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SM/82/38
Correction 1

CONTAINS CONFIDENTIAL
INFORMATION

March 3, 1982

To: Members of the Executive Board
From: The Secretary
Subject: Colombia - Recent Economic Developments

The following corrections have been made in SM/82/38 (2/22/82):

Page 3, para. 1, line 4: for "have been 27 per cent" read "have risen
by 27 per cent"

Page 13, last para., lines 7-10: for "the north area at El Cerrejon...
an Exxon affiliate." read "the northern
area at El Cerrejon are being developed
by INTERCOR, an Exxon affiliate, and
CARBOCOL in a joint venture, and the
central area deposits are being developed
jointly by CARBOCOL and Spanish-Colombian
private interests."

Page 16a, Chart 1: "Nonfood component" and "Food component" have been
reversed.

Page 60, 2nd full para., line 6: for "highly income inelastic" read "highly
price inelastic"

Corrected pages are attached.

Att: (4)

Other Distribution:
Department Heads

In spite of the relatively faster expansion of aggregate demand, price pressures, as measured by both the consumer price index and the wholesale price index, did not intensify. The consumer price index is estimated to have risen by 27 per cent per annum during these two years, a bit lower than the 1979 rate. The increased availability of foreign goods, especially of capital goods, helped constrain price pressures. The explanation of the continuation of the inflation rate in the 25-30 per cent range must probably be found in the high degree of indexation of the economy, in well established inflationary expectations and in the relative closeness of the economy notwithstanding the increased availability of imports in 1980.

The trend of increasing balance of payments surpluses came to a halt in 1980. In 1980, a more liberal import policy, particularly for capital goods imports, which accommodated the investment plans, and a fall in service receipts, which might include unrecorded exports and capital inflows, resulted in a current account deficit--the first one in five years. This deficit was more than offset by higher net capital inflows on account of direct investment, trade financing and public sector borrowing. The increase in net international reserves, although smaller than that registered in 1979, was still substantial at US\$1.3 billion. In 1981 the balance of payments surplus fell to US\$170 million. The current account deficit rose because of lower coffee prices and a lower volume of coffee exports arising from Colombia's quota commitments under the International Coffee Agreement. Noncoffee export earnings stagnated during 1981. Although imports did not expand as rapidly as before, the export decline resulted in a trade deficit of US\$1.1 billion triggering a current account deficit of US\$1.7 billion, equivalent to 4.7 per cent of GDP. Increased foreign borrowing by the private sector, which continued to take advantage of relatively lower interest rates abroad, resulted in a strong expansion of capital receipts once again.

The authorities used a number of instruments during this period to cushion the impact of the fall in coffee prices on the income of the coffee-growing sector. The minimum exchange surrender requirement for coffee exports, the ad valorem coffee tax, and the retention of quota (a share of the volume of coffee exported retained by the National Federation of Coffee Growers) were lowered, permitting an increase of the domestic support price which, combined with the increases in coffee production, limited the drop in the coffee sector income to 6 per cent in real terms in each of these two years.

During this period fiscal policy was relatively cautious; at the same time investment efforts of the public sector were increased to provide some countercyclical stimulus to the domestic economy. The overall deficit of the public sector increased from 0.4 per cent of GDP in 1979 to 0.8 per cent in 1980 to 1.6 per cent in 1981. The deficits were mainly financed through recourse to external credit without increasing the ratio of external public debt to GDP. As in the previous two years,

the monetary stance of the Banco de la Republica continued to be contractionary in 1980 mostly because of the increase in the public sector internal surplus. However, in 1981 the contraction in net domestic assets of the Banco de la Republica came almost completely to a halt because both the accumulation of deposits by the public sector and the net absorption of resources from financial intermediaries declined with respect to 1980. During these two years the Colombian financial system was liberalized with a view to reducing the proportion of transactions conducted in unsupervised markets. Legal reserve requirements were reduced, interest rate ceilings on a number of operations in the formal market eliminated, and the penalty on the immediate conversion of coffee export proceeds eliminated. These policies succeeded in attracting funds back to the organized financial system, whose operations increased in real terms. The expansionary impact of these measures on the money supply was ameliorated by an aggressive open-market policy pursued by the Banco de la Republica until the first quarter of 1981.

the state company, 40 per cent to the exploration corporation, and 20 per cent as royalties to the Government. This approach has been successful in significantly increasing private investment in oil exploration in recent years and expanding the volume of petroleum production. Although the 1980-81 production increase was attributable mainly to the recovery of existing wells, the discovery of new fields leads the Colombian authorities to believe that oil extraction will increase substantially in the next few years. The recently discovered fields at Arauca, Casanare, and Meta (which are scheduled to come into operation by 1985), together with increased production in the Huila field, will increase Colombian petroleum production by 35,000 barrels a day, equivalent to an increase of 25 per cent over the 1981 output in the next three years. Installed refinery capacity is sufficient to process the entire present and projected domestic production. The processing plants of the refineries of Barrancabermeja and Cartagena--which make up over 90 per cent of installed refining capacity--were recently enlarged by 20 per cent.

The authorities expect to change energy consumption patterns gradually during this decade by adjusting consumption to the country's available primary energy sources. Petroleum represents today approximately 50 per cent of total energy consumption, natural gas 22 per cent, coal 21 per cent, and hydroelectricity 7 per cent. In comparison, an inventory of existing energy resources shows that the hydroelectric potential accounts for 55 per cent of available energy reserves, coal for 40 per cent, natural gas for 4 per cent, and petroleum for 1 per cent. Electricity generating capacity equaled 4.5 million kilowatts in 1980 and was expected to increase to 5.1 million kilowatts in 1981. However, mainly because of the delay in the start of operation of the 500,000-kilowatt Chivor II hydroelectric power plant, the projected increase was not achieved, leading to the imposition of electricity rationing in 1981. About 1.8 million kilowatts will be added to the 1981 electric generating capacity during the next two years as projects now underway are completed, and the rationing in effect will tend to become less strict after the first half of 1982. Average electricity tariffs increased by 28 per cent a year in 1980 and 1981; the largest increases were made on residential tariffs.

Domestic extraction and consumption of coal equaled 5.5 million metric tons in 1981. Domestic consumption is projected to reach 8.5 million tons by 1986, while production is expected to amount to 18 million tons by the same year, leaving a significant exportable surplus. This addition to coal mining volume will come about as a result of the conclusion of the initial stages of the exploration projects at El Cerrejon deposits. The deposits in the northern area at El Cerrejon are being developed by INTERCOR, an EXXON affiliate, and CARBOCOL in a joint venture, and the central area deposits are being developed jointly by CARBOCOL and Spanish-Colombian private interests.

Finally, natural gas production grew at an average annual rate of 6 per cent in 1980-81. Projects are currently in study for utilization of natural gas to produce fertilizers (ammonia and urea) and methanol, the latter for use as a gasoline substitute.

d. Construction

During 1980 and 1981 construction activity recovered somewhat from its depressed 1979 level. Real value added in the construction sector grew by 2 per cent in 1980 and an estimated 3 per cent in 1981. The growth in 1980 is attributable essentially to increased public works; demand for housing dropped, as evidenced by the decline in licenses issued for housing construction (Table 6). In 1981 the demand for housing recovered as evidenced by a 7.5 per cent increase in approved licenses for housing construction during the first nine months of the year. This recovery was probably attributable to a partial rent decontrol implemented by the Colombian authorities in the second half of 1980, whereby rents are to be adjusted by an annual correction of 10 per cent for current leases, provided inflation equals or exceeds this rate, and frees rents charged on new leases from control.

Table 6. Colombia: Indicators of Construction Activity

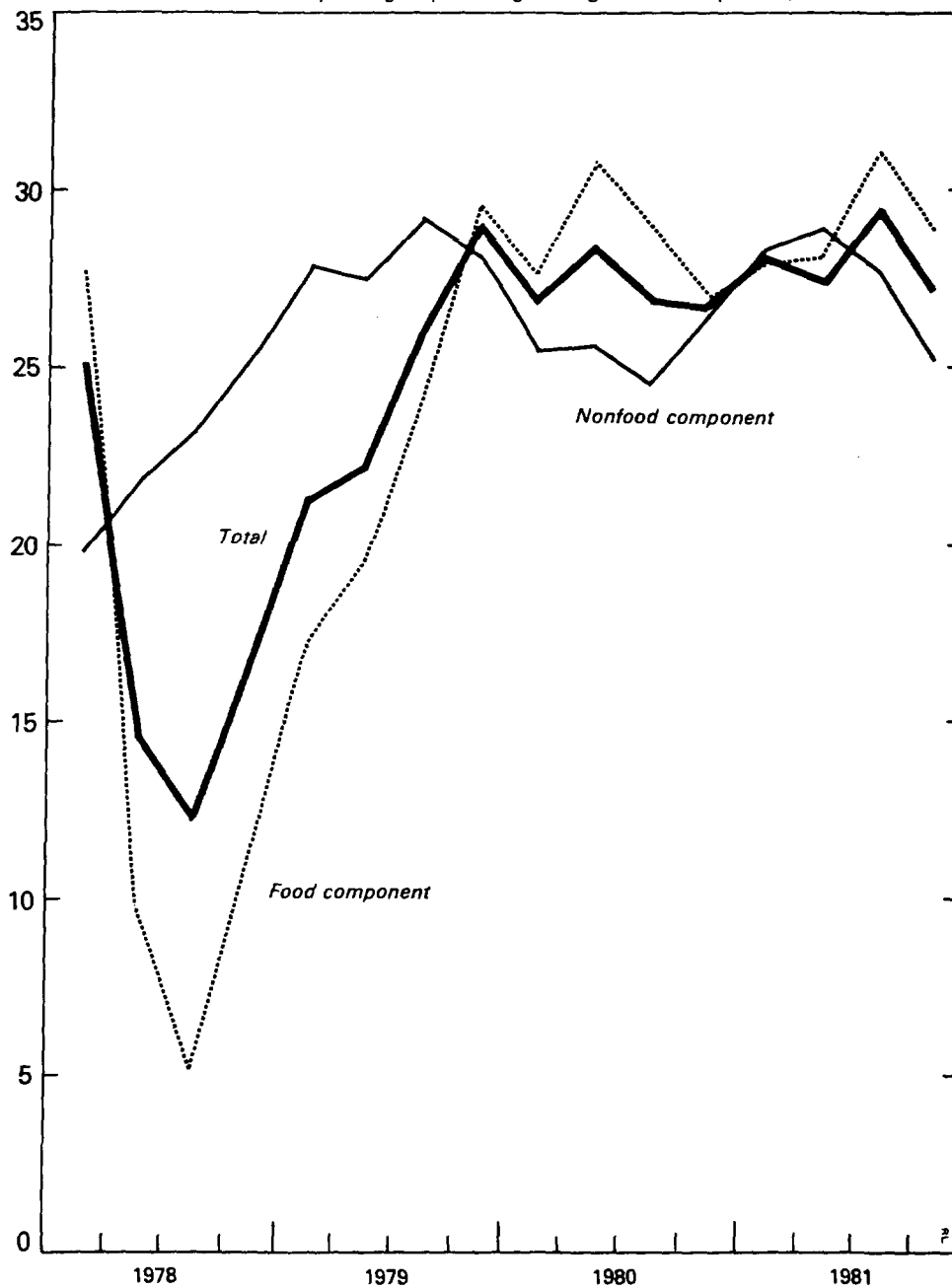
(Annual percentage change)

	1977	1978	1979	1980	Jan.-Sept.	
					1980	1981
Total approved construction licenses (area)	18.1	12.8	-14.8	-3.5	-4.4	2.5
Approved licenses for housing construction (area)	19.5	29.6	-32.9	-7.8	-3.4	7.6
Construction costs (at current prices)	23.9	38.1	32.7	34.1	27.5	19.0
Steel	(5.4)	(59.2)	(16.1)	(32.3)	(18.7)	(14.3)
Cement	(20.9)	(25.5)	(29.4)	(74.5)	(56.7)	(2.5)
Brick	(47.4)	(45.4)	(36.4)	(19.2)	(12.3)	(9.7)
Cement production (volume)	-8.7	25.9	2.5	2.2	0.5	4.6
Steel production (volume)	-17.1	26.9	-11.8	12.4	19.8	-6.4

Source: Banco de la Republica.

CHART 1
COLOMBIA
CONSUMER PRICE INDEX¹

(Quarterly averages - percentage change over four quarters)



Source: Banco de la Republica; and Fund staff estimates
¹ Consumer price index for low income groups.

Table 29. Colombia: Coffee Stocks, Production, and Exports
(In thousands of 60-kilo bags)

	1976-77	1977-78	1978-79	1979-80	Prel. 1980-81	Est. 1981-82
<u>Opening registered stocks</u>	1,812	3,999	5,601	4,765	3,761	6,550
<u>Derived production 1/</u>	8,784	10,580	12,233	12,264	13,300	13,700
<u>Domestic consumption 2/</u>	1,305	1,420	1,638	1,728	1,480	1,500
<u>Exportable production</u>	7,479	9,160	10,970	10,976	12,175	12,650
<u>Registered exports</u>	5,292	7,558	11,431	11,540	9,031	9,463
<u>Change in registered stocks</u>	2,187	1,602	-836	-1,004	2,789	2,737
Memoranda						
Nonregistered production	516	470	367	448	700	...
Contraband	(500)	(735)	(700)	(700)	(700)	(...)
Change in nonregistered stocks	(16)	(-265)	(-333)	(-252)	(--)	(...)

Sources: National Federation of Coffee Growers; International Coffee Organization; U.S. Department of Agriculture; and Fund staff estimates.

1/ Exportable production plus domestic consumption.

2/ Registered domestic sales of semiprocessed coffee by the Coffee Federation.

with over 300,000 individual farms growing coffee in 16 departments of the country. About one third of the coffee acreage is cultivated with modern technology and supplies 60 per cent of overall output.

After reaching a peak in the 1979-80 coffee year, when 11.5 million 60-kilogram bags were shipped, registered exports declined to 9 million bags in 1980-81, due to the cut of 1.4 million bags in Colombia's original quota under the International Coffee Agreement and to the decline in sales to non-ICO countries. Exports during the 1981-82 coffee year are expected to amount to 9.5 million bags, including 8.6 million bags to ICO members under the quota agreed in September 1981 and 900,000 bags to nonmembers. Stocks held by the National Federation of Coffee Growers declined by approximately 1 million bags in 1979-80 as a result of the extraordinary export performance during two years in a row. In 1980-81, however, Colombian coffee stocks increased by 2.8 million bags as production growth accelerated while exports and domestic consumption declined. Coffee stocks are expected to increase by an estimated 2.7 million bags in 1981-82, raising Colombia's reserve stocks to 9.3 million bags by the end of the current coffee year. This level represents approximately 70 per cent of the country's average annual production in recent years.

With the existing coffee production trend in Colombia and the current world market conditions, both the Government and the National Federation of Coffee Growers advocate a policy of reducing world coffee production with a view to stabilizing prices at remunerative levels for producers. This advocacy is based on the belief that world coffee demand is highly price inelastic and that the release of present production into world markets therefore would lead to a disastrous drop in prices. As a means of achieving this policy objective, the Colombian authorities are implementing a program of agricultural diversification in the country's coffee growing regions, with a view to adjusting the growth of domestic production in the near future to the projected increase in demand.

3. Coffee policy management in Colombia

Colombian coffee policy is determined by the Government in collaboration with the National Federation of Coffee Growers, an autonomous entity which represents the coffee growing regions and to whose governing committee the Government appoints seven of the fifteen directors. The National Federation of Coffee Growers is directly responsible for the management of domestic and external marketing of Colombia's coffee, including the enforcement of quality control, the provision of storage facilities, the representation of Colombia in the international coffee forums, and the promotion of Colombian coffee sales abroad. In addition, the Coffee Federation is entrusted with the management of the resources of the National Coffee Growers' Fund, which is the main recipient of Colombian coffee taxes and which channels a proportion of its resources to infrastructure investment in the coffee growing regions.