	-2,996	-4,332	-4,850
Investment income (net)	-301	-255	-260	-351
Other services and transfers (net)	-19	235	-31	-248
Balance on current and transfer account	386	565	-195	-1,694
Official capital (net)	94	520	796	752
Private capital (net) and errors and omissions	187	530	700	1,088
Allocation of SDRs	--	24	24	24
Change in banking system net reserves (increase -)	-667	-1,639	-1,325	-170
<u>International reserve position</u>	<u>Dec. 31 1980</u>	<u>June 30 1981</u>	<u>Est. Dec. 31 1981</u>	
	<u>(millions of SDRs)</u>			
Central Bank (gross)	4,247.0	4,672.1	4,841.7	
Central Bank (net)	4,246.5	4,668.9	4,838.5	
Rest of banking system (net)	-1,016.5	-1,160.3	-1,205.8	

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.