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June 12, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Colombia - Staff Report for the 1985 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Colombia. A draft decision appears on page 26; a draft decision on Colombia's economic program and request for monitoring will be circulated soon.

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

Mr. Bonangelino (ext. 7148) or Mr. Pérez (ext. 7154) are available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

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INTERNATIONAL MONETARY FUND

COLOMBIA

Staff Report for the 1985 Article IV Consultation

Prepared by the Staff Representatives for the
1985 Consultation with Colombia

Approved by S. T. Beza and Manuel Guitian

June 11, 1985

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I. Introduction

The 1985 Article IV consultation discussions with Colombia were initiated in Bogota in the period February 11-March 7, 1985 and were concluded in Washington in the period March 27-April 5, 1985. The representatives of Colombia in the discussions included the Ministers of Finance, Economic Development, Agriculture, and Mines and Energy, the General Manager of the Banco de la Republica, the Director of the National Planning Department, the Director of the Foreign Trade Institute, and other senior officials of the Ministry of Finance and the Banco de la Republica. The staff representatives in the mission to Bogota were Messrs. Bonangelino (Head-WHD), Antonaya (FAD), Caetano (WHD), Kalter (ETR), Sol-Perez (WHD), and Ms. Lanio (Secretary-WHD).

The last Article IV consultation discussions took place in July 1984 and the reports (SM/84/216 and SM/84/220) were discussed by the Executive Board on October 10, 1984 (EBM/84/148). The 1985 Article IV consultation discussions were advanced at the request of the Colombian authorities to facilitate an evaluation of Colombia's economic adjustment program by the staff. In the attached letter and accompanying summary of economic policies dated May 27, 1985, the Minister of Finance and the General Manager of the Banco de la Republica describe Colombia's economic adjustment program for 1985 and establish quarterly quantitative targets and ceilings to measure performance under the program; the authorities will be submitting the summary of economic policies for 1986 later this year. In their letter the authorities also request that the Fund monitor compliance with such quarterly targets and ceilings in order to facilitate the implementation of a financial arrangement which recently has been agreed in principle with foreign commercial banks. Colombia continues to avail itself of the transitional arrangements of Article XIV.

II. Recent Developments

In recent years Colombia experienced a substantial deterioration in its overall economic and financial performance as the growth of the economy decelerated and the balance of payments weakened considerably. Real GDP rose by 1 percent in 1982 and 1983, compared with an annual average increase of about 5 percent in 1975-80 and slightly more than 2 percent in 1981 (Table 1). The slowdown in economic growth reflected a contraction of output in manufacturing and commerce and a slackening in agricultural and construction activity. The rate of unemployment increased from 7 percent in December 1981 to 12.5 percent in December 1983; at the same time, the rate of domestic inflation declined to about 16.5 percent in 1983 from over 26 percent in 1981.

The balance of payments shifted from a cumulative overall surplus of about US$5 billion in the 1975-81 period to a deficit of US$0.8 billion and US$1.8 billion in 1982 and 1983, respectively. The overall balance of payments deficit reflected a drastic weakening of the current account, which moved from a small surplus in 1980 to a deficit equivalent to about 10 percent of GDP in 1982 and 1983, and a large reduction in the net inflow of private capital in 1983.

Table 1. Colombia: Economic Indicators

	1980	1981	1982	1983	Prel. 1984
	(Percentage change)				
GDP at constant prices	4.1	2.3	0.9	1.0	3.0
GDP at current prices	32.8	25.6	26.0	21.6	21.6
Agricultural value added (at constant prices)	2.2	3.2	-1.9	1.8	0.7
Manufacturing value added (at constant prices)	1.2	-2.6	-1.4	0.5	8.3
Consumer price index (December-December)	25.9	26.4	24.0	16.6	18.3
Wholesale price index (December-December)	25.4	23.5	24.6	18.0	21.2
	(In percent)				
Unemployment rate (December)	9.1	7.1	8.9	12.5	13.4

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

The deterioration of the current account reflected the stagnation of exports, the continued growth of imports through 1982, and a large increase in net service payments which resulted mainly from higher remittances by foreign oil companies and a significant reduction of remittances from Colombian workers abroad. Higher interest payments on the external debt, and lower interest income from foreign reserves as they declined also contributed to the rise of net service payments.

Exogenous factors such as a relatively weak international coffee market and the deterioration in trade flows with neighboring countries have affected recent balance of payments developments. However, the negative impact of these factors was compounded by the expansionary domestic demand policies pursued by the authorities with the aim of reversing the recessionary trends in the economy.

The overall financing of the public sector increased from about 2.5 percent of GDP in 1980 to almost 7 percent of GDP in 1982 as spending increased while revenue growth weakened. In early 1983 the Colombian authorities began to take measures designed to reduce the public sector deficit. A reform of the income tax and the state and local taxes was introduced in that year. While those measures resulted in a moderate increase in tax revenue relative to GDP, and nontax revenue also rose as a ratio to GDP reflecting an increase in nontax revenue of local governments, the public sector deficit continued rising and reached 7.6 percent of GDP in 1983 because of a rapid increase in expenditures. Public sector outlays rose from almost 24 percent of GDP in 1982 to 27 percent of GDP in 1983, reflecting strong increases in both current and capital expenditure.

Monetary policy became increasingly expansionary over the 1982-83 period. The Banco de la Republica began to release funds which had been sterilized in the form of special reserve requirements imposed during the coffee export boom of 1975-77, eased its rediscount facilities and broadened the role of the special funds it administers with the aim of promoting economic activity. These actions, together with the increased financing needs of the public sector, led to an acceleration in the growth of the net domestic assets of the Banco de la Republica from about 5 percent in 1981 to 61 percent in 1982 and 68 percent in 1983. For the financial system as a whole, the expansion of net domestic assets accelerated from 29 percent in 1981 to 34 percent in 1982 and over 37 percent in 1983. Credit to the private sector expanded at a steady rate of about 25 percent a year in 1981-83, despite the slowdown in the expansion of nominal GDP and a decline in the rate of price increase. At the same time, there was a deceleration in the growth of the financial system's liabilities to the private sector from almost 30 percent in 1981 to 23 percent in 1983 (Table 2).

Economic activity improved during 1984 with real GDP growing by about 3 percent, mainly on the strength of a recovery in the output of manufacturing, commerce, and transportation. Domestic inflation, however, accelerated slightly to 18.3 percent and the rate of unemployment increased further to almost 13.5 percent as of December 31, 1984. Reflecting the full year impact of the tax reforms of 1983 and a change in the application of the sales tax to a value-added basis, public sector revenue increased from 19.7 percent of GDP in 1983 to 20.9 percent of GDP in 1984. Nonetheless, the overall public sector deficit remained unchanged at 7.6 percent of GDP because of the continued growth of outlays.

There was some slowdown in the pace of credit growth in 1984, but policy in this area continued to be expansionary. The net domestic assets of the Banco de la Republica rose by 64 percent (compared with 68 percent in 1983) as the expansion of credit to the public sector accelerated

Table 2. Colombia: Summary Accounts of the Financial System

(Percentage change over preceding 12 months)1/

	1980	1981	1982	1983	1984
I. Financial System					
Net international reserves	10.8	-1.1	-6.7	-11.9	-6.9
Net domestic assets	40.0	29.4	33.6	37.4	29.3
Credit to the public sector (net)	1.6	4.8	9.9	13.2	14.4
Central Administration (net)	(2.4)	(4.9)	(11.0)	(11.3)	(12.7)
Rest of the public sector (net)	(-0.8)	(-0.1)	(-1.1)	(1.9)	(1.7)
Official capital and surplus	-2.2	-2.6	-3.7	-1.5	-1.8
Credit to the private sector	37.1	26.7	24.8	25.6	17.3
Interbank float and unclassified assets (net)	3.5	0.5	2.6	0.1	-0.6
SDR allocation and valuation adjustment	2.1	-1.2	1.8	2.6	-0.5
Medium- and long-term foreign liabilities	1.4	0.1	0.4	-0.1	1.3
Liabilities to the private sector	47.3	29.4	24.7	23.0	21.6
II. Banco de la Republica					
Net international reserves	51.3	-0.5	-25.8	-52.1	-44.3
Net domestic assets	-12.3	4.6	61.2	68.0	63.9
Credit to the public sector (net)	7.6	18.2	49.8	47.9	63.4
Central Administration (net)2/	(7.4)	(17.7)	(51.1)	(47.5)	(64.2)
Rest of public sector (net)	(0.2)	(0.5)	(-1.3)	(0.4)	(-0.8)
Rest of the financial system (net)	-23.6	-14.1	-0.8	18.7	1.6
Credit to the private sector	--	2.2	1.3	1.1	-0.3
Net unclassified assets	3.9	-1.7	10.9	0.3	-0.8
SDR allocation and valuation adjustment	5.4	-7.7	4.5	8.4	-2.8
Medium- and long-term foreign liabilities	2.3	0.8	0.6	-0.1	-0.4
Liabilities to the private sector	31.3	11.0	30.3	7.6	22.8

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

1/ In relation to the stock of liabilities to the pivate sector at the beginning of the period.
2/ Includes tranfers to the Central Administration of profits from the purchases and sales of foreign exchange.

while the growth of credit to the financial system slowed somewhat. The total expansion of credit by the Banco de la Republica in 1984 continued to exceed by a substantial margin the growth of liabilities to the private sector, and as a result an additional sizable loss of foreign reserves took place last year (equivalent to US$1.4 billion).

Despite a reduction in the current account deficit to about 6.5 percent of GDP (from nearly 10 percent in 1983) the balance of payments recorded a large overall deficit in 1984 because of a further significant weakening in private capital flows and a reduction in trade credit lines from foreign commercial banks. The improvement in the current account reflected a reduction in the trade deficit of almost US$1 billion, from about 4.5 percent of GDP in 1983 to 1 percent of GDP in 1984. After having been stagnant for three years, exports rose by 16 percent while imports declined for the second consecutive year. However, the cutback in imports reflected to large extent the tigthening of import controls beginning in the second half of 1982. In the last two years, the authorities have been making efforts to improve the external competitiveness of the economy. In August 1982 and again in October 1983 the pace of adjustment of the exchange rate was accelerated, and as a result, the real effective exchange rate has been depreciating since the end of 1982, partly reversing the real appreciation which had taken place from the mid-1970s through 1982.

III. Report on the Discussions

At the time of the 1984 Article IV consultation discussions, the Colombian authorities recognized the need for a reorientation of their financial policies with a view to dealing with the country's balance of payments problem. Thus, in the second half of 1984 the adjustment effort was strengthened with a view to re-establishing virtual external payments equilibrium in 1985 and thus facilitating the resumption of sustained economic growth. The authorities plan to achieve this objective through a sizable reduction of the public sector deficit, a tightening of monetary policy, and the implementation of an appropriate exchange rate policy.

This year's discussions with the Colombian authorities centered on the policies that form the basis of their economic adjustment program for 1985. To ensure the achievement of the fiscal and balance of payments objectives of the program the following targets and ceilings have been established by the authorities for 1985: (a) quarterly ceilings on the net domestic assets of the Banco de la Republica; (b) quarterly ceilings on net credit to the public sector from the Banco de la Republica; (c) quarterly targets on the net international reserves of the Banco de la Republica; and (d) a limit on the total outstanding public and publicly guaranteed external debt.

The authorities have indicated that they intend to continue the adjustment process in 1986 and that later this year they will be submitting to the Fund the summary of Colombia's economic policies for next year. In this connection, they have requested a mission in the second half of this year to review performance under the 1985 program and to evaluate the policies--including the quantitative targets and ceilings--for 1986.

1. Fiscal policy

One of the main elements of Colombia's adjustment program is the reduction of the overall public sector deficit from 7.6 percent of GDP in 1984 to 4.9 percent of GDP in 1985 (Table 3). The authorities intend to achieve this reduction through revenue measures and the pursuit of a tight expenditure policy.

On the revenue side, last December Congress approved a series of measures designed to strengthen the position of the Central Administration. The actions taken included: (1) an increase of 50 percent in the stamp tax; (2) adoption of a surcharge of 8 percent on the value of imports; (3) a reduction in the amount of deductions permitted under the income tax for interest on mortgages; and (4) the elimination of several exemptions to the value-added tax. In addition, Congress has recently approved a change in some earmarked taxes in favor of the Central Administration and certain other revenue measures that would produce an amount equivalent to approximately 0.4 percent of GDP in 1985. The combined effect of revenue measures is estimated at about 1.5 percent of GDP in 1985 (Statistical Appendix Table 9).

Steps also have been adopted to strengthen the revenue position of the rest of the public sector. Late last year the Government raised gasoline prices by 15 percent, and it intends to make further adjustments to ensure that prices are in line with those abroad and produce an additional increase of at least 5 percent in public sector revenue from gasoline and diesel fuel in 1985 over the estimates before the planned adjustments. Electricity and telephone rates have recently been restructured and raised, and in the period ahead will be adjusted by about 3 percent a month. Furthermore, the Government is also planning to raise water rates in the near future.

On the basis of the measures described above and the full-year impact of the reforms to the sales tax which became effective in May 1984, the current revenues of the public sector are projected to increase from 20.7 percent in 1984 to 23 percent of GDP in 1985.

The authorities emphasized that part of the fiscal adjustment should come from the side of expenditures, particularly since these had been growing in real terms in the recent past. Therefore, they have designed

Table 3. Colombia: Consolidated Nonfinancial Public Sector Operations

(As percent of GDP)

	1980	1981	1982	1983	1984	Proj. 1985
Total revenue	16.8	16.2	16.1	19.7	20.9	23.3
Current revenue	16.5	16.0	15.8	19.5	20.7	23.0
Tax revenue	12.4	12.1	11.9	12.7	12.8	14.3
Nontax revenue	7.9	5.4	6.0	7.8	8.6	9.3
Operating surpluses	(5.2)	(2.4)	(3.1)	(3.3)	(4.2)	(4.7)
Property income	(1.6)	(1.8)	(1.5)	(1.5)	(1.6)	(1.6)
Other nontax revenue	(1.1)	(1.2)	(1.4)	(3.0)	(2.8)	(3.0)
Current transfers	0.1	0.1	0.1	0.1	0.1	0.1
Adjustment 1/	-3.9	-1.6	-2.2	-1.1	-0.8	-0.7
Capital revenue	0.3	0.2	0.3	0.2	0.2	0.3
Total expenditure	19.6	22.6	23.7	27.3	28.5	28.2
Current expenditure	13.0	14.7	15.5	17.4	17.8	17.6
Wages and salaries	5.7	6.4	6.7	8.1	8.0	7.3
Purchases of goods and services	2.1	2.9	3.2	3.1	3.0	2.8
Interest payments	1.8	1.7	1.8	1.8	2.3	2.9
Current transfers	3.4	3.8	3.5	4.0	3.9	4.0
Other current expenditure	0.6	0.7	0.6	0.6	0.6	0.6
Adjustment 2/	-0.6	-0.8	-0.3	-0.2	--	--
Capital expenditure	6.6	7.9	8.2	9.9	10.7	10.6
Overall surplus or deficit (-)	-2.8	-6.4	-7.6	-7.6	-7.6	-4.9
Net residual 3/	0.2	1.2	0.8	--	--	--
Overall financing	2.6	5.2	6.8	7.6	7.6	4.9
External financing (net)	2.1	3.5	2.8	2.6	2.4	3.8
Banking system (net)	0.4	1.5	3.7	4.2	4.9	1.1
Other	0.1	0.2	0.3	0.8	0.3	--
Memorandum item						
Current account surplus or deficit (-)	3.5	1.3	0.3	2.1	2.9	5.4

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

1/ Statistical discrepancies resulting from differences in intersectoral transfers.
2/ Adjustment arising from differences in reporting on an accrual and cash basis.
3/ Reflects reporting lags and statistical discrepancies.

a policy of expenditure restraint which is expected to produce a modest reduction in total public sector outlays relative to GDP in 1985. This policy will reflect on both current and capital expenditure.

The authorities have limited salary increases in the Central Administration to a weighted average of 10.5 percent in 1985, with higher increases being applied to lower paid employees. The increase for 1985 compares with an adjustment of 22 percent in 1984 and with a projected rate of inflation of about 22 percent in 1985. The authorities have adopted measures to enforce this salary policy in the rest of the public sector, although Colombia's legal framework permits collective bargaining in most of the decentralized agencies and public sector enterprises. As a result of the salary policy and a moderation in spending on goods and services, the ratio of current outlays of the public sector to GDP (excluding interest payments) is expected to decline by almost 1 percentage point in 1985.

With regard to capital expenditures, the authorities have reassessed their investment program with priority being given to projects related to the production of oil and coal which are essential in Colombia's efforts to increase exports. At the same time, various other projects not considered critical at this stage, mainly in the electricity sector, have been postponed. On the whole, public sector capital outlays are projected to remain virtually unchanged relative to GDP in 1985, after an increase of over 3 percent of GDP in the period 1980-83 and one of almost 1 percent of GDP last year. The IBRD has been assisting Colombia to adjust its public investment program and is in agreement with both the level and composition of the public investment planned for 1985.

The strengthening of the financial position of the public sector in 1985 should permit a significant reduction in the dependence on banking system credit, especially on net credit from the Banco de la Republica, to finance its operations. The overall public sector deficit in 1985 is expected to be financed largely through the use of foreign loans, including the disbursement of US$150 million under a trade policy and export diversification loan from the IBRD, and US$415 million of a new credit from foreign commercial banks, mainly to cover outlays related to the oil and coal projects.

The authorities recognize the importance of achieving the target for projected revenue and implementing fully the planned expenditure policy, particularly the salary policy, in order to attain the envisaged reduction in the public sector deficit. They agreed with the staff that it will be important to strengthen tax administration as there is usually a tendency for evasion to increase when taxes are raised. In this connection, they have indicated their interest in technical assistance from the Fund in the areas of customs and value-added tax administration.

The authorities intend to establish a committee that will monitor and control public sector outlays to ensure that the policy of expenditure restraint is implemented. In addition, to improve control over spending, the authorities recently have submitted to Congress two draft laws and plan to submit two others early in the second semester of this year which would: (1) grant extraordinary powers to the Government to modify or eliminate public sector functions and to strenghten its control over public sector outlays; (2) limit the amount and number of supplementary budgets that can be presented to Congress (no limits exist at present); (3) provide for a gradual dismantling of revenue earmarking; (4) limit the transfers made by the Central Administration to local governments for teachers' salaries; and (5) modify the present system of automatic promotion for teachers. Another law, which introduces reforms to the social security system to improve its financial situation, was approved last December. Although none of these measures, except that relating to social security, is expected to have a measurable impact in 1985, the authorities believe that they will improve the financial position of the public sector significantly in 1986 and beyond.

2. Monetary policy

The authorities plan to reduce substantially the overall expansion of credit during 1985 in order to alleviate the balance of payments pressures. Their monetary program for 1985 is aimed at limiting the loss of net international reserves of the Banco de la Republica to US$75 million. On the basis of the fiscal policy described above, the program assumes a reduction in the flow of net credit from the Banco de la Republica to the public sector from Col$155 billion in 1984 to Col$45 billion in 1985 (Table 4); the flow of net credit to the public sector from the financial system is to decline from over Col$180 billion to about Col$50 billion. This cutback in credit to the public sector should make possible an increase in bank credit to the private sector of about 23 percent, which would correspond to the projected growth of nominal GDP, while permitting at the same time the achievement of the target mentioned above for the net official international reserves (Table 5).

The monetary program assumes that private sector claims on the financial system will grow by about 21 percent in 1985, on the basis of current trends and the anticipated expansion of nominal GDP. Because of the need to provide adequate incentives for the growth of financial savings, the authorities plan to continue with their present policy of not interfering with market forces in the determination of interest rates. At present, interest rates on credit and deposits are 45 percent and 35 percent, respectively, or about 18 percent and 10 percent in real terms. The authorities are concerned about the high level of real interest rates, but recognize that under present circumstances the current levels of interest rates are necessary to encourage the expansion of financial savings and their retention in the country.

Table 4. Colombia: Banco de la Republica Operations

(In billions of Colombian pesos)

	1983 Dec.	1984 Dec.	1985 Actual March 1/	1985 Projected June	1985 Projected Sept.	1985 Projected Dec.
Net international reserves	438.1	240.1	222.6	188.7	191.5	229.7
Net domestic credit	-270.2	-21.1	-74.7	-11.1	-18.5	35.3
Net credit to public sector	229.5	384.3	413.7	429.3	422.3	429.3
Central Administration	(227.0)	(383.9)	(412.4)	(428.9)	(421.9)	(428.9)
Rest of the public sector	(2.5)	(0.4)	(0.3)	(0.4)	(0.4)	(0.4)
Net credit to financial institutions	-32.1	-27.4	-98.8	-64.8	-62.8	-5.7
Net credit to private sector	-97.1	-112.8	-130.7	-119.4	-122.7	-126.1
Medium- and long-term foreign liabilities	-49.7	-47.8	-47.3	-49.4	-54.1	-66.6
Net unclassified assets and adjustment account 2/	-320.8	-217.4	-211.6	-206.8	-201.2	-195.6
Currency issue	168.1	219.0	147.9	177.6	173.0	265.0

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

1/ Preliminary.
2/ Includes the counterpart of the Special Exchange Account's transfers to the Central Administration.

Table 5. Colombia: Financial System Operations

(In billions of Colombian pesos)

	December 1984			December 1985		
	Banco de la Republica	Other Financial Institutions	Total	Banco de la Republica	Other Financial Institutions	Total
Net international reserves	240.1	--	240.1	229.7	--	229.7
Other foreign assets (net)	--	-184.4	-184.4	--	-98.8	-98.8
Domestic credit	405.9	1,417.5	1,823.4	453.3	1,738.8	2,192.1
Public sector	384.3	43.6	427.9	429.3	48.1	477.4
Central Administration (net)	(383.9)	(16.7)	(400.6)	(428.9)	(16.7)	(445.6)
Rest of the public sector (net)	(0.4)	(26.9)	(27.3)	(0.4)	(31.4)	(31.8)
Private sector	13.2	1,466.6	1,479.8	14.0	1,800.7	1,814.7
Net unclassified assets 1/	8.4	-92.7	-84.3	10.0	-110.0	-100.0
Intersystem transactions	-44.3	22.5	-21.8	-26.1	4.3	-21.8
Credits	203.5	-338.4	-134.9	254.2	...	...
Deposits	-247.8	360.9	113.1	-280.3	...	...
Adjustment account (liability) 2/	225.8	-38.4	187.4	205.6	--	205.6
Medium- and long-term foreign liabilities	47.8	53.8	101.6	66.6	129.0	195.6
Liabilities to the private sector	328.1	1,240.2	1,568.3	384.7	1,515.3	1,900.0

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

1/ Includes official capital and surplus.
2/ Includes counterpart of the Special Exchange Account's transfers to the Central Administration, allocation of SDRs, and adjustment for change in the accounting exchange rate.

The authorities also are of the view that the interest rates charged by the funds administered by the Banco de la Republica and those charged by the Export Promotion Agency (PROEXPO) should be positive in real terms so as to minimize the subsidy element and strengthen the financial position of the funds.1/ The rates charged by the funds administered by the Banco de la Republica are at present around 21 percent on agriculture and 24-29 percent on industry, and PROEXPO raised its interest rates from 18 percent to 22 percent beginning April 1, 1985. The authorities have indicated their intention to continue adjusting these rates in the future if necessary to ensure that they are positive in real terms.

The authorities expressed concern about the financial situation of some local commercial banks because of the difficulties in collecting past-due loans. With a view to mitigating the effect of the increase in nonperforming loans on the financial situation of those banks, the Banco de la Republica established in 1984 a special credit facility to help finance the capitalization of the banks. The authorities were studying other measures to help improve the financial situation of commercial banks, such as exempting them from the requirement to constitute provisions for bad loans in those cases in which banks were prepared to grant a rescheduling (under specified conditions) to the debtor.

While the financial position of local banks continues to be worrisome, the authorities were confident that the situation would improve in 1985 and felt that the monetary program allowed for a sufficient margin of credit from the Banco de la Republica to help finance the capitalization of the banks, including for this purpose the use of US$100 million of a new credit from foreign commercial banks (part of the total new credit to be obtained from the foreign commercial banks as is discussed below).

3. Wage policy

Official wage policy in Colombia consists of determining the salary adjustments for government employees and setting the legal minimum wages for the nation. Private sector wages covering a significant portion of the labor force are determined through collective bargaining.

In the recent past, both public sector salaries and minimum wages have risen faster than inflation. Central administration salaries rose by 23 percent in 1983 and 22 percent in 1984, compared with an inflation rate of 16.5 percent and 18.3 percent in 1983 and 1984, respectively. Minimum wages were increased by 25 percent in 1983 and by 22 percent in metropolitan and 24 percent in rural areas in 1984. Further increases in the minimum wages for rural workers were introduced in the first half of 1984, to bring those wages into line with the metropolitan minimum wage.

1/ The amount of credit granted through these funds, including credit by PROEXPO, represents 10-15 percent of total credit to the private sector.

The authorities recognize that a prudent salary policy will be essential to their efforts to improve the balance of payments and keep inflation under control. Therefore, as mentioned above, they have decided to reduce significantly the rate of wage increase to public sector employees in 1985. The increase in minimum wages approved by Congress for this year, which amounted to 20 percent, was also lower than the one granted in the last two years, although it still exceeded the rate of inflation in the preceeding year.

4. External policies

The authorities believe that policies of fiscal effort and monetary restraint need to be complemented by an adequate exchange rate policy to ensure the success of the adjustment program.

As was indicated in section II above, Colombia accelerated the pace of depreciation of its currency in August 1982 and again in October 1983. As a result, some real depreciation was achieved in the last two years, but not enough to reverse in full the real appreciation which had occurred since the mid-1970s (Chart 1). Thus, the authorities have again accelerated the pace of depreciation of the peso this year with the aim of restoring, by the end of 1985, the real effective exchange rate that prevailed in 1975, which is considered to have provided an adequate degree of competitiveness. The authorities believe that implementation of their policy in respect of the exchange rate would help strengthen the balance of payments and would also permit a gradual reduction of exchange and trade restrictions. Once the desired real effective exchange rate is achieved, the authorities intend to depreciate the currency according to the inflation differential between Colombia and its trading partners, but taking into account the effect of the planned reduction in exchange and trade restrictions.

Recent information indicates that substantial progress has been made so far this year toward the targeted real effective exchange rate. As of the end of April the exchange rate was Col$132.58 per U.S. dollar compared with Col$113.89 per U.S. dollar as of December 31, 1984, and the real effective exchange rate is estimated by the authorities to have been within 15 percent of the real rate that is being sought. As of the same date (April 30, 1985), the exchange rate in the unofficial market was Col$145 per U.S. dollar, or about 10 percent more depreciated than the official rate.

The authorities expect implementation of their policies to result in a further reduction of the deficit on the current account of the balance of payments, from 6.5 percent of GDP in 1984 to 4.8 percent of GDP in 1985 (Table 6). The value of total exports is projected to grow by 10 percent (in U.S. dollar terms), on the basis of an increase in exports of oil, coal, and other nontraditional exports; the value of imports is projected to remain unchanged. As a result, the trade account is expected to move from a deficit of over US$300 million in 1984 to a small surplus in 1985.

Table 6. Colombia: Summary Balance of Payments

	1981	1982	1983	Prel. 1984	Proj. 1985
(In millions of U.S. dollars)					
Current account	-1,722	-2,885	-2,826	-1,869	-1,400
Trade balance	-1,333	-2,076	-1,317	-321	25
Exports, f.o.b.	(3,397)	(3,282)	(3,147)	(3,659)	(4,025)
Imports, f.o.b.	(-4,730)	(-5,358)	(-4,464)	(-3,980)	(-4,000)
Services (net)	-631	-978	-1,673	-1,753	-1,650
Interest (net)	(-306)	(-649)	(-739)	(-1,055)	(-1,151)
Other	(-325)	(-329)	(-934)	(-698)	(-499)
Transfers (net)	242	169	164	205	225
Capital account	1,707	2,110	1,041	443	1,325
Public sector (net)	992	992	910	1,150	1,504 1/
Disbursements	(1,258)	(1,323)	(1,311)	(1,778)	(2,320)
Amortization	(-266)	(-331)	(-401)	(-628)	(-816)
Nonfinancial private sector (net)	613	985	89	-434	21
Direct investment (net)	(228)	(337)	(514)	(411)	(500)
Long-term (net)	(403)	(330)	(73)	(49)	(21)
Short-term (net) 2/	(-18)	(318)	(-498)	(-894)	(-500)
Financial private sector	102	133	42	-273	-200
Overall balance 3/	-15	-775	-1,785	-1,426	-75
(As percent of GDP)					
Current account deficit 4/	6.1	10.1	9.9	6.5	4.8

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

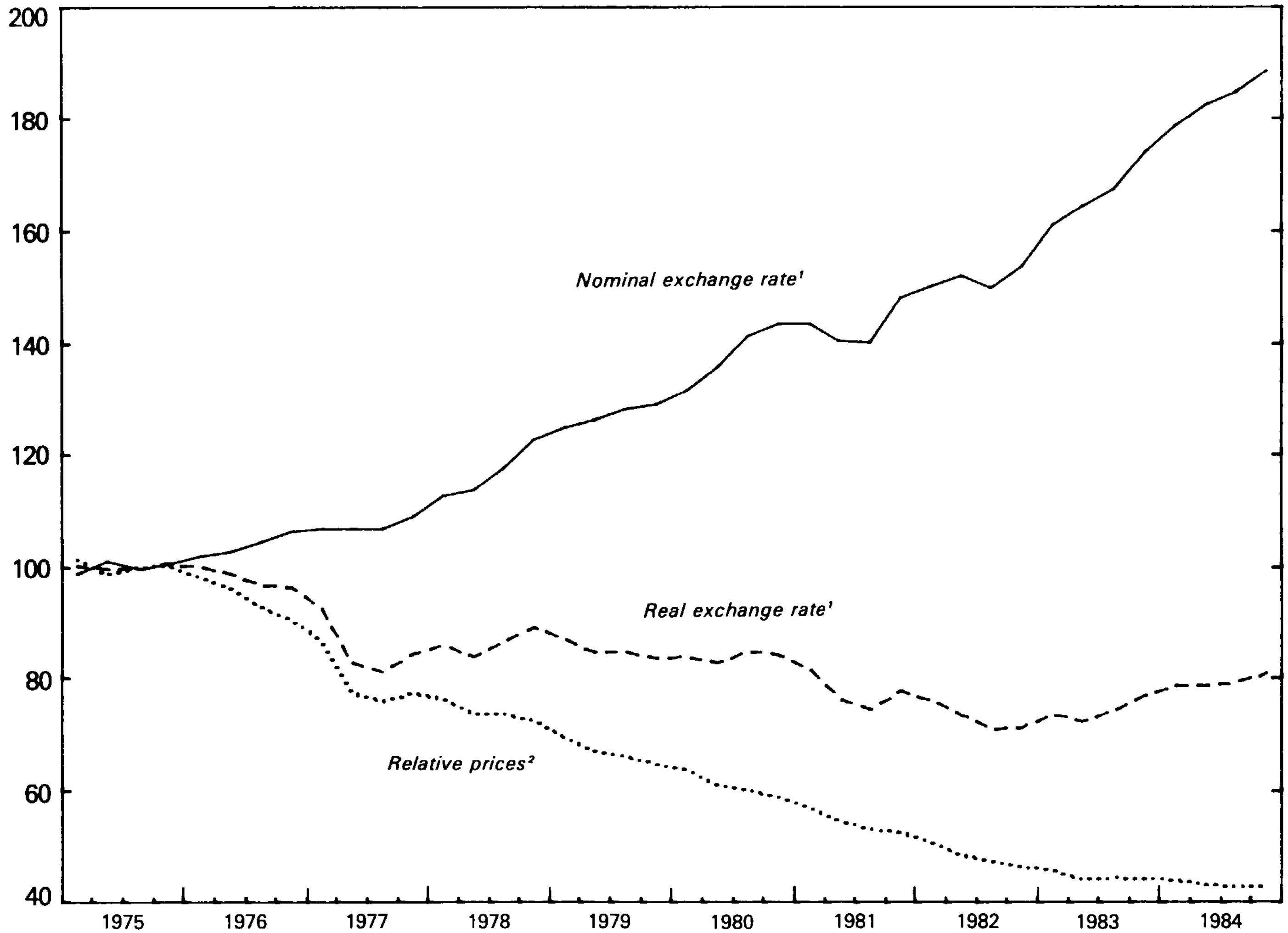
1/ Includes a US$200 million loan from commercial banks to the Government in order to finance repayment of an equivalent amount by the Marketing Board to a local commercial bank, which in turn will repay this sum to foreign commercial banks (see negative US$200 million under financial private sector).
2/ Includes errors and omissions.
3/ Overall balance as measured by changes in net foreign reserves of the Banco de la Republica adjusted to account for the actual transaction value of gold and the main foreign currencies.
4/ For the purpose of this calculation, the nominal GDP in pesos has been converted into U.S. dollars using the real effective exchange rate.

CHART 1

COLOMBIA

EFFECTIVE EXCHANGE RATE INDICES, 1975-1984

(1975=100)



Sources: Banco de la Republica; IMF, *International Financial Statistics;* and Fund staff estimates.

[1]Domestic-currency denominated index. An increase (decrease) in the index implies a depreciation (appreciation) of the Colombian peso.

[2]Relative prices were measured by consumer price indices.

Net capital inflows are anticipated to rise sharply in 1985, more than recovering their level of 1983, reflecting both an increase in net disbursements to the public sector and a substantial improvement in private capital flows. The change in the private capital account is expected to result from an increase in direct investment and a reduction in capital flight as confidence strengthens.

The Colombian authorities have recently held negotiations with foreign commercial banks to arrange the financing required for 1985. In mid-April the advisory committee of banks agreed in principle to present to the wider banking community, Colombia's proposal for a new medium-term loan in an amount of nearly US$1,000 million, of which US$515 million is to cover the needs of 1985 with the reminder to be used in 1986. The new loan will be at almost nine years, including four years of grace and will bear an interest rate of 1 1/2 percent over LIBOR, during the first four years and 1 3/8 percent over LIBOR during the last five years of the term; there will also be a prime rate option. Disbursements are to be made quarterly and are contingent upon Colombia's compliance with the targets and ceilings of its economic program; the banks are proceeding on the assumption that it will be possible to arrange Fund monitoring of such compliance on a quarterly basis. The new borrowing would result in an increase in exposure by Colombia's commercial bank creditors of less than 3 percent in 1985 and of less than 1 percent in 1986.

Colombia's exchange and trade system remains complex, involving multiple currency practices, exchange restrictions, and bilateral payment agreements with Fund members.1/ During 1983 and the first half of 1984 the exchange and trade system became more restrictive. In the face of the deteriorating external situation, the authorities reduced the limits on the sale of foreign exchange for travel purposes, and introduced, and subsequently raised, an advance deposit applicable to such transactions. In mid-July 1983 ceilings were imposed on remittances abroad for study purposes. In November 1983 one multiple currency practice was terminated with the elimination of an advance import deposit required before clearing customs. However, another multiple currency practice continues to result from the maintenance of a 95 percent exchange license deposit for import payments to be made prior to the issuance of the corresponding exchange license.

Regarding the trade system, a reversal of previous liberalization efforts has ocurred in recent years. Across-the-board increases in import tariffs were introduced and the requirement of a prior import license was extended to virtually all imports. In addition, in early 1984 a prohibition was placed on the importation of goods affecting more than 800 customs items, and a barter trade system was instituted for a small group of products.

1/ A complete description of Colombia's exchange and trade system is presented in the accompanying report on recent economic developments.

At the time of the 1984 consultation discussions, the authorities expressed the hope that they would be in a position to begin dismantling exchange and trade restrictions by the end of 1985. They now believe that the implementation of their economic adjustment program will make it possible to initiate this process earlier. They regard the dismantling of restrictions as necessary to foster export growth and a more satisfactory resource allocation, which are very important to the dual objectives of achieving a viable balance of payments position and sustained economic growth in the medium term.

In accordance with this strategy, the authorities have already started the process of transferring imports from the prohibited list to the list for which a permit is required, and from the latter to the category of free imports (for which no permit is required). In mid-March 1985, 350 items were shifted from the list of prohibited imports to the list for which a permit is required, and 500 items were shifted from the latter to the category of free imports. Additional transfers are planned for the remainder of the year in accordance with the schedule shown in Statistical Appendix Table 10. Furthermore, in connection with the disbursement of the trade policy and export diversification loan from the IBRD, imports of raw materials and inputs will be allowed to enter without an import permit whenever such items are used in the manufacture of export goods, regardless of the import list in which they are classified.

The authorities estimate that, as a result of the above actions, by December 1985 the value of imports for which an import permit will not be required will represent about 55 percent of total imports on an annual basis, compared with about 17 percent in 1984 and 50 percent in the mid-1970s. The authorities intend to continue the process of reducing import restrictions in 1986; the specific steps to be followed will be established later this year in the context of the IBRD trade policy loan referred to above.

As part of the process of simplification of the trade and exchange system, the authorities also have recently adopted administrative measures to reduce impediments to exports, including the elimination of export permits on a large number of products which were based on the requirement that the local market be adequately supplied. The authorities are also committed to dismantle before midyear the barter trade system, except in the case of one agricultural product of small export value. They are also committed to reduce the minimum financing period required for imports, from 18 months to 12 months in the case of intermediate products and from 3 years to 2 years in the case of capital goods, once foreign commercial banks representing the critical mass of the financing package for 1985 have confirmed their participation. Furthermore, the authorities plan to eliminate completely the import financing requirements by the end of the first quarter of 1986, and to start a gradual dismantling of the prior deposit required for the purchase of foreign exchange by January 1986.

The authorities consider that a rationalization of the structure of import tariffs is important to promote the reorientation of resources toward the export sector. Thus, the Government has recently made changes in about one fifth of the tariff universe and intends to introduce further changes in the second semester of the year and in 1986. The recent measures reduced the dispersion among rates and also lowered somewhat the average tariff.

The authorities believe that as the external competitiveness of the economy improves with the implementation of their exchange rate policy, there will be room for a significant reduction in the granting of tax credit certificates (CERTs) to exporters. In March 1985 the Government eliminated the special CERT of 10 percent which applied to exports to countries of the Latin American Integration Association (ALADI). Various other options are being studied by the government to bring about further reductions in CERTs, including the application of CERTs to the value added of exports rather than to the total value of exports as is done currently. The authorities intend to start to reduce the use of CERTs in the second half of the year.

The authorities noted that in October 1984 they had modified the scheme which had been put in place earlier last year to facilitate the rescheduling of private sector external debt. The scheme, which does not imply the assumption of debt by the Banco de la Republica, consists of an extended payment plan offered to those enterprises that refinance their debts with foreign creditors on the following terms: six-year maturity, including a three-year grace period, and a maximum interest rate of two-and-a half points above LIBOR, with payments to be made on a quarterly basis. Under the scheme, the Banco de la Republica commits itself to make foreign exchange available to service the rescheduled foreign debt as it falls due, and in return it receives payments in local currency from the Colombian debtor according to a predetermined schedule; the debtor is to pay an interest rate of 3 percentage points over the average rate paid by finance corporations on their term deposits. Originally, it was established that if at the end of the six-year period the scheme should result in higher payments than receipts for the Banco de la Republica at the exchange rate at which each of the payments abroad is made, the Colombian debtor would be obligated to cover the losses in installments over an additional three-year period with interest paid at the above-mentioned rate. The modification introduced in October 1984 stipulates that the Banco de la Republica would assume the loss, if such loss were to exceed 50 percent of the original value of the loan in pesos. While this modification opens up the possibility that the Banco de la Republica may incur exchange losses in the future, the authorities felt confident that such a risk was small, as the losses would have to be large (over 50 percent of the peso value of the loan) for that to occur. The total debt eligible to be refinanced under the scheme amounts to close to US$2 billion of which over one half is held by just ten private firms. So far, six firms have rescheduled debt for a total of almost US$100 million.

IV. IBRD Operations in Colombia

The IBRD is Colombia's largest creditor with outstanding credits to the public sector of US$1.9 billion at the end of 1984 or the equivalent of almost one fourth of Colombia's total outstanding public sector external debt. The volume of net disbursements by the IBRD to Colombia increased to over US$300 million in 1984 compared with less than US$170 million in the previous year (Statistical Appendix Table 11). This increase reflected mainly higher gross disbursements to public sector enterprises; disbursements rose from US$88 million in 1983 to almost US$200 million in 1984. Much of this lending was for major projects of ECOPETROL and CARBOCOL.

Bank lending to Colombia has become quite diversified. Although through the mid-1960s almost 90 percent of the loans made were for power or transport, since then the Bank has raised substantially its lending for agriculture and industry, and initiated lending for irrigation and watershed management, education, water supply, telecommunications, urban development, and nutrition. By the late 1970s, more than one half of the loans made to Colombia were for projects other than transport and power. Of the loans made since 1978, 36 percent were for power and transport, 17 percent for industry, 19 percent for agriculture and irrigation, 9 percent for water supply, 6 percent for urban development, 4 percent for telecommunications, 2 percent for petroleum development, and 6 percent for education, nutrition and multipurpose projects.

Bank lending in FY 1984 consisted of loans for the power sector, coal exploration, earthquake reconstruction, agricultural diversification and multipurpose water supply and electricity development, totaling US$464.1 million. In addition, the Bank participated in two cofinancing loans (B-loans) to the extent of 14 percent of the loans, or almost US$30 million.

In 1985 the main IBRD operation will be the trade sector and export diversification loan mentioned above, in an amount of US$300 million. In this year and in coming years, the IBRD plans to place increased emphasis on projects in the areas of agricultural diversification, small-scale industry, petroleum, development banking, and water supply and sewerage. In infrastructure, the Bank is stressing rehabilitation, modernization, and a more intensive use of the existing facilities in ports rehabilitation, water supply and electricity distribution projects, and rural feeder roads. These projects will be supported by a five-year lending program which could average some US$500 million a year.

V. Medium-Term Outlook

While Colombia has undertaken an adjustment effort that is expected to result in a sharp reduction of its large internal and external imbalances this year, the continued pursuit of prudent financial policies will be required to achieve satisfactory growth and a viable external position over the medium term. Staff calculations show that, if policies of this kind are maintained, the external current account deficit could continue to decline gradually and at the same time a small overall surplus could be achieved in every year over the 1986-90 period. Such overall surpluses would permit Colombia to maintain gross international reserves at about 5 1/2 months of merchandise imports (Table 7).

The medium-term scenario for 1986-90 is based on a number of assumptions. The value of coffee exports is assumed to increase by 8.5 percent a year (in U.S. dollar terms); coffee export volume is projected to remain unchanged, while coffee prices are assumed to increase in line with the latest WEO estimates. The value of coal exports is projected to increase significantly, from less than US$200 million in 1985 to about US$1 billion in 1990, or at an average annual rate of over 35 percent. Most of this increase is expected to come from a rise in the volume of coal exports from almost 4.5 million tons in 1985 to 16 million tons by 1990, as the new mine operated by CARBOCOL/Exxon begins production. Also, the value of exports of petroleum is projected to increase from US$500 million in 1985 to US$1,125 million by 1990, as production from new fields operated by Occidental Petroleum come on stream; this might be a conservative estimate as it only takes into account known reserves and the prospects for new discoveries are viewed as favorable. The authorities' commitment to flexible exchange rate management and to the attainment of an appropriate level of external competitiveness is expected to aid in the achievement of a rate of growth of 10 percent in the value of nontraditional exports. These exports consist of a mix of agricultural and manufactured products which stagnated when the peso appreciated significantly in real terms in the second half of the 1970s.

The projected strong export performance would facilitate an increase in the ratio of imports to GDP from 14 percent in 1984-86 to an average of 15 percent in 1987-90, but would still be well below the average of over 17 percent maintained in 1981-83. Interest payments are expected to increase at a rate of 5 percent a year during the period 1986-90, reflecting a like increase (on average) in the stock of both outstanding public and private sector debt. U.S. dollar interest rates are assumed to remain constant over the period 1985-90.1/ Noninterest service payments are assumed to increase from 5.2 percent of GDP in 1986 to 5.9 percent of GDP in 1990, and service income from about 4 percent of GDP in 1986 to 4.7 percent of GDP by 1990, basically paralleling the increase in the ratio of imports and exports to GDP, respectively.

The assumptions described above would appear to be broadly consistent with a 3 percent annual rate of real economic growth, compared with an annual average of 2 percent in the 1980-84 period and about 5 percent over the period 1975-80. Prices in U.S. dollar terms are expected to increase at about 4 percent a year throughout the period.

1/ Average interest rates in 1984 were: 11 percent on debt to commercial banks; 9.1 percent on debt to suppliers; 8 percent on debt to multilateral institutions; and 7.2 percent on bilateral credits.

Table 7. Colombia: Medium-Term Balance of Payments

(In millions of U.S. dollars)

	1986	1987	1988	1989	1990
Current account	-1,307	-1,093	-895	-730	-717
Trade balance	92	407	703	945	1,033
Exports, f.o.b.	4,429	5,412	6,060	6,677	7,165
Coffee	(1,816)	(1,971)	(2,140)	(2,322)	(2,516)
Hydrocarbons	(526)	(1,000)	(1,100)	(1,110)	(1,125)
Coal	(314)	(506)	(709)	(941)	(1,008)
Gold	(260)	(270)	(280)	(290)	(300)
Other	(1,514)	(1,665)	(1,831)	(2,015)	(2,216)
Imports, f.o.b.	4,383	5,005	5,357	5,732	6,132
Services (net)	-1,628	-1,740	-1,848	-1,935	-2,020
Interest (net)	(-1,137)	(-1,220)	(-1,286)	(-1,349)	(-1,398)
Other (net)	(-491)	(-520)	(-552)	(-586)	(-622)
Transfers (net)	230	240	250	260	270
Capital account	1,527	1,393	1,065	910	907
Public sector (net)	1,082	872	474	343	368
Disbursements	(2,028)	(2,032)	(1,853)	(1,888)	(2,014)
Amortization	(946)	(1,160)	(1,379)	(1,545)	(1,646)
Nonfinancial private sector (net)	425	471	491	467	439
Direct investment (net)	(400)	(400)	(400)	(375)	(350)
Long-term loan (net)	(25)	(40)	(50)	(50)	(50)
Short-term loan (net) 1/	(--)	(31)	(41)	(42)	(39)
Financial private sector (net)	20	50	100	100	100
Overall Balance	220	300	170	180	190
Memorandum items					
Exports (percent of GDP	14	16	17	18	18
Imports (percent of GDP)	14	15	15	15	15
Current account (percent of GDP)	-4.2	-3.3	-2.5	-1.9	-1.8
Gross international reserves (months of merchandise imports)	5.4	5.4	5.4	5.4	5.4

Sources: Fund staff estimates.

1/ Including errors and omissions.

If these assumptions were to materialize the current account deficit would decline from US$1,400 million in 1985 to slightly over US$700 million in 1990, or from the equivalent of 4.8 percent of GDP to less than 1.8 percent of GDP.

Net capital inflows are expected to decrease throughout the period from a total of US$1.5 billion in 1986 to just over US$900 million by 1990. The composition of these net capital inflows is anticipated to change markedly, with the proportion of net disbursements to the public sector declining from two thirds in 1986 to two fifths by 1990 while net private capital inflows would increase from less than one third in 1986 to some three fifths by 1990. Net inflows from multilateral and bilateral sources to the public sector are projected to decline gradually after 1986, while net repayments to commercial banks are likely to take place over the period 1987-90. Foreign direct investment is projected to remain at an average annual rate of US$400 million throughout the period.

Implementation of the policies described above would be consistent with a reduction in the total external debt as a proportion of GDP from about 44 percent in 1985 to 41 percent by 1990, with public sector external debt declining from 33 percent of GDP to 31 percent of GDP (Table 8). These ratios of total external debt to GDP compare with an average of 28 percent in the period 1980-82, and reflect the magnitude of the economic imbalances which Colombia financed externally in the early 1980s. The debt service ratio, which averaged 24 percent in 1980-82, is expected to peak at 46 percent in 1985 and decline gradually to 41 percent by 1990.

While the scenario just presented is consistent with the attainment of a viable external position in the medium term on the basis of satisfactory economic policies and a strong export effort, many of the underlying assumptions are beyond the authorities' control. Over the medium term, Colombia will be particularly vulnerable to developments affecting the value of its coffee, coal, and oil exports, as well as to changes in interest rates in the international lending centers. At the same time, it should be noted that Colombia is in the process of diversifying its export base.

Sensitivity analysis shows that if the volume of coffee exports were to increase by 5 percent a year instead of the zero growth assumed in the central scenario presented above, other things being equal, Colombia would require on average US$400 million less foreign financing a year, or the equivalent of 1 percent of GDP a year over 1986-90. Also, if the average interest rate paid on public sector external debt were to decline by 2 percentage points in 1986 and remain at that level, instead of the assumption in the central scenario of no change in the average interest rate from its average of 1984, the balance of payments would be affected favorably, on average, by some US$200 million a year. An equivalent decline in average interest rates on the private sector debt would yield a positive effect averaging US$100 million a year.

Table 8. Colombia: External Debt and Debt Service

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
	(In millions of U.S. dollars)										
Public sector debt outstanding	4,135	5,072	5,980	6,872	8,096	9,600	10,682	11,554	12,028	12,371	12,739
Private sector debt outstanding	2,166	2,814	3,433	3,536	3,432	3,203	3,248	3,388	3,613	3,863	4,113
Medium term	560	963	1,293	1,366	1,415	1,436	1,461	1,501	1,551	1,601	1,651
Short term	1,606	1,851	2,140	2,170	2,017	1,767	1,787	1,887	2,062	2,262	2,462
Total debt outstanding	6,301	7,886	9,413	10,408	11,528	12,803	13,930	14,942	15,641	16,234	16,852
Medium term	4,695	6,035	7,273	8,238	9,511	11,036	12,143	13,055	13,579	13,972	14,390
Short term	1,606	1,851	2,140	2,170	2,017	1,767	1,787	1,887	2,062	2,262	2,462
Total debt service	892	1,490	1,576	1,647	2,041	2,367	2,498	2,810	3,160	3,439	3,649
Public sector	546	732	931	963	1,297	1,612	1,859	2,161	2,440	2,643	2,776
Amortization	(252)	(266)	(331)	(401)	(628)	(816)	(946)	(1,160)	(1,379)	(1,545)	(1,646)
Interest	(294)	(466)	(600)	(562)	(669)	(796)	(913)	(1,001)	(1,061)	(1,098)	(1,130)
Private sector	346	758	645	684	744	755	640	650	720	796	873
Amortization	(13)	(287)	(98)	(235)	(248)	(294)	(300)	(300)	(350)	(400)	(450)
Interest	(333)	(471)	(547)	(449)	(496)	(461)	(340)	(350)	(370)	(396)	(423)
	(As a percent of adjusted GDP)										
Public sector debt	15	18	21	24	28	33	34	35	34	32	31
Private sector debt	8	10	12	12	12	11	10	10	10	10	10
Total debt	22	29	33	36	40	44	44	45	44	42	41
	(As a percent of exports of goods and services)										
Public sector debt service	9	14	18	22	28	31	33	32	32	31	31
Private sector debt service	6	14	12	16	16	15	11	10	9	9	10
Total debt service	15	28	30	38	45	46	45	42	41	40	41
Of which: interest payments	(11)	(18)	(22)	(23)	(25)	(24)	(22)	(20)	(19)	(18)	(17)
amortization payments	(4)	(10)	(8)	(15)	(20)	(22)	(23)	(22)	(22)	(22)	(24)

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

The combined effect of higher coffee export volumes and lower interest rates for both the public and private sectors would yield a positive effect of almost US$700 million, equivalent to nearly 2 percent of GDP. The current account deficit, which averages 2.7 percent over the 1986-90 period in the central scenario, would decline to an average of less than 1 percent of GDP and the debt service ratio in 1990 would drop from 41 percent under the central scenario to 34 percent. By contrast, a reduction in coffee export volumes of 5 percent a year and a 2 percent increase in international interest rates would give rise to a financing gap of the order of 2 percent of GDP a year, and a deterioration in the current account deficit and debt service ratios equivalent to the improvement just described for the case in which these variables are affected favorably.

VI. Staff Appraisal

Colombia's economic and financial performance has deteriorated significantly in recent years. The balance of payments registered a cumulative overall deficit of almost US$4 billion in 1982-84, following a cumulative overall surplus of about US$5 billion in 1975-81. At the same time, economic growth slowed from an annual average rate of about 5 percent in 1975-80 to slightly over 2 percent in 1981 and to 1 percent in 1982 and 1983. Economic activity started to recover in 1984, with real GDP expanding by about 3 percent. Domestic inflation declined from a rate of more than 26 percent in 1981 to about 16.5 percent in 1983, but increased to slightly over 18 percent in 1984.

The weakening of the balance of payments in recent years reflected both a deterioration of international economic conditions and the pursuit of an expansionary domestic demand policy aimed at compensating for the recessionary trends in the economy. The public sector deficit rose significantly in recent years and it exceeded 7.5 percent of GDP in 1983 and 1984. During the last three years, monetary policy has been expansionary as a result of the accomodation of the growing financing requirements of the public sector and the provision of assistance to banks in difficulties.

The Colombian authorities started to adopt measures in late 1982 and early 1983 in order to reduce the public sector deficit and improve the competitiveness of the economy. Despite these measures the public sector deficit continued to grow, primarily because of a rapid increase in outlays, and the balance of payments continued to weaken.

The continued deterioration of the overall financial situation led the Government to strengthen its adjustment efforts in the last half of 1984 when it adopted a comprehensive economic program. For 1985, the Government aims at re-establishing virtual balance of payments equilibrium and creating the conditions for sustained economic growth. The authorities have expressed their intention to continue the adjustment process in 1986, and later this year they will present to the Fund the summary of Colombia's economic policies for next year.

The staff welcomes the authorities' decision to address Colombia's financial difficulties through the implementation of a comprehensive adjustment program. It believes that the program is adequate and that if fully implemented it should result in a substantial improvement of the balance of payments.

The authorities have emphasized the reduction in the public sector deficit as a major element of their program. Substantial revenue measures were approved last December and further measures will be put in place shortly. In addition, the authorities recently adjusted electricity and telephone rates and are planning to adjust water rates in the near future. Late in 1984 gasoline prices were raised and will be adjusted further in coming months to ensure that public sector revenue from gasoline will increase by at least an additional 5 percent this year over the estimates made before the planned adjustments.

The staff welcomes the measures being taken by the authorities to raise public sector revenues and would like to emphasize the need to make every effort to achieve the revenue projection for 1985. In this connection, it will be important to strengthen tax administration as evasion usually tends to increase when taxes are raised.

The staff notes the authorities' intention to pursue a prudent public sector expenditure policy, which is essential for the attainment of the targeted reduction of the deficit. Of particular importance is the authorities' policy of keeping wage increases in the Central Administration, and to the extent possible in the rest of the public sector, to a weighted average of 10.5 percent in 1985. Also, the reassessment of priorities in respect of public sector investment should result in a significant deceleration in the rate of growth of such outlays in 1985. The IBRD indicated that it is in general agreement with both the size and composition of the public investment program for 1985.

The staff would emphasize the importance of implementing fully the expenditure policy that has been designed. Pressures to increase expenditures will have to be resisted if the aims of the adjustment program are to be achieved. The staff would urge the authorities to intensify the efforts they have been making to improve control over the operations of the rest of the public sector.

The monetary program for 1985 contemplates a significant slowdown in the rate of expansion of credit by the Banco de la Republica, based to a large extent on the substantial reduction expected in the financing needs of the public sector. The staff views the implementation of such a credit policy as essential to the achievement of the objective of containing inflation and limiting the loss of net foreign reserves of the Banco de la Republica to US$75 million in 1985.

The staff welcomes the authorities' intention not to interfere with the market forces in the determination of interest rates. This approach to interest rate policy should help to produce an efficient allocation of credit and promote the growth of financial savings. While the authorities are concerned about the level of real interest rates in Colombia, they are aware that rates may rise even further until the adjustment being sought in the real exchange rate is attained. The recent adjustment of the interest rate charged by the Export Promotion Agency (PROEXPO) on credit to exporters was a useful step, and the authorities' stated their intention to adjust the rates charged by the funds administered by the Banco de la Republica and by PROEXPO in the future, if necessary to ensure that those rates are positive in real terms.

The staff is encouraged by the recent acceleration in the pace of depreciation of the peso with the aim of fully recovering by the end of 1985 the competitiveness lost over the period since the mid-1970s. An early improvement in external competitiveness would contribute to the strengthening of the balance of payments and at the same time would facilitate the dismantling of exchange and trade restrictions. In this context, it is essential for Colombia to maintain sufficient flexibility in its exchange rate policy to ensure that the target for net official international reserves is achieved.

The staff welcomes the process of reduction of trade and exchange restrictions initiated this year by the authorities; the planned actions, if implemented in their entirety, would represent a significant reversal of the severe tightening of controls in the previous two years. The phasing out of restrictions should reduce distortions and make the use of resources more efficient, and the staff would like to encourage the authorities to proceed with the removal of restrictions as quickly as possible. The staff notes that the process of trade liberalization in Colombia is being supported by the IBRD with a trade policy and export diversification loan. Despite the steps to be taken, an early elimination of restrictions is not envisaged. In these circumstances, the authorities are not requesting, and the staff is not proposing, Fund approval of Colombia's exchange restrictions and multiple currency practices subject to Article VIII (described in section III of the report).

Colombia's total external debt has risen significantly in recent years and the debt service ratio has more than doubled over the 1980-84 period. Despite the adjustment efforts being undertaken by the authorities, a further small increase in the external debt and in the debt service ratio is expected for 1985. The staff believes that the continued pursuit of restrained financial policies in coming years will be necessary to ensure that the debt service burden remains manageable.

In view of the measures already adopted and those which are being implemented, the staff believes that on the basis of the program presented by the authorities Colombia would have qualified for the use of Fund resources in the upper credit tranches had a request to that effect been made to the Fund.

Finally, it is recommended that the next Article IV consultation with Colombia be held on the standard 12-month cycle.

VII. 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 1985 Article XIV consultation with Colombia, in the light of the 1985 Article IV consultation with Colombia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Colombia continues to maintain a complex system of restrictions on payments and transfers for current international transactions and multiple currency practices as described in SM/85/___. The Fund welcomes the process of simplification of the exchange system initiated recently and urges the authorities of Colombia to continue this process. The Fund notes that Colombia maintains bilateral payments agreements with two Fund members and encourages Colombia to eliminate them as soon as possible.

Colombia - Fund Relations
(As of April 30, 1985, unless otherwise indicated)

I. Membership Status

(a) Date of membership:	December 27, 1945.
(b) Status:	Article XIV.

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota:	SDR 394.2 million.
(b) Total Fund holdings of pesos:	SDR 394.2 million or 100.0 percent of quota.

III. SDR Department

(a) Net cumulative allocation:	SDR 114.3 million.
(b) Holdings:	SDR 2.4 million or 2.1 percent of allocation.
(c) Current designation plan:	None.

B. Nonfinancial Relations

IV. Exchange rate arrangement: The exchange rate for the Colombian peso is adjusted in small amounts at relatively short intervals taking into account movements in a set of indicators. Exchange surrender and foreign payments are generally effected through the medium of exchange certificates, which are traded in the official market at the official rate. Exchange certificates are also traded in the stock exchange at varying rates of discount. On April 30, 1985, the rate in the official market for the U.S. dollar, the intervention currency, was Col$132.58 per U.S. dollar.

V. Last Article IV consultation: The 1984 Article IV consultation discussion was completed on October 10, 1984 (EBM/84/149 and SM/84/216).

VI. Technical assistance: The Bureau of Statistics has provided technical assistance to the Banco de la Republica and the National Administrative Department of Statistics on the revision of price and monetary statistics. A Bureau of Statistics mission visited Bogota for two weeks beginning November 6, 1984. The main objectives of the mission were to gather information on the sources and methods of collecting balance of payments data and to evaluate the current methodology in light of the recommendations of the Balance of Payments Manual. A technical assistance mission on money and banking statistics took place on February 21-March 6, 1985. The main purpose of this mission was to develop new methodologies for the production of data and the derivation of the monetary accounts for the Banco de la Republica, and the deposit money banks.

VII. Statistical Data: The currentness and coverage of Colombia's statistical data in the IFS is considered reasonably adequate at this time.

Colombia: Selected Economic and Financial Indicators

	1981	1982	1983	Prel. 1984	Proj. 1985
(Annual percent changes, unless otherwise specified)					
National income and prices					
GDP at constant prices	2.3	0.9	1.0	3.0	2.0
GDP deflator	22.8	24.8	20.4	18.0	20.9
Consumer prices (average)	27.5	24.5	19.8	16.2	20.0
Consumer prices (end of period)	26.4	24.0	16.6	18.3	22.0
External sector (on the basis of U.S. dollars)					
Exports (f.o.b.)	-20.9	-3.4	-4.1	16.3	10.0
Imports (f.o.b.)	10.4	13.3	-16.7	-10.2	0.5
Terms of trade (deterioration -)	-6.3	6.2	3.8	3.5	-0.7
Nominal effective exchange rate (depreciation -)	-10.2	-4.9	-10.9	-9.2	...
Real effective exchange rate (depreciation -)	6.7	6.9	-6.5	-5.8	...
Central government					
Revenues	21.9	16.5	13.1	28.6	52.8
Expenditures	32.6	35.9	15.1	36.6	20.5
Money and credit					
Domestic credit 1/	29.4	33.6	37.4	29.3	23.6
Public sector	(4.7)	(9.9)	(13.2)	(14.4)	(3.2)
Private sector	(26.7	(24.8)	(25.6)	(17.3)	(21.4)
Money and quasi-money (M2)	29.4	24.7	23.0	21.6	21.2
Interest rate (effective annual rate, 90 day certificate of deposit)	38.7	36.2	33.6	34.6	...
(In percent of GDP)					
Overall public sector balance	-5.2	-6.8	-7.6	-7.6	-4.9
Central government savings	1.0	-0.6	-1.2	-1.8	0.2
Central government deficit (-)	-2.5	-4.3	-4.0	-5.1	-2.9
Domestic financing	(1.4)	(3.5)	(4.0)	(4.5)	(1.9)
Foreign financing	(1.1)	(0.8)	(--)	(0.6)	(1.0)
Gross domestic investment	20.6	20.4	19.4	18.9	19.8
Gross national savings	14.5	10.3	9.5	12.4	15.0
Current account deficit (-)	-6.1	-10.1	-9.9	-6.5	-4.8
External debt	29.0	33.0	36.0	40.0	44.0
Of which: public sector	(18.0)	(21.0)	(24.0)	(28.0)	(33.0)
(In percent of exports of goods and services)					
Debt service 2/	32.0	34.0	41.0	45.0	47.0
Of which: public sector	(16.0)	(20.0)	(24.0)	(28.0)	(32.0)
Interest payments 2/	20.3	24.7	25.2	25.6	24.7
Of which: public sector	(10.1)	(12.9)	(14.0)	(14.7)	(15.7)
(In millions of U.S. dollars, unless otherwise specified)					
Overall balance of payments	-15	-775	-1,785	-1,426	-75
Gross official reserves (months of imports of goods and nonfactor services of the following year)	10.4	10.8	7.6	4.0	4.0

1/ In relation to liabilities to the private sector at the beginning of the period.
2/ Includes interest on short-term debt.

Colombia--Statistical Issues

1. Outstanding statistical issues

a. Prices

A revised wholesale price index (1982=100) had been prepared in 1983; finalization and publication were scheduled first for April 1984, then postponed until July 1984. It has, however, not yet been published as of early 1985. A technical assistance mission visited Colombia from January 16-27, 1984 to review the preparation of the revised wholesale price index.

b. Money and banking

Colombia is currently receiving technical assistance on money and banking statistics, aimed at improving the classification and sectorization of financial data, the coverage of the financial sector, and the reporting system.

During the first technical assistance visit, which took place July 24-August 8, 1984, work was mainly devoted to: (a) reviewing the sectorization of the Colombia economy, placing special emphasis on the definition of the general government sector and its components, as well as the public enterprise sector; (b) analyzing the current methodology applied to the classification of the items in the Banco de la Republica's and deposit money banks' balance sheets, and the derivation of the monetary accounts; (c) developing new methodologies for the production of data and the derivation of the monetary accounts for the Banco de la Republica, and the deposit money banks; (d) analyzing the treatment given to the various trust funds in the Banco de la Republica accounts and the mechanism for the channeling of those resources to the economy through the financial sector; (e) reviewing the conversion procedures and valuation adjustments used in deriving the domestic currency values of foreign assets and liabilities, with special emphasis on the "Special Exchange Account" in which the monetary authorities exchange gains/losses and reserves management proceeds are registered; and (f) updating the IFS page for Colombia. A report on this mission's work was sent to the Banco de la Republica, which includes a numerical exercise using data for December 1983 to illustrate the derivation of the relevant data for the monetary sector.

During a follow-up visit which took place February 21-March 6, 1985, time was devoted to revising the work done by the Banco de la Republica on the monetary sector accounts following the recommendations of the report on the previous visit, and to analyzing the accounts of the specialized banks in order to integrate them within the monetary sector scheme. An addendum to the report was submitted to the Colombian authorities which extends the practical exercise to cover the specialized banks. Monetary and financial surveys were also generated.

c. Government finance

The 1984 Government Finance Statistics Yearbook includes statistical tables through 1981 and derivation tables for the consolidated Central Government for the period 1979-81, the latter were compiled during the technical assistance mission in February 1984. As mentioned in the report of that mission, the statistical tables need to be revised to ensure complete coverage of all extrabudgetary units (decentralized units) for all years. The consistency in the classification of some transactions should also be reviewed. Disaggregated data for the functional classification of expenditure and for financing and debt need to be compiled, as well as data for all years after 1981.

d. Balance of payments

A technical assistance mission visited Colombia in November 1984 and a report was sent to the Colombian authorities on May 1, 1985.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Colombia in the May 1985 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Banco de la Republica, which during the past year have been provided on an irregular basis, except for Report Forms OIR and 60R.

Status of IFS Data

		Latest Date in May 1985 IFS
Real Sector	- National Accounts	1983 (partial)
	- Prices	March 1985
	- Production	August 1984
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	September 1984
	- Financing	September 1984
	- Debt	Q4 1983
Monetary Accounts	- Central Bank	March 1985
	- Deposit Money Banks	November 1984
	- Other Financial Institutions	December 1983
External Sector	- Merchandise Trade: Value	November 1984
	- Merchandise Trade: Prices	March 1985
	- Balance of Payments	1983
	- International Reserves	February 1985
	- Exchange Rates	March 1985

May 27, 1985

Mr. J. de Larosiere
Managing Director
International Monetary Fund
Washington, D.C.

Dear Mr. de Larosiere:

It has been very satisfactory to learn through your letter of March 28, 1985 to President Betancur that the recent Fund mission concluded that Colombia's economic adjustment program lays a solid base for recovery with stabilization by narrowing substantially the fiscal and external imbalances of the economy.

We have undertaken this program, as you know, on our own initiative, convinced, as we are, of the need for self-discipline. Its fundamental aim is to attend to the social needs of our people. We are certain that the timely implementation of the adjustments will result in curtailment of unemployment, in control of inflationary pressures, and in an infusion of new vigor into social investments such as housing, health, and education.

We are very proud of the fact that the adjustment measures have been adopted through an open and democratic process, with the active participation of the Colombian Congress.

In order to ensure the success of our program, it will be essential to obtain resources from foreign commercial banks. Such financing will be used mainly to support export-oriented projects by CARBOCOL and ECOPETROL.

In accordance with your suggestion to the President, we are attaching the Summary of the Economic Policies of Colombia including quarterly quantitative targets for 1985, with the request that the IMF--in order to facilitate the implementation of a financial arrangement with foreign commercial banks--review these policies, monitor compliance with the quarterly targets, and advise the authorities of the results of such monitoring. Later this year we will be presenting to the Fund for review our summary of economic policies for 1986, including appropriate quantitative targets by which to assess the continued implementation of the adjustment effort that is underway. A continued close collaboration with the World Bank will be called for in our view, since that institution will be monitoring certain medium-term variables of Colombia's economy.

We will provide your staff with any information and assistance it may require to facilitate its assessment of the implementation of our program for 1985-1986

Yours very truly,

Minister of Finance

General Manager of the
Banco de la Republica

Summary of the Economic Policies of Colombia

1. Significant developments took place in the world economy in recent years which had a negative impact on Colombia's economy. The price of Colombia's main export products deteriorated, while interest rates abroad rose to all-time highs making external financing increasingly onerous. The world economic recession, the deterioration in trade flows with neighboring countries, and the worsening of financial conditions in Latin America in general also have affected recent balance of payments developments. These external factors, together with the impact of a domestic demand policy aimed at compensating for recessionary trends in the economy, resulted in a significant fiscal and balance of payments deterioration.

2. After increasing at an annual average rate of about 5 percent over the period 1975-80, real GDP growth slowed to 2.3 percent in 1981 and to 1 percent a year in 1982 and 1983. At the same time, the balance of payments experienced large overall deficits in 1982 and 1983 (US$0.8 billion and US$1.8 billion, respectively), after registering a cumulative surplus of US$5 billion over the 1975-81 period. The overall payments deficit resulted from a large deterioration in the current account, which shifted from a small surplus in 1980 to a deficit of around 10 percent of GDP in 1982 and 1983, and a considerable weakening in private capital flows in 1983 (Table 1). Meanwhile, the rate of domestic inflation slowed to about 16.5 percent in 1983 from over 26 percent in 1981.

3. In late 1982-early 1983, the Colombian authorities began to adopt measures aimed at reducing the deficit of the public sector (Central Administration, local governments, and decentralized agencies), which had grown from about 2.5 percent of GDP in 1980 to almost 7 percent of GDP in 1982, and at improving the external competitiveness of the economy. A reform of the income tax and state and local taxes was introduced in 1983, and in October 1982 and August 1983, the authorities accelerated the pace at which the peso was being depreciated. Despite these measures, the public sector deficit continued to rise and reached 7.6 percent of GDP in 1983, as an improvement in revenue relative to GDP was more than offset by a continued rise in outlays. Monetary policy was expansionary in that year reflecting mainly the need to finance a large part of the public sector deficit.

4. During 1984 economic activity improved, with real GDP rising by 3 percent. However, the country suffered an additional sizable loss of foreign reserves and domestic inflation increased slightly to over 18 percent. The deficit on the current account of the balance of payments declined to 6.5 percent of GDP reflecting a reduction in the trade deficit of nearly US$1 billion. However, there was a loss of foreign reserves of US$1.4 billion (most of it in the first half of the year), as a result of a further significant weakening of private capital flows and a reduction of trade credit lines from foreign commercial banks. While public sector revenue increased as a percentage of GDP, reflecting the full-year impact

of the 1983 tax reforms and the effect of a change in the application of the sales tax to a value-added basis, which represented an increase in the rate as well as an extension of coverage, the overall public sector deficit remained unchanged as a percentage of GDP because of a continued expansion of outlays. The deficit was financed to a large extent with net credit from the Banco de la Republica.

5. Faced with the continued deterioration of the overall balance of payments situation, in the latter part of last year the Government decided to strengthen substantially its adjustment efforts with the aim of reestablishing virtual external payments equilibrium in 1985, while at the same time providing the basis for sustained economic growth and an improvement in employment and income distribution in the medium term. The Colombian authorities are working toward these objectives through a significant reduction of the public sector deficit, a tightening of monetary policy, and the implementation of an adequate exchange rate policy.

6. Colombia's adjustment program has as its main fiscal policy objective that of reducing the overall public sector deficit from an estimated 7.6 percent of GDP in 1984 to 4.9 percent of GDP in 1985 (Table 2). The reduction of the deficit will be achieved through a combination of revenue measures and a tight expenditure policy. In December 1984, Congress approved, at the proposal of the Government, a series of revenue measures which include: (1) an increase of 50 percent in the stamp tax; (2) a surcharge of 8 percent on the value of imports; (3) a decrease in the maximum deductible amount permitted under the income tax for interest on mortgages; and (4) the elimination of several exemptions to the value-added tax. Two additional revenue measures--a reallocation of some earmarked taxes in favor of the Central Administration and a surcharge on imports that are paid for with repatriated foreign exchange resources--have been presented to Congress. Either the proposed measures or others that would produce an equivalent amount in 1985 will be in place in the near future. The authorities also recently restructured and raised in real terms electricity and telephone rates and will continue to adjust such rates on a monthly basis. Late last year the Government increased gasoline prices by 15 percent and it intends to make further periodic adjustments with the objective of maintaining price levels that are both in line with international prices and that increase public sector revenue from gasoline and diesel fuel by at least 5 percent in 1985. On the basis of the above measures and the full-year impact of the reforms to the sales tax which became effective in May 1984, public sector current revenues are estimated to rise from 20.7 percent of GDP in 1984 to 23.0 percent of GDP in 1985.

7. As a result of the expenditure policy that the authorities are implementing, total public sector outlays are projected to decline by about 0.5 percent of GDP in 1985. The authorities have limited the increase in wages of central administration and national public agencies employees to a weighted average of 10.5 percent in 1985--with higher increases accruing to lower paid employees--and have adopted measures

designed to enforce this salary policy in the rest of the public sector. As a result, current outlays of the public sector, excluding interest payments, are projected to decline by almost 1 percent of GDP this year. The public sector investment program for 1985 reflects a reassessment of priorities with a continued emphasis on the social sectors and on projects related to the production of oil and coal, the latter being the key to the efforts which Colombia is making to increase exports. Meanwhile, a number of other projects not considered essential at this juncture, mainly in the electricity sector, have been postponed. Overall, public sector capital outlays are projected to remain unchanged relative to GDP in 1985, after an increase equivalent to almost 1 percent of GDP in 1984.

8. The strengthening of the financial position of the public sector should permit it to lower significantly its dependence on banking system credit, and more particularly on net credit from the Banco de la Republica, during 1985. Consistent with the fiscal policy described above, the monetary program contemplates a reduction in the expansion of net credit from the Banco de la Republica to the public sector from Col$155 billion in 1984 to Col$45 billion in 1985. Such a reduction in credit to the public sector should make it possible for the banking system to expand credit to the private sector by about 23 percent, or approximately in line with the anticipated growth of nominal GDP. The monetary program for 1985 specifies ceilings on the net domestic assets of the Banco de la Republica and on the Banco de la Republica's net credit to the public sector, as detailed in the attached Tables 3 and 4, respectively. The expansion planned in the net domestic assets of the Banco de la Republica is consistent with the objective of limiting the loss of net foreign reserves to US$75 million in 1985. Quarterly targets for net foreign reserves, incorporating seasonal factors and the anticipated sequence of disbursements of foreign loans, have been established as shown in attached Table 5.

9. The interest rates on a large proportion of credit and deposits are market determined in Colombia. The authorities believe that adequate incentives should be provided for the growth of financial savings during the implementation of the adjustment program. Therefore, they intend to continue with their present policy of not interfering with market forces in the determination of interest rates, which in real terms are presently about 11 percent for certificates of deposit. The authorities also believe that the interest rates charged by several funds administered by the Banco de la Republica and those applied by the export promotion agency (PROEXPO) on its credit to exporters should be positive in real terms in order to strengthen the financial situation of the funds and minimize subsidies. Consistent with this policy, PROEXPO approved an increase in its interest rates from 18 percent to 22 percent, effective on April 1, 1985. The rates charged by the funds administered by the Banco de la Republica on new loans are presently about 21 percent for agriculture and 26 percent for industry. The authorities intend to continue to adjust these rates if necessary to ensure that they are positive in real terms.

10. The authorities believe that the pursuit of an adequate exchange rate policy is essential to the success of the adjustment program. They have, therefore, accelerated the pace of depreciation of the peso with the objective of reaching, by the end of 1985, the real effective exchange rate that prevailed in 1975, which was judged to represent an adequate level of competitiveness for the economy. Such an exchange rate policy should facilitate the strengthening of the balance of payments, while at the same time permitting the initiation of a reduction of exchange and trade restrictions. The authorities contemplate reducing the pace of depreciation of the peso to the equivalent of inflation differentials after having reached the desired real effective exchange rate, taking into account the plans for exchange and trade liberalization.

11. A reduction in trade and exchange restrictions is considered necessary to facilitate the growth of exports and a more adequate allocation of resources, which are important in the achievement and maintenance of a viable balance of payments position consistent with sustained economic growth in the medium term. In the context of such a strategy, the Government is in the process of shifting items from the prohibited import list to the list for which a permit is required, and from the latter to the category of free imports (those for which no permit is required). As part of this process, in mid-March 1985, 350 import items were shifted from the list of prohibited imports to the list for which a permit is required, and 500 items were shifted from the latter to the category of free imports. Further shifts are planned for the third and fourth quarters of the year. In addition, linked to disbursements under the IBRD loan discussed below, the importation of raw materials and intermediate goods will be allowed without an import permit whenever such products are used in the manufacture of export goods, even if they remain on the list of prohibited imports or in the one for which an import permit is required. As a result of the actions contemplated, it is estimated that by December 1985 the value of products that will be permitted to be imported freely, which include imports on the free list as well as all imports under international trade agreements, imports of inputs for exports, and imports not requiring access to foreign reserves of the Banco de la Republica for their payment, will amount on an annual basis to about 55-60 percent of all imports. Free imports accounted for about 50 percent of the total in the mid-1970s and for a considerably lower amount in 1983-84. The gradual process of reduction of import restrictions will be continued in 1986, and the specific steps to be followed will be established in the second semester. The export and trade liberalization effort by Colombia will be supported by the IBRD with a trade-sector loan, which is expected to be considered by its Executive Board in the near future.

12. In addition to the planned reduction of import restrictions, the authorities have adopted administrative measures to facilitate the export process, including the elimination of certain restrictions to export, such as the requirement of export permits on a large number of products. The authorities have decided to dismantle before midyear the barter trade system except in the case of one agricultural product of

minor export value, and to reduce the minimum financing period required for imports, from 18 months to 12 months in the case of intermediate goods and from 3 to 2 years in the case of capital goods, once agreement is reached in principle with foreign commercial banks regarding the financing requirements for 1985. It is planned that the financing requirements for imports will be eliminated by the end of the first quarter of 1986. Also, in January 1986, the authorities will begin a gradual elimination of the prior deposit required for the purchase of foreign exchange.

13. The Government is of the view that there is a need to rationalize the structure of import tariffs with the ultimate objective of promoting a reorientation of resources toward export, while maintaining an adequate level of overall effective protection. In such an endeavor, the Government has recently introduced changes on about one fifth of the total tariff universe. The recent measure reduced the dispersion among rates and also reduced moderately the average tariff; it has been estimated that the fiscal effect of the measure will be neutral. Further changes in tariffs are being planned for the second semester of this year and for 1986.

14. As the external competitiveness of the peso improves with the application of the present exchange rate policy, the Government believes that there will be room for a significant reduction of export incentives being granted through tax credit certificates (CERTs). In the last week of March 1985, the Government eliminated the special CERT of 10 percent applicable on the value of exports to countries members of the Latin American Integration Association (ALADI). In addition, the Government is presently studying various options to instrument further reductions in CERTs, which include among others the application of such CERTs on the value added of exports rather than on their total value as it is being done at present. The gradual reduction in CERTs will be implemented early in the second semester of the year.

15. As a result of the adjustment program, a further reduction in the deficit on the current account of the balance of payments from 6.5 percent of GDP in 1984 to 4.8 percent of GDP in 1985 is envisaged (10 percent of GDP in 1982-83). At the same time, a significant improvement in private capital flows is projected which will be dependent on a restoration of confidence expected to result from the adjustment policies being pursued by the Government. Nonetheless, the implementation of the public sector financial program will require a limited access to new borrowing from foreign commercial banks in 1985, and the disbursement of US$150 million out of a total of US$300 million of the trade-sector loan from the IBRD mentioned above, within a total amount of gross disbursements of US$2,320 million. The authorities are planning to approach the foreign commercial banks with a request for a new loan equivalent to US$515 million, of which US$415 million will be for the nonfinancial public sector and US$100 million for the Banco de la Republica to support the capitalization of the financial system. On a net basis, the financing sought from commercial banks amounts to US$194 million and is equivalent to only about a 3 percent increase in exposure.

16. Colombia's external debt situation is better than in most other Latin American countries; the level of the debt relative to the size of the economy is lower and its structure reflects a relatively high concentration of long-term development loans (about one third of the debt has been contracted at over 12 years and almost four fifths at over 1 year of maturity). Despite the recent deterioration of the balance of payments, Colombia has been able to continue servicing its debt without the need for a rescheduling of public sector debt. Nonetheless, the servicing of the external debt will entail considerable burden on Colombia's balance of payments in coming years. Therefore, the Government considers that it will be advisable to monitor closely future external debt developments and with such an objective it has established a limit on the total outstanding public external debt as shown in annexed Table 6.

17. During the period of the program Colombia will not introduce or intensify restrictions on payments and transfers for current international transactions, introduce or modify multiple currency practices except as stated in paragraph 12, conclude any bilateral payment arrangements or impose or intensify import restrictions for balance of payments reasons.

18. The Colombian Government believes that the policies set forth in this summary are adequate to achieve the objectives of its economic program, but will take any further measures that may become appropriate for this purpose.

Table 1. Colombia: Summary Balance of Payments

	1981	1982	1983	Prel. 1984	Proj. 1985
	(In millions of U.S. dollars)				
Current account	-1,722	-2,885	-2,826	-1,869	-1,400
Trade balance	-1,333	-2,076	-1,317	-321	25
Exports, f.o.b.	(3,397)	(3,282)	(3,147)	(3,659)	(4,025)
Imports, f.o.b.	(-4,730)	(-5,358)	(-4,464)	(-3,980)	(-4,000)
Services (net)	-631	-978	-1,673	-1,753	-1,650
Interest (net)	(-306)	(-649)	(-739)	(-1,055)	(-1,151)
Other	(-325)	(-329)	(-934)	(-698)	(-499)
Transfers (net)	242	169	164	205	225
Capital account	1,707	2,110	1,041	443	1,325
Public sector (net)	992	992	910	1,150	1,504
Disbursements	(1,258)	(1,323)	(1,311)	(1,778)	(2,320)
Amortization	(-266)	(-331)	(-401)	(-628)	(-816)
Nonfinancial private sector (net)	613	985	89	-434	21
Direct investment (net)	(228)	(337)	(514)	(411)	(500)
Long-term (net)	(403)	(330)	(73)	(49)	(21)
Short-term (net) 1/	(-18)	(318)	(-498)	(-894)	(-500)
Financial private sector	102	133	42	-273	-200
Overall balance 2/	-15	-775	-1,785	-1,426	-75
	(As percent of GDP)				
Current account deficit 3/	6.1	10.1	9.9	6.5	4.8

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

1/ Includes errors and omissions.
2/ Overall balance as measured by changes in net foreign reserves of the Banco de la Republica adjusted to account for the actual transaction value of gold and the main foreign currencies.
3/ For the purpose of this calculation, the nominal GDP in pesos has been converted into U.S. dollars using the real effective exchange rate.

Table 2. Colombia: Consolidated Public Sector Operations

	1983	1984	1985	1983	1984	1985
	(In billions of Colombian pesos)			(As percent of GDP)		
Total Revenue	600.7	772.0	1,062.0	19.7	20.9	23.3
Current	593.3	763.0	1,048.9	19.5	20.7	23.0
Capital	7.4	9.0	13.1	0.2	0.2	0.3
Total expenditure	830.4	1,054.3	1,287.0	27.3	28.5	28.2
Current 1/2/	529.1	658.5	802.7	17.4	17.8	17.6
Capital	301.3	395.8	484.3	9.9	10.7	10.6
Overall deficit (-)	-229.7	-282.3	-225.0	7.6	7.6	4.9
External financing (net)	79.7	89.3	172.9	2.6	2.4	3.8
Disbursements	(107.4)	(145.5)	(274.5)	(3.5)	(3.9)	(6.0)
Amortizations 2/	(-27.7)	(-56.2)	(-101.6)	(-0.9)	(-1.5)	(-2.2)
Domestic financing (net)	150.0	193.0	52.1	4.9	5.2	1.1
Banco de la Republica	(106.8)	(155.0)	(45.0)	(3.5)	(4.2)	(1.0)
Rest of the financial system	(22.5)	(26.2)	(4.5)	(0.7)	(0.7)	(0.1)
Coffee bonds	(6.8)	(-2.0)	(-17.7)	(0.2)	(-0.1)	(-0.4)
Other	(13.9)	(13.8)	(20.3)	(0.5)	(0.4)	(0.4)

Sources: Ministry of Finance; National Planning Department; and Fund staff.

1/ Includes defense spending.

2/ Interest and amortization payments on the external debt of the Central Administration are converted into pesos using the official exchange rate instead of the accounting exchange rate.

Table 3. Colombia: Limits on the Net Domestic Assets of the Banco de la Republica 1/

(Outstanding amounts in billions of pesos)

Time Period	Limits
Up to March 31, 1985	-46.6
April 1 - June 30, 1985	-11.0
July 1 - September 30, 1985	-18.5
October 1, 1985 - December 31, 1985	35.3

1/ Defined as the difference between (1) currency issue (Billetes en Circulacion) and (2) net international reserves of the Banco de la Republica. The definition of the net international reserves of the Banco de la Republica is indicated in Table 5. For the purpose of these ceilings, the net international reserves of the Banco de la Republica will be converted into Colombian pesos at the accounting rate of Col$139 per U.S. dollar.

Table 4. Colombia: Limits on the Banco de la Republica Net Credit to the Nonfinancial Public Sector 1/

(Outstanding amounts in billions of pesos)

Time Period	Limits
Up to March 31, 1985	419.5
April 1 - June 30, 1985	429.5
July 1 - September 30, 1985	422.5
October 1, 1985 - December 31, 1985	429.5

1/ For purposes of these limits, the Banco de la Republica net credit to the nonfinancial public sector is defined as the net claims of the Banco de la Republica on the nonfinancial public sector, including the Special Exchange Account and the subsidy on the sale of foreign exchange to the Central Administration. All accounts denominated in foreign exchange will be converted at the accounting rate of Col$139 per U.S. dollar.

Table 5. Colombia: Targets on the Net International Reserves of the Banco de la Republica 1/

(Outstanding amounts in millions of U.S. dollars)

Date	Targets
March 31, 1985	1,497
June 30, 1985	1,357
September 30, 1985	1,377
December 31, 1985	1,652

1/ Defined as the difference between the foreign assets of the Banco de la Republica and its external liabilities of up to one year, including obligations to the Fund and obligations to the Andean Reserve Fund and under the Caribbean and Santo Domingo Agreement. For the purpose of these targets, the external liabilities of up to one year exclude the deposits of international nonmonetary organizations in the Banco de la Republica. The gold holdings of the Banco de la Republica will be valued at US$308.3 per ounce; the accounts denominated in SDRs will be converted at the rate of US$0.981985 per SDR; and the holdings of foreign exchange in currencies other than U.S. dollars will be converted at the market rate of December 31, 1984.

Table 6. Colombia: Limit on the Total Outstanding External Debt of the Public Sector or Guaranteed by the Public Sector 1/2/

(In millions of U.S. dollars)

All maturities	
Up to December 31, 1985	10,755

1/ Excludes external debt of up to one year of the Banco de la Republica.

2/ Any excess over this limit for up to US$100 million will not be counted as such provided that the corresponding quarterly target for net international reserves of the Banco de la Republica is exceeded by at least an equivalent amount. This adjustment is necessary to allow for the possibility that disbursements (in an amount that cannot be determined a priori) take place in advance of actual need under a mechanism of revolving funds in effect for loans from the IDB and IBRD.

Table 9. Colombia: Fiscal Measures of the 1985 Adjustment Program

	Billions of Pesos	Percent of GDP
Total value of fiscal measures	66.2	1.5
Fiscal measures approved in December 1984	49.2	1.1
Increase of 50 percent in the stamp tax	(6.2)	(0.1)
Surcharge of 8 percent on the value of imports	(34.0)	(0.8)
Decrease in the maximum deductible amount permitted under the income tax for interests on mortgage	(1.0)	(--)
Elimination of several exemptions to the value added tax	(8.0)	(0.2)
Fiscal measures to be approved in 1985 1/	17.0	0.4

Sources: Colombian authorities; and staff estimates.

1/ A change in earmarking of government revenue in favor of the Central Government and other revenue measures.

Table 10. Colombia: Schedule of Import Liberalization

	1985				
	First Quarter 1/	Second Quarter	Third Quarter	Fourth Quarter	Total
Items Transferred					
From prohibited list to prior import permit list	350	354	--	50	754
From prior import permit list to free list	500	218	200	218	1,136

Source: Ministry of Finance

1/ Transferred in March 1985.

Table 11. Colombia's Relations with the IBRD

(In millions of U.S. dollars)

	Commitment 1/	Disbursed	Undrawn Balance
A. IBRD Operations 2/			
Total	4,331	2,948	1,383
Fully disbursed	1,632	1,632	--
Agriculture	133	15	118
Airports	61	59	2
Communications	102	79	23
Earthquake reconstruction	40	13	27
Financial sector	90	7	83
Highways and railways	314	151	163
Industry	205	131	74
Irrigation	37	18	19
Nutrition	25	23	2
Power	1,273	644	629
Rural development	153	80	73
Urban development	39	28	11
Water supply	87	48	39
Petroleum	130	20	110
Coal	10	--	10

B. IBRD Disbursements

	1980	1981	1982	1983	1984
Net disbursements	152.4	174.2	183.0	164.3	307.9
Disbursements	217.9	250.7	280.2	291.0	462.5
Repayments	65.5	76.5	97.2	126.7	154.6

1/ Net of cancellations.
2/ As of March 31, 1985.