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FOR
AGENDA

EBS/85/149
Supplement 1

CONFIDENTIAL

June 14, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Colombia - Arrangement to Monitor Performance Under
Economic Program

Attached for consideration by the Executive Directors is a paper on a request by Colombia for an arrangement with the Fund to monitor performance under its economic program. Draft decisions appear on pages 3-6.

This subject, together with the staff report for the 1985 Article IV consultation with Colombia (EBS/85/149, 6/12/85), is proposed to be brought to the agenda for discussion on Friday, July 19, 1985.

Mr. J. G. Evans, Jr. (ext. 8327) or Mr. Bonangelino (ext. 7148) are available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

INTERNATIONAL MONETARY FUND

COLOMBIA

Arrangement to Monitor Performance
Under Economic Program

Prepared by the Western Hemisphere,
Exchange and Trade Relations,
and Legal Departments

Approved by S.T. Beza, C. David Finch,
and James G. Evans, Jr.

June 14, 1985

The Colombian authorities have requested that the Fund undertake to review their economic adjustment program and to monitor Colombia's compliance with the quantitative targets of this program in order to facilitate the implementation of a financial arrangement between Colombia and certain foreign commercial banks. Executive Directors have been informed of the issues arising from this request and the suggested means for accommodating the need of Colombia to provide its creditor banks with assurances that it was implementing an economic program adequate to deal with the problems that confront it, as reflected in the proposed decision.

The proposed decision provides for an initial endorsement of the program by a finding of the Executive Board that the program would have qualified Colombia for an arrangement in the upper credit tranches, and for the monitoring of the implementation of the program on the basis of a list of relevant performance criteria. The monitoring would be done through quarterly communications of the Managing Director to the member based on information supplied by Colombia. The decision also notes Colombia's statement that it will provide the information required by the Fund to monitor the relevant performance criteria.

Endorsement of the program by the Fund and the quarterly statements to Colombia on observance of the performance criteria are to serve as the basis for the initial and periodic drawdowns respectively under the credit facility with the foreign commercial banks. In Colombia's discussions with the commercial banks, it was observed that insubstantial deviations from the performance criteria might occur from time to time and that it was not the intention of the lenders that drawdowns be interrupted in circumstances where the Fund would have waived a deviation from a performance criterion for the purpose of a purchase under an arrangement with the Fund, because the deviation was of a minor or self-reversing character. It is envisaged, therefore, that the Executive Board be

asked to decide, if a deviation should occur, whether the Fund would have waived such a deviation for the purpose of a drawing under an arrangement. However, no provision is made for the modification of performance criteria. Such a provision would in any event go beyond the understandings and procedures that had been developed between management and the Colombian authorities and that had been described by management to the commercial bank advisory committee.

As Executive Directors were informed, Colombia had been requested by the commercial banks to transmit to them the reports prepared by the Fund staff on the economic situation of Colombia and developments under the country's economic program for 1985 and 1986, and the formal approval of the Executive Board for these transmittals is being requested.

Executive Directors have commented upon and raised a number of important questions about the procedures proposed by Colombia. A general question that was voiced was whether the Fund may not be involving itself too directly in the relationships between a member and its private creditors and the concern was expressed that there was a danger the creditors would look to the Fund for guidance rather than form their own opinion on a country's creditworthiness. More specific questions were whether endorsement of a program was appropriate when the Fund was not committing its own resources, and, whether in this kind of situation provision should be made for waivers.

The questions and issues raised by Executive Directors have been considered further by the management and staff. It should first be emphasized that the procedures in this case were developed in response to a specific request from the President of Colombia that the Fund undertake an exceptional role in endorsing and monitoring Colombia's economic program for the purpose of enabling the country to obtain external financing. If it were decided to eliminate the endorsement, the commercial banks in all likelihood would not go ahead with the financing package that they have been arranging for Colombia. In this connection, it should be noted that the commercial banks have desired Fund involvement because their own credit evaluation of Colombia's economic developments and policies over the recent past left them with doubts and uncertainties about the country's economic prospects. While it is necessary and appropriate that commercial banks take the responsibility for determining the creditworthiness of each borrower, Executive Directors are aware that one of the elements in this determination is whether a country has an arrangement with the Fund for use of resources in the upper credit tranches, especially when economic developments and prospects in a country give rise to doubts and uncertainties about a country's ability to service its debts. If the Board were to agree on the endorsement of the program, there would be some logic in providing for waivers for minor or self-reversing deviations. Therefore, it is the view of management and staff that a decision along the lines proposed below would be suitable in the particular circumstances of

Colombia. This is, of course, subject to the results of the Board meeting on this matter.

As Directors are aware, the management of the Fund is often asked by member country authorities to assist them in completing financial packages with commercial banks through a communication that indicates that, in the light of the economic program undertaken, management is willing to recommend to Executive Directors acceptance of the country's request for a financial arrangement with the Fund subject to the assurance of adequate financing. In the case of Colombia, while financial assistance is not being sought from the Fund, the authorities have requested similar support for their presentation to the international banking community. The message that the Managing Director is sending to the commercial bank committee for Colombia is attached as Annex I.

Proposed Decisions

The following decisions are proposed for adoption by the Executive Board.

I. Colombia--Arrangement to Monitor Economic Program

1. Attached to EBS/85/149 is a letter dated May 27, 1985 from the Minister of Finance and the General Manager of the Banco de la Republica of Colombia ("their letter") to which is attached a memorandum entitled, "Summary of the Economic Policies of Colombia" setting forth the objectives and policies that the authorities of Colombia intend to pursue during the period through December 31, 1985. By their letter, the authorities of Colombia have requested that the Fund (i) review these objectives and policies ("the program"); (ii) monitor the implementation of the program; (iii) provide to the authorities, for communication to the creditors referred to in their letter, the results of the Fund's initial review and continued monitoring of the program; and (iv) review the policies, including appropriate quantitative targets, that the member

intends to pursue under the program in 1986 in order to continue the adjustment effort that is under way.

2. The Fund has reviewed the objectives to be achieved under the program and the policies that the Colombian authorities intend to implement as set forth in their letter and memorandum. The Fund finds that on the basis of this program, Colombia would have qualified for access to the Fund's resources under an arrangement in the upper credit tranches.

3. The Fund will keep the implementation of the program under review during 1985 and 1986. The authorities of Colombia will be advised, through communications of the Managing Director transmitted after the end of each quarter, whether, on the basis of the information supplied by the authorities of Colombia:

- (a) the performance criteria as set forth below have been observed at the end of each calendar quarter for the period through December 31, 1985;

- (i) the limit on the net domestic assets of the Banco de la Republica specified in Table 3 of the memorandum attached to their letter,

- (ii) the limit on the net credit of the Banco de la Republica to the nonfinancial public sector specified in Table 4 of the memorandum attached to their letter,

- (iii) the target on the net international reserves of the Banco de la Republica specified in Table 5 of the memorandum attached to their letter,

- (iv) the limit on the total outstanding external debt of, or guaranteed by, the public sector, specified in Table 6 of the memorandum attached to their letter;
- (b) during the preceding calendar quarter, the intention relating to exchange restrictions, multiple currency practices, bilateral payments agreements and trade restrictions for balance of payments purposes specified in paragraph 17 of the memorandum attached to their letter has been observed;
- (c) with respect to the program during 1986:
 - (i) after a review, the policies and quantitative targets to serve as performance criteria submitted as proposed in 1(iv) above would have qualified Colombia for the continuation of an arrangement in the upper credit tranches, and
 - (ii) the performance criteria thus established are being observed at the relevant times during the remaining period of the program.

4. If a communication sent under paragraph 3 indicates that any of the performance criteria set forth in that paragraph are not met, but the Fund finds that the deviations are minor or self-reversing and that it, therefore, would have waived the noncompliance for the purpose of a purchase under a stand-by arrangement, it will so inform Colombia.

5. The Fund notes the statement by Colombia that it will provide all the information and assistance required to facilitate the assessment of the implementation of its program during 1985 and 1986 in order that this information may be transmitted by Colombia to certain creditors.

II. Colombia--Release of Documents

The Executive Board agrees that Colombia could provide the foreign commercial banks referred to in the letter of May 27, 1985, with copies of reports prepared by the Fund staff on the economic situation in Colombia and developments under the country's economic program for 1985 and 1986.

TO: INTERNATIONAL BANKING COMMUNITY AND
THE COLOMBIA CONSULTATIVE COMMITTEE
NEW YORK, NEW YORK

1. I WISH TO INFORM YOU ABOUT COLOMBIA'S ECONOMIC PROGRAM, WHICH HAS BEEN PRESENTED TO THE FUND FOR ITS EVALUATION. FOR 1985, THE COLOMBIAN PROGRAM AIMS AT THE RE-ESTABLISHMENT OF VIRTUAL BALANCE OF PAYMENTS EQUILIBRIUM THROUGH A SUBSTANTIAL REDUCTION OF THE PUBLIC SECTOR DEFICIT, THE PURSUIT OF A PRUDENT MONETARY POLICY, AND AN IMPROVEMENT IN THE EXTERNAL COMPETITIVENESS OF THE ECONOMY. THE STRENGTHENING OF THE BALANCE OF PAYMENTS AND THE CONTAINMENT OF INFLATION ARE EXPECTED TO FACILITATE THE RESUMPTION OF SUSTAINED ECONOMIC GROWTH. THE COLOMBIAN AUTHORITIES HAVE EXPRESSED THEIR INTENTION TO CONTINUE THEIR ADJUSTMENT EFFORT IN 1986 AND LATER THIS YEAR THEY WILL PRESENT TO THE FUND THE SUMMARY OF COLOMBIA'S ECONOMIC POLICIES FOR THAT PERIOD, FOLLOWING A FUND STAFF MISSION THAT WILL REVIEW PERFORMANCE UNDER THE 1985 PROGRAM AND ASSESS THE POLICIES FOR 1986.

2. A MAJOR ELEMENT 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. THE AUTHORITIES INTEND TO ACHIEVE THIS OBJECTIVE THROUGH A COMBINATION OF REVENUE MEASURES AND THE PURSUIT OF A RESTRICTIVE EXPENDITURE POLICY. AS A RESULT OF SEVERAL TAX MEASURES ALREADY ADOPTED AND THE ADJUSTMENT OF PUBLIC SECTOR RATES AND OTHER ADMINISTERED PRICES, PUBLIC SECTOR REVENUES ARE EXPECTED TO INCREASE BY NEARLY 2.5 PERCENTAGE POINTS OF GDP IN 1985. ON THE SIDE OF EXPENDITURE, THE SALARY ADJUSTMENT FOR CIVIL SERVANTS HAS BEEN LIMITED TO A WEIGHTED AVERAGE OF 10.5 PERCENT IN 1985, AN INCREASE WHICH IS CONSIDERABLY LOWER THAN THAT GRANTED IN 1984 AND BELOW THE PROJECTED RATE OF INFLATION FOR THIS YEAR. FURTHERMORE, PRIORITIES IN RESPECT OF PUBLIC SECTOR INVESTMENT HAVE BEEN REASSESSED AND THE ACTIONS TAKEN SHOULD LEAD TO A SIGNIFICANT DECELERATION IN THE RATE OF GROWTH OF SUCH OUTLAYS IN 1985.

3. THE MONETARY PROGRAM CONTEMPLATES A SUBSTANTIAL REDUCTION IN THE AMOUNT OF NET CREDIT FROM THE BANCO DE LA REPUBLICA TO THE PUBLIC SECTOR, AND IT IS CONSISTENT WITH LIMITING THE LOSS OF NET OFFICIAL INTERNATIONAL RESERVES TO USDOLLARS 75 MILLION IN 1985 COMPARED WITH A LOSS OF RESERVES OF USDOLLARS 1.4 BILLION IN 1984. THE PROGRAM SPECIFIES QUARTERLY CEILINGS FOR THE NET DOMESTIC

ASSETS OF THE BANCO DE LA REPUBLICA AND FOR THE BANCO DE LA REPUBLICA'S NET CREDIT TO THE NONFINANCIAL PUBLIC SECTOR, AND QUARTERLY TARGETS FOR THE NET OFFICIAL FOREIGN RESERVES. A LIMIT ON THE TOTAL OUTSTANDING PUBLIC AND PUBLICLY GUARANTEED EXTERNAL DEBT ALSO IS PART OF THE PROGRAM.

4. IN ADDITION TO THE TIGHTENING OF FISCAL AND MONETARY MANAGEMENT, THE ADJUSTMENT PROGRAM ENVISAGES AN EXCHANGE RATE POLICY CONSISTENT WITH THE ACHIEVEMENT OF THE PROJECTED STRENGTHENING OF THE BALANCE OF PAYMENTS EVEN AS RESTRICTIONS ON TRADE AND PAYMENTS ARE REDUCED. WITH THE PLANNED DEMAND MANAGEMENT AND EXTERNAL POLICIES, THE AUTHORITIES EXPECT TO ACHIEVE A REDUCTION IN THE DEFICIT IN THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS FROM 6.5 PERCENT OF GDP IN 1984 TO 4.9 PERCENT OF GDP IN 1985.

5. IT IS THE VIEW OF THE MANAGEMENT OF THE FUND THAT ON THE BASIS OF THE ECONOMIC PROGRAM DESCRIBED ABOVE COLOMBIA WOULD HAVE QUALIFIED FOR ACCESS TO THE RESOURCES OF THE FUND UNDER AN ARRANGEMENT IN THE UPPER CREDIT TRANCHES HAD COLOMBIA SO REQUESTED IT. MANAGEMENT IS THEREFORE PREPARED TO SUBMIT COLOMBIA'S PROGRAM TO THE EXECUTIVE BOARD FOR ITS ENDORSEMENT AND AUTHORIZATION TO MONITOR COMPLIANCE ON A QUARTERLY BASIS THROUGH THE END OF 1986.

6. COLOMBIA'S PROGRAM ASSUMES THAT USDOLLARS 515 MILLION IN NEW CREDITS WILL BE MADE AVAILABLE BY THE BANKING COMMUNITY TO COVER THE EXTERNAL FINANCING NEEDS ESTIMATED FOR 1985. IT IS CUSTOMARY TO SUBMIT TO THE EXECUTIVE BOARD OF THE FUND FOR ITS CONSIDERATION ONLY PROGRAMS THAT ARE ADEQUATELY FINANCED, AND THEREFORE I WOULD APPRECIATE RECEIVING WRITTEN CONFIRMATION BY JULY 17 THAT COLOMBIA'S REQUEST FOR NEW CREDITS FROM BANKS FOR 1985 WILL BE MET.

REGARDS,

J. DE LAROSIERE
MANAGING DIRECTOR
INTERFUND