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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/114

3:00 p.m., July 26, 1985

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
C. H. Dallara	M. K. Bush
J. de Groote	H. G. Schneider
B. de Maulde	S. de Forges, Temporary
	T. Alhaimus
H. Fujino	M. Sugita
	B. Goos
J. E. Ismael	Jaafar A.
R. K. Joyce	
A. Kafka	H. A. Arias
H. Lundstrom	H. Fugmann
	P. E. Archibong, Temporary
F. L. Nebbia	B. Jensen
Y. A. Nimatallah	J. E. Suraisry
P. Pérez	
J. J. Polak	J. de Beaufort Wijnholds
	A. V. Romuáldez
	O. Kabbaj
	A. A. Agah, Temporary
	A. S. Jayawardena
	T. A. Clark
S. Zecchini	N. Coumbis
	Wang E.

L. Van Houtven, Secretary
R. S. Laurent, Assistant

Also Present

IBRD: M. Schloss, Latin America and the Caribbean Regional Office. African Department: I. C. Tandeciarz. Asian Department: W. G. L. Evers. Central Banking Department: L. M. Koenig, Deputy Director. European Department: L. A. Whittome, Counsellor and Director; O. J. Evans, L. Hansen, H. B. Junz. Exchange and Trade Relations Department: C. D. Finch, Counsellor and Director; M. Guitián, Deputy Director; G. Belanger, J. T. Boorman, L. H. Duran-Downing, J. Hicklin, M. Nowak. External Relations Department: G. P. Newman, B. Nowzad, H. P. Puentes. Fiscal Affairs Department: A. L. Antonaya. IMF Institute: P. R. Rado. Legal Department: G. P. Nicoletopoulos, Director; P. L. Francotte, W. E. Holder, Ph. Lachman, S. A. Silard. Research Department: W. C. Hood, Economic Counsellor and Director. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: T. Leddy, Deputy Treasurer. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; M. E. Bonangelino, O. Gronlie, L. L. Pérez, R. K. Rennhack. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: J. Hospedales, G. Nguyen, G. W. K. Pickering, T. Sirivedhin, E. M. Taha, M. A. Weitz. Assistants to Executive Directors: J. R. N. Almeida, W.-R. Bengs, M. B. Chatah, J. de la Herrán, J. J. Dreizzen, G. Ercel, R. Fox, S. Geadah, G. D. Hodgson, Z. b. Ismail, H. Kobayashi, M. Lundsager, J. A. K. Munthali, J. E. Rodríguez, M. Sarenac, A. A. Scholten, L. Tornetta, A. Yasseri.

1. COLOMBIA - 1985 ARTICLE IV CONSULTATION AND ARRANGEMENT TO MONITOR ECONOMIC PROGRAM

The Executive Directors considered the staff report for the 1985 Article IV consultation with Colombia (EBS/85/149, 6/12/85; and Cor. 1, 7/22/85), together with a paper on a request by Colombia for an arrangement with the Fund to monitor performance under its economic program (EBS/85/149, Sup. 1, 6/14/85). They also had before them a report on recent economic developments in Colombia (SM/85/172, 6/19/85; and Cor. 1, 7/22/85).

The staff representative from the Western Hemisphere Department informed Executive Directors that Colombia's creditor banks had so far pledged $925 million out of a total package of $1 billion. Thus, the "critical mass" had been attained.

Performance under the authorities' stabilization program had been satisfactory so far, the staff representative considered. As of end-June 1985, the country had met the relevant credit ceilings and the objective for net official international reserves with comfortable margins. During the first half of the year, reserves had fallen by about $100 million, compared with a loss of over $1 billion during the same period in 1984; at end-June, net international reserves had been $1,605 million, compared with the objective of $1,358 million. Although data were not yet available on public external debt at end-June, the staff was confident that the applicable limit had been met. At the end of March, the margin under the limit on debt had been $1.6 billion.

On July 22, 1985, the official exchange rate had been Col$146.31 per U.S. dollar, representing a change of 43 percent against the dollar compared with one year previously, the staff representative continued. On the same date, the parallel market rate had been Col$154 per U.S. dollar, or about 5 percent above the official rate. According to official estimates, by mid-July the real effective exchange rate for the Colombian peso had depreciated by about 13 percent since December 1984 and by about 16.5 percent since July 1984.

On June 5, 1985, the authorities had reduced the minimum financing period required for imports from three years to two years for capital goods and from 18 months to 11 months for intermediate goods, the staff representative from the Western Hemisphere Department concluded. On June 27, they had eliminated the barter trade system. Furthermore, the reduction in the number of prohibited imports and the number of imports requiring prior permits had proceeded in accordance with the schedule shown in Table 10 of the staff report.

Mr. Kafka made the following statement:

> The staff report for the Article IV consultation portrays the radical change that has occurred in the last 18 months, particularly the last year, in Colombia's economic policy, as well as the causes for the policy stance adopted.

The worldwide recession of the early 1980s affected Colombia considerably, and the debt crisis experienced by other developing countries reduced Colombia's access to the international capital markets, despite Colombia's relatively strong financial position. Beginning in 1981, there was a sharp fall in exports, to which both falling coffee prices and unfavorable crops contributed. The GDP growth rate fell progressively through 1983--a decline led by manufactured production, to which falling or low agricultural production contributed.

In reaction to falling GDP growth, the Government expanded public sector expenditures. Imports rose sharply from 1980 to 1982, and the current account deficit of the balance of payments reached a high level. At the same time, conditions in the international markets led to a progressive fall in net capital inflows.

The public sector deficit continued to rise through 1983; the consequential monetary expansion was aggravated by the rise in private sector financing. In the context of the high current account deficit, the rate of inflation moderated substantially but the real effective exchange rate appreciated considerably through 1983; later, only the sharp devaluation of the Venezuelan bolívar contributed to further real appreciation of the Colombian currency, but the Colombian authorities did not consider it appropriate to meet this specific change by depreciation.

In 1983, however, the Government took the first steps to correct the situation through a series of tax measures. In 1984 the growth of the public sector deficit was arrested, although there was no fall. The readjustment of the public sector fiscal deficit in 1984 reflected in part the full effect of the tax measures introduced in 1983. In addition, during the second half of 1984 the adjustment effort was substantially strengthened. The effort concentrated on a further reduction in the public sector deficit, a sharp reversal of monetary expansion, and an acceleration of exchange rate adjustments that had been initiated in 1982. The current account deficit of the balance of payments declined, although it remained high.

The 1985 program substantially intensifies the adjustment program in all fields. In the fiscal field, of particular importance--in additional to the new revenue measures adopted in December 1984--is the substantial increase in gasoline prices and in electricity and other public utility rates. Of equal importance, and showing the authorities' great courage, are the expenditure restraint policies and the reassessment of investment priorities, with particular emphasis on coal and oil projects. The investment program has been formulated in full agreement with the World Bank. Other measures designed to restrain expenditures include the elimination of revenue earmarking, a practice that has greatly reduced the Government's flexibility, the reduction of transfers for teachers' salaries, and the

improvement of the fiscal position of the social security system. The acceleration of devaluation is expected to make possible soon a substantial reduction in the percentage of tax credit certificates delivered to exporters and to thereby reduce government expenditures. To reinforce the revenue collection effort, the Colombian authorities have requested the Fund's technical assistance with respect to customs and the value-added tax. At the same time, they have established a technical committee to monitor public sector outlays and a ministerial committee, which includes academic experts, to propose legislation designed to improve the control of public sector expenditures.

A sharp reduction in the flow of credit from both the Banco de la Republica and the overall financial system to the public sector, amounting to about 75 percent in real terms, will be made possible by the fiscal measures outlined earlier. This will allow a slight increase in private sector credit in real terms, while maintaining the overall monetary expansion at a rate compatible with the overall balance of payments target. Furthermore, to aid monetary policy, the Government intends to move interest rates charged by the Banco de la Republica to positive levels in real terms. Some adjustments have already been made in this area. The measures taken will, moreover, make it possible for the Government, without prejudice to its overall monetary objectives, to assist in the capitalization of certain commercial banks that have been facing difficulties.

Concerning wage policy, in addition to the restrictive adjustment of central government wages, the adjustment of minimum wages this year is being held to a level lower than the inflation rate expected for 1985.

These measures are expected to lead to a substantial reduction of the current account deficit of the balance of payments in 1985 and to a modest trade surplus, as a result of an estimated expansion in the dollar value of exports of at least 10 percent. That forecast is particularly noteworthy in the context of the sharply reduced rate of growth, compared with 1984, in world trade foreseen for 1985. The acceleration in the depreciation of the peso, as well as the tightening of fiscal and monetary policies, will permit the Colombian Government to initiate the liberalization of the import regime. This will comprise a rationalization of the import tariff structure and shifts of imports from the prohibited list to the list of imports subject to prior permit and from the latter list to the free list, so that it is expected that by the end of 1985 no less than 50 percent of all imports will be on the free list. The program adopted by the Colombian authorities is the basis for an expected sharp increase in net capital inflows; there will be an increase in gross inflows of official capital, an increase in direct investment, and the stabilization of the commercial credit lines

granted by foreign banks. The net result will be a very small increase in banks' exposure in Colombia this year, and an almost negligible one in 1986. Also worthy of mention is the scheme whereby the Colombian central bank assists private debtors in repaying their foreign debts, minimizing the danger of exchange losses on the part of the central bank.

Based on the program, it is expected that Colombia will be able to maintain a strong export performance and, over the next five years, obtain sufficient overall surpluses so that reserves will be maintained at the present level relative to imports. The current account deficit is expected to fall to less than 2 percent of GDP by the end of the period. This deficit is expected to be amply covered by credit and direct investment flows expected to be made available to Colombia. The GDP growth rate is expected to be 3 percent and therefore to permit a steady, if modest, increase in per capita income. Obviously, there are uncertainties deriving from developments beyond the control of the Colombian authorities.

In informal meetings the Executive Board has had occasion to discuss the particular circumstances that make it necessary for Colombia to request the assistance of the Fund in monitoring the economic program adopted by its authorities, without requesting access to the Fund's resources. Let me repeat once more that Colombia's program and prospects would fully justify such access. Colombia's request that the Fund should take a decision recording the fact that the program would qualify for IMF financial assistance seems to me, therefore, entirely appropriate. Colombia has also requested the Fund to make available to it quarterly statements on the progress of its adjustment program, and in the case of minor or self-reversing deviations from that program, to declare that in such a case, in the context of a financial program, a waiver would have been available. Colombia has requested permission to make the communications it will receive from the Fund on its program available to its creditor banks.

The question has been raised whether by monitoring Colombia's program the Fund would become excessively involved in Colombia's relationship with its creditors including whether the arrangement would mean that the Fund was giving creditors guidance on whether to disburse loans to Colombia. It seems clear that the Fund will in no way become more involved than it would be if it had granted a stand-by arrangement with access to its resources. If stand-by arrangements are appropriate with their varying degrees of access, then surely they cannot be rejected because the access has been reduced to zero. I can also see no reason why the Fund would be more lenient in appraising Colombia's progress simply because the Fund had not been asked for access to its resources; the Fund would have been perfectly willing to grant such access if asked by Colombia.

Mr. Pérez expressed strong support for Colombia's request for the Fund to undertake an exceptional role in endorsing and monitoring the economic adjustment program designed by the authorities. The request clearly fell within the purposes of the Fund as contained in the Articles of Agreement.

In the past three years, Mr. Pérez noted, Colombia's external financial position had deteriorated sharply, in part because of the extremely difficult external environment both within the region and worldwide but principally because of the expansionary fiscal and monetary policies pursued by the authorities since the early 1980s. The rapid growth in current and capital expenditures had increased the share of public expenditures in GDP by 9 percentage points in only five years; consequently, the overall public sector deficit had risen to 7.6 percent of GDP in 1982, a level that had continued in 1983 and 1984 despite the good performance recorded in fiscal revenues. Monetary policy had also been strongly expansionary, mainly as a result of large credits to the public sector. Expansionary monetary and fiscal policies had allowed the country to register a moderate rate of growth in 1984, but it had come at the cost of an acceleration in the rate of inflation, a further deterioration in the external position that had been contained only by import restrictions, and additional losses of international reserves. Thus, Colombia needed an adjustment program geared to arresting internal and external disequilibria if it were to lay the foundation for a new phase of economic recovery.

Two aspects of Colombia's request deserved the attention of Executive Directors, Mr. Pérez remarked: the structure of the program itself, and the fact that it was the first instance of national authorities' adopting a program that did not contemplate at least the contingent use of Fund resources.

The program elaborated by the authorities combined an appropriate mix of adjustment and financing, considering the large energy project that they planned to implement, Mr. Pérez considered. Measures aimed in the right direction included the planned reduction of the overall public sector deficit by 2.7 percentage points of GDP in 1985, the sharp contraction envisaged in the flow of net credit to the public sector while bank credit to the private sector was to grow at the same rate as projected GDP in nominal terms, and the pursuit of a realistic exchange rate policy. Especially remarkable were the actions already adopted affecting wages; the decrease of 11 percentage points in real terms in public sector salaries and the reduction in minimum wages by 2 percentage points in real terms would stimulate employment and contribute to the recovery of competitiveness while reducing pressures on the fiscal deficit. While they were implementing a restrictive demand management policy, the authorities planned to maintain an ambitious investment program, cofinanced by the World Bank and foreign commercial banks. The program was addressed to widening the productive base, thus allowing the country to register a substantial increase in export proceeds. After analyzing those measures and the quarterly quantitative ceilings, he agreed with the Fund management and staff that Colombia would have qualified for an arrangement with the Fund in the upper credit tranches.

Some aspects of the program and the current financial situation in Colombia were worthy of special attention, Mr. Pérez observed. In view of the weak financial position of some local commercial banks, it would be extremely important to preserve the health of the financial system, apparently a necessary condition for restoring private sector confidence. The authorities had already demonstrated their willingness to cope with that problem by adopting measures such as the special credit facility to help finance the capitalization of the banks and the exemption from the requirement to constitute provisions for bad loans and by permitting a rescheduling of some overdue loans under specified conditions. Nevertheless, the monetary authorities must adopt all necessary measures to restore the financial system to satisfactory condition.

Fiscal adjustment would occur mainly on the revenue side, Mr. Pérez remarked. In fact, revenue increases would account for fully 90 percent of the deficit reduction programmed for 1985, while only 10 percent would result from a tighter expenditure policy. On the one hand, that continuous increase in the fiscal burden could bring about a crowding out of the private sector, which might jeopardize the program's targets for investment and growth. On the other hand, given the features of Colombia's fiscal system, increases in tax revenue would only partly offset the fiscal deficit, owing to the widespread use of earmarking mechanisms. A more decisive effort to hold down expenditure appeared to be called for during the second phase of the program.

Table 3 of the staff report showed that the share of capital expenditures in GDP had risen by 4 percentage points in the past five years, Mr. Pérez noted. It was clear from the staff report and the report on recent economic developments that Colombia had carried out an ambitious investment program encompassing diverse economic and social sectors.

In the light of current economic circumstances, Mr. Pérez asked whether the staff could assess the profitability of the investment projects financed by the public sector, taking into account the scarcity of foreign exchange in Colombia. Did the World Bank assessment suggest any possibility of cutting down investment projects without jeopardizing the economic strategy that the Government was pursuing?

Table 8 of the staff report indicated that Colombia--which until 1980 had succeeded in maintaining cautious debt management compared with other Latin American countries--had doubled its total debt as a percentage of GDP in only four years and trebled its debt service outlays as a percentage of exports, Mr. Pérez recalled. It was true that a large portion of that increase had been associated with the financing of investment projects that should generate more than enough proceeds to service and repay the loans, but, given the level of debt already reached, the authorities should handle new foreign loans in a very cautious manner.

In addition to the normal features of an Article IV consultation, Mr. Pérez said, Colombia's case presented some interesting aspects related to Fund policies and the Fund's financial character. He was in favor of broadening the spectrum of Fund policies and tools if it could contribute to fulfilling the purposes of the institution in a more appropriate manner.

Turning to the specific features of the request by Colombia, Mr. Pérez noted that a question arose as to how it might be classified in the context of Fund policies. During the previous informal discussion, it had not been clear whether the Colombian case could be classified as a type of Fund surveillance or as an adjustment program. His chair had no doubt that it fell within the program category: features like quarterly ceilings, conditionality, and periodic reviews were the essence of Fund programs. If only one feature were chosen to distinguish between programs and surveillance, conditionality was perhaps the most distinctive element. Directors should bear in mind that, even in the most extreme example of surveillance--enhanced surveillance--there was no element of conditionality. An examination of the terms of the agreements between national authorities and commercial banks in the various cases of enhanced Fund surveillance showed that the only characteristics that distinguished them from Article IV consultations were the shorter cycle and the fact that the report was released by the authorities to the commercial banks. Certain elements--among them the so-called quantitative program--might lead some to think that there was a closer relationship between the Colombian program and enhanced surveillance.

In his view, there was quite a difference between the quantitative program included in enhanced surveillance exercises and the quantitative ceilings that pertained to Fund programs, Mr. Pérez continued. Under enhanced surveillance, a macroeconomic framework--common in the design of any economic policy for a set period--helped the authorities to monitor the economy. In contrast, ceilings in Fund programs referred to a specific group of selected economic variables, for which strict quarterly quantitative ceilings were set, with clear financial implications if any of those ceilings were exceeded. The Colombian case fell into the second category.

Another set of issues related to the present case referred to possible implications, if the case of Colombia were generalized, for the financial capacity of the Fund to cope with members' external difficulties in the short term and for its own financial character in the long term, Mr. Pérez remarked. A generalization of the Colombian case would allow the Fund to split its programs into two categories: programs of the first generation, without Fund financial resources, and programs of the second generation, with such resources. In the short run, such a split might provide grounds for reducing current access limits on the basis of the enhanced catalytic effect of the Fund. In the long run, it would allow the Fund to work with a lower level of such resources.

That split approach would be inappropriate for two reasons, Mr. Pérez explained. First, programs of the first generation might be applied only to a selected group of countries with well-diversified economic structures or those with rich resource endowments, in sum, to countries able to obtain money on the international financial market despite temporary external difficulties. Second, he had the impression that, besides amplifying the catalytic effect, a split of Fund programs into first-generation and second-generation programs might simply change the Fund's direction. For example, a greater amount of financial resources might come from banks in first-generation programs and a lesser commitment in second-generation programs, an outcome that could also represent a shift in the risk distribution between the banks and the Fund. In any event, to deal with the financial requirements of second-generation programs, the Fund would need to maintain or perhaps raise access limits, owing to the more reluctant bank stance on participation in those programs. In addition, and for the same reason, the Fund would have to maintain a financial position in the medium and long term allowing it to cope with greater participation in financing the external gap in each case. Paradoxically, the possibility that he was assuming might lead to the need for a larger financial endowment for the Fund than at present.

The Chairman suggested that Executive Directors in their interventions should examine both the Article IV consultation and the proposed program, which involved a monitoring procedure; he would urge speakers not to cover the entirety of the issue of enhanced surveillance and monitoring procedures, which would be discussed at a later date.

Mr. Ismael said that he would have felt more comfortable had Colombia's proposed economic program been accompanied by a request for the use of Fund resources. Nevertheless, the financing required from commercial banks for the country to close its financing gap in 1985 and 1986 was contingent upon the existence of an adjustment program with the Fund. More important, the authorities strongly desired to avoid any outward appearances of Fund involvement, and, according to management, the method being proposed was an exceptional one that would not become a regular feature of Fund assistance. To facilitate Colombia's adjustment effort, he was therefore willing to go along with the proposal for the Fund to monitor the country's performance under the economic program.

The proposal might have implications on several fronts: the future role of the Fund in supporting a member's adjustment effort, whether the Fund would henceforth tend to promote greater reliance on commercial sources of financing, whether commercial banks would be encouraged to request habitual Fund endorsement of debtor countries' programs in the future, and the perceptions that might develop of future requests for the use of Fund resources, Mr. Ismael continued. In any event, it should be made clear that endorsement by the Fund of a member's economic program, whether or not supported by the use of Fund resources, did not absolve commercial creditors from making their own credit judgments. It should simply mean that, under the circumstances, the Fund considered that the policies to be followed would direct the member toward a sustainable growth path.

During the course of the program, the Fund was to monitor observance of performance criteria, which the Board was being requested to approve, Mr. Ismael noted. Indeed, disbursements by commercial banks during the 18 months of the agreement with Colombia were linked to observance of those criteria, with the understanding that small, self-correcting variances might be waived by the Executive Board but that no provision existed for making modifications in the program. Such an undertaking placed a great deal of responsibility on the Fund, which might be inappropriate when the Fund was not committing its own resources. He wondered what was envisaged if a departure from the performance criteria were such that the Board would not be expected to grant a waiver.

As his chair had consistently opposed Board approval of the release of Fund documents concerning member countries, Mr. Ismael remarked, he would prefer that the proposed decision not mention Board approval of the release to commercial banks of reports prepared by the staff. The matter should be left to the discretion of the Colombian authorities. He would also appreciate learning how the Board's decision was to be communicated to the authorities for transmittal to the creditors.

External factors such as sluggish demand for the country's exports, especially coffee, and high interest rates overseas were principally responsible for the plight of the Colombian economy, Mr. Ismael considered. Those factors had been exacerbated by expansionary demand management policies that the authorities had implemented to combat unemployment. Adjustment had begun in late 1983 and had intensified in the second half of 1984. The adjustment program for 1985--including reform measures, vigilance in fiscal and monetary policy, and a flexible exchange rate system--appeared to go in the right direction. He also welcomed the continued involvement of the World Bank. However, the medium-term scenario was based on a number of optimistic assumptions, and the staff seemed to have underplayed the possibility that the actual outturn might be worse than projected. Considering that the program as designed did not call for a very rigorous adjustment, he wondered whether a somewhat stronger program might have been more appropriate.

Mr. Joyce said that, for some years, the Colombian economy had not been attaining its full potential, and the authorities had not been taking sufficiently strong, broadly based measures to address that situation. Growth had recovered to about 3 percent in 1984, but inflation, unemployment, and the overall balance of payments position had worsened, while the current account deficit had remained unacceptably high. Underlying Colombia's spotty performance was a large deficit in the consolidated public sector, an unduly accommodative monetary policy, and an increase in exchange and trade restrictions. Although the authorities had taken steps to improve Colombia's external competitiveness through more rapid devaluations of the peso, the overall policy mix was clearly inadequate to restore economic stability. He supported the adjustment program that

the authorities had initiated in late 1984 and were committed to follow in 1985 and 1986; if implemented vigorously and without any deviation, the measures outlined in the staff report should help Colombia to regain a viable payments position in the medium term. The coming on stream of new production facilities for coal and petroleum provided further reason to be optimistic about Colombia's future. Nevertheless, the rapid buildup of external debt in recent years and the growth in the debt service ratio, which would remain at about 40 percent for the rest of the 1980s, gave the authorities little room for slippage in implementing the program. The indication in the staff's medium-term outlook that the Colombian economy was sensitive to changes in the external environment suggested that the authorities should be prepared to take remedial action quickly should adverse external circumstances emerge; indeed, they might well consider building some margin for maneuver into their plans for 1986.

Reductions in the public sector deficit were the key element in the adjustment effort, Mr. Joyce remarked; although the measures outlined to increase revenue appeared appropriate, they needed to be supported by improved tax collection and administration. He was encouraged by the authorities' intention to seek Fund assistance in the fiscal field. They might also pay attention to the expenditure side, as outlays had grown rapidly during the past five years. The proposed wage restraint was important, but in coming years the authorities should place greater emphasis on containing expenditure more effectively, a process that would be facilitated by rapid submission to Congress and approval by it of expenditure-controlling legislation.

The authorities' commitment to exercising greater restraint over monetary policy and to keeping real interest rates positive would be important to avoid feeding inflation and to stem capital flight, Mr. Joyce indicated. However, he wondered whether the recent acceleration in inflation to an annual rate of almost 28 percent had reflected purely temporary factors or whether some reassessment of policy was called for. As term deposits were the only instrument with uncontrolled interest rates, he wondered whether rates on other deposit instruments were being set at suitable levels to encourage financial savings. Although the recent adjustments in the rates charged by the Banco de la Republica were welcome as an interim step, the authorities should consider allowing those rates to move to market-determined levels.

He was encouraged by the more rapid depreciation of the peso and by the authorities' declared intention to maintain a flexible exchange rate policy, as both steps would be important if they were to attain their balance of payments objectives and to pursue trade and exchange liberalization at a sufficiently rapid pace, Mr. Joyce said. Persistent trade and exchange restrictions had done little to promote economic efficiency. He encouraged the authorities to eliminate some of those restrictions as quickly as possible; it would be inappropriate for the Executive Board to grant approval of such practices in the proposed decision.

Many statistics in Colombia, such as those on employment and earnings, appeared to be either nonexistent or available only after a long lag, Mr. Joyce noted. The authorities must improve the statistical base if they and their creditors were to be in a position to monitor progress in the economy. He would support any request that the authorities might make for technical assistance from the Fund in statistics.

From the outset, his chair had been concerned about the special procedure proposed for Colombia under the monitoring arrangement, Mr. Joyce recalled. A request by the authorities for a normal stand-by arrangement would have been appropriate and, on the basis of objective criteria, would have been fully justified. Other governments had negotiated stand-by arrangements with the Fund despite domestic political difficulties. Should the Fund be asked to demonstrate such flexibility when a member country was embarrassed to be publicly associated with it in a program?

The proposal by the Fund to exercise enhanced surveillance over Colombia represented a significant departure from the instances of enhanced surveillance with which the Board had dealt recently, Mr. Joyce considered. In the previous instances, special monitoring arrangements had been seen as a means of helping the member country return to a more normal, spontaneous pattern of external financing, usually with a multiyear rescheduling agreement. The case of Colombia was different. However much the proposed procedure might be designed to safeguard the Fund's position, he feared that it would transmit the kind of "on-off" signals to commercial lenders that the Fund had attempted to avoid in instances of enhanced surveillance. Despite his concern, he was prepared to support the proposed monitoring arrangement for Colombia, but his authorities would be loath to support any future proposals of that type. In any event, the Fund regarded the case as exceptional.

Colombia's creditor banks were interested in receiving information from the Fund under the special monitoring arrangement, Mr. Joyce said, but the Board must be careful to ensure that the privacy of its discussions and the independence of its decision-making process would be fully protected. The Board must avoid implementing procedures or granting formal approval for the release of documents that would go beyond what it had deemed advisable in other cases involving enhanced surveillance in its pure form. Finally, he would respond to Mr. Kafka's suggestion--that the Board should not reject stand-by arrangements and therefore Fund involvement with creditors merely because a country's access to Fund resources had been reduced to zero--by pointing out that the proposed program was not a stand-by arrangement, even one with low or zero access.

Mr. de Maulde recalled that the Chairman, in summing up the 1984 Article IV consultation with Colombia (EBM/84/149, 10/10/84), had said that Executive Directors had noted with deep concern that Colombia's financial situation had continued to deteriorate markedly since the previous consultation and that the authorities should adopt decisive action

to reduce substantially the public sector deficit, cut the rate of growth of credit from the Banco de la Republica, and seek a major improvement in Colombia's competitive position and external current account. Since that time, indeed, the authorities had strengthened their adjustment efforts by adopting a program comprehensively addressing the main points of the summing up: they had accelerated reductions in the public sector deficit, significantly slowed the expansion of credit, and carried out a flexible exchange rate policy together with further measures of trade liberalization. At present, he wished the authorities success in implementing their courageous and serious program. The role played by the World Bank in the forthcoming development of mineral resources like petroleum and coal--which would help to counteract the sluggishness of Colombia's traditional coffee exports--increased his confidence in the country's future.

In the monitoring procedure presented in EBS/85/149, Supplement 1, Mr. de Maulde continued, the various concerns and reservations that he had expressed earlier in principle had not been answered or taken into account. His authorities had two main concerns about the specific procedure proposed. First, it constituted in fact a tripartite agreement between the Fund, Colombia, and a group of commercial banks; it should involve only the Fund and the member country, without explicit reference to commercial creditors. Therefore, in paragraph 1 of the proposed decision, the phrase "for communication to the creditors referred to in their letter" should be deleted. In paragraph 5, the final phrase, "in order that this information may be transmitted by Colombia to certain creditors," should also be deleted.

The Executive Board should not be called upon to decide whether any slippage from the program targets was minor or not, Mr. de Maulde suggested. Rather, the Fund should carefully limit its intervention to the provision of technical assistance by the staff, leaving full responsibility for risk assessment to the commercial banks. Thus, paragraph 4 of the proposed decision should be deleted. Finally, the proposed decision should not constitute a precedent. With the revisions that he had suggested, he was prepared to support the decision.

Mr. Lundstrom welcomed the fact that Colombia had begun implementing a comprehensive economic adjustment program. Colombia's experience with expansionary policies had been the same as that of other countries, developing and developed alike: when they were significantly out of line with the external environment, such policies led to unsustainable balance of payments developments. Thanks to a long period of prudent economic management, Colombia still had the opportunity to change course without having to cope with the severe constraints, external as well as internal, that other countries were facing. Thus, the proposed program did not aim at a radical turnaround in economic developments, as shown by the fact that most of the improvement in the overall balance was intended to come from the capital account rather than the current account; the proposed balance between improvements in the two accounts was an indication that the program was mainly a confidence-building exercise, implying a weaker

adjustment in the short term than under most Fund-supported programs. In view of the special monitoring procedure proposed, there was little margin for the authorities to make adaptations, should slippages occur in any part of the program, so that it would be vital for them to implement all of it.

The overall fiscal stance seemed adequate, Mr. Lundstrom considered. If a need for follow-up measures should arise, there would be room for tighter policies on the expenditure side. Although in general agreement with the monetary stance, he would not exclude the possibility of a slightly lower rate of increase in bank credit to the private sector, given the reliance on the prospective improvement in the external capital account. Developments in private sector liquidity were essential for a successful exchange rate policy. Even if a good case could be made for a large, one-step devaluation of the peso in connection with the stabilization program, it was understandable that the authorities preferred to accelerate the crawling peg depreciation. Yet there was a risk that exchange rate depreciations and price increases might chase after each other. It was already clear that increases in various administered prices as well as the high rate of depreciation of the peso were contributing significantly to the expected acceleration in the rate of increase of consumer prices in 1985. The staff report should have contained an estimate of price developments in 1986.

An enduring commitment to dismantling the highly complex and restrictive exchange and trade system would no doubt have a beneficial impact on private capital flows, Mr. Lundstrom observed. In addition to supporting the basic aim of the economic program--to strengthen the capital account--such a policy would also reduce the present necessity for the authorities to rely on extremely high real rates of interest. In addition, the envisaged liberalization of imports, including the elimination of import surcharges, seemed to call for compensating fiscal measures in order to maintain the fiscal policy stance already adopted. As full implementation of the program seemed to be the minimum required, he could support the proposed decision on the Article IV consultation.

While accepting the proposed arrangement to monitor Colombia's economic program, Mr. Lundstrom said, his authorities wished to emphasize the risks both in the relationship between the Fund and the banks and in a continuation of "spontaneous" lending by the banks. First, the design and implementation of the monitoring arrangement should be such that the Fund could in no respect be regarded as a guarantor. Second, the arrangement should be kept under continual and careful review, by both the staff and the Board. Third, the arrangement should be seen as an isolated case that set no precedent, and management should exercise great caution in initiating preparatory discussions about similar arrangements in the future. If an arrangement of that type were to become a possibility for another member country, the Board should have the opportunity to consider the principles involved at an early stage. With those understandings, he would support both proposed decisions on the monitoring arrangement.

Mr. de Maulde suggested that the second proposed decision, on the release of documents, should be omitted. He had no problem with the authorities' giving such documents to whomever they wished, but he would prefer that the Fund not approve the release.

The Director of the Legal Department explained that, under the rules adopted and endorsed by the Executive Board, documents such as Fund staff reports on the economic situation in member countries were not to be used outside the Fund. It was true that they were transmitted by Executive Directors to national authorities, but it had been the rule and the practice that the documents were not to go beyond those circles; they were not for public use. As the Chairman had indicated, it was necessary for the Board to decide, on either a general or an ad hoc basis, to permit the release of those documents beyond the circles that he had mentioned.

Permission for release could be included in the Chairman's summing up, the Director of the Legal Department remarked. It was true that Fund staff reports had been made available on certain occasions by the authorities of member countries to commercial banks. Although aware of such incidents, the Fund had not made them an issue, because it was recognized that the authorities had considered it important to make the documents available.

Mr. Nebbia expressed support for the proposed decision. As Mr. Pérez had said, Colombia should not be incorporated into the group of countries over which the Fund exercised enhanced surveillance. Rather, what was being proposed was a typical Fund program, except that it did not involve the use of Fund resources. The proposed mechanism would support an adjustment policy that would help to mobilize financial resources from creditors other than the Fund. Colombia's economic program and prospects fully justified the request.

Nevertheless, there was a risk in promoting a gradual reliance on commercial sources of finance as a replacement for the use of Fund resources, Mr. Nebbia continued. Indeed, a perception might arise that, under pressure from commercial banks, the present arrangement would put the Fund in the difficult position of a universal monitoring agency. Although Colombia was in the early stages of resolving its balance of payments difficulties, which were less grave than those of most other indebted Latin American countries, the policies proposed in the program would be adequate to permit a significant improvement in the external position.

Colombia's economic performance during the 1970s and so far in the 1980s could be assessed as satisfactory, particularly when compared to that of other Latin American countries, Mr. Nebbia remarked. The Government had pursued sensible economic policies that had partly freed the country from the disruptive external shocks that had affected most developing countries. Colombia's external debt was not particularly large and was concentrated in long-term development loans, so that the

authorities had to a great extent been able to escape the international debt problems that had confronted a number of other countries. However, in recent years, the deterioration of trade flows with neighboring countries and Colombia's limited access to private capital markets, together with the absence of an appropriate response through domestic policies, had affected the external position, especially foreign reserves. Indeed, Colombia's exports as a proportion of the total in the Latin American Integration Association had declined by more than 50 percent from 1981 to 1984. Colombia demonstrated the need for consistency in simultaneous adjustment programs among countries, particularly their regional effects.

The proposed program contained a set of strong fiscal, monetary, and exchange rate measures, Mr. Nebbia continued. The projected improvement in the overall balance of payments of US$0.4 billion would be achieved through a reduction in the current account deficit and through capital inflows. Furthermore, the decline in international reserves that had taken place for the past three years would come to an end in 1985, an advantageous development.

Although the staff viewed the slowdown in the rate of expansion of credit by the Banco de la Republica as essential to containing inflation, Mr. Nebbia noted, a comparison of the inflation rate in recent years with changes in net assets of the Banco de la Republica and of the financial system indicated that variations in inflation had shown no correlation with the change in domestic assets. In fact, the two variables had moved in opposite directions. Moreover, he had been surprised to learn that the trend in the overall public sector deficit had also moved in the opposite direction to inflation during the past five years. What were the inflation mechanisms in Colombia? What was the relative weight of the different factors that had determined the rate of inflation in recent years?

He would like to learn more about the problems caused by high real interest rates and the vicissitudes of the financial system, Mr. Nebbia said. He wondered whether the high expected real interest rate would increase the difficulties that commercial banks might have in collecting past due loans. In considering those issues, Directors should take into account that devaluation of the peso at a rate faster than that of domestic inflation would keep real interest rates high, and that the difficulties experienced by the financial sector might undermine the authorities' monetary targets. Moreover, the medium-term balance of payments projections' great sensitivity to external developments was noteworthy; once again, the important role played by Fund surveillance deserved attention. Finally, he welcomed the assistance provided by the World Bank to Colombia in adjusting its public investment program in terms of both value and composition.

Mr. Romuâldez supported the proposed decisions and the authorities' request for quarterly monitoring by the Fund under the adjustment program, which was comprehensive and focused correctly on reducing the public sector deficit, tightening monetary policy, and managing the exchange

rate more realistically. He was, however, less certain about its rigor, and wondered whether more ambitious cuts in expenditure could not have been attempted for 1985. With current transfers projected to rise by 0.1 percent of GDP, perhaps some such cuts ought to have been included in the program. Projections also indicated a large increase in interest payments, an expenditure item over which the authorities had little or no control. As the bulk of the improvement in public sector finances was to derive from revenue increases such as new tax measures and financial strengthening of other public sector entities, the elimination of revenue earmarking should enhance the Government's fiscal flexibility. In addition, Colombia had requested Fund technical assistance in the administration of customs duties and value-added taxes. Also welcome was the intention to establish a committee to monitor and control public sector outlays; what progress had been made in that direction?

Although the proposed 71 percent reduction in the flow of net credit to the public sector from the Banco de la Republica was apposite, Mr. Romuáldez continued, he was unsure whether maintaining the increase in bank credit to the private sector at about 23 percent could help to realize the authorities' balance of payments targets or keep inflationary pressures in check. He appreciated the need to encourage financial savings and discourage capital flight but considered that real interest rates for credits and deposits of 18 percent and 10 percent, respectively, might blunt whatever private sector initiatives still remained.

Colombia's crawling peg devaluation had not been greatly successful; on the contrary, it seemed to have nurtured inflationary expectations and fostered capital outflows, Mr. Romuáldez recalled. Even at a faster rate of depreciation, he wondered about its appropriateness. Perhaps a once-and-for-all decision toward flexible exchange management would be more effective in stabilizing Colombia's exchange system. At the earliest possible opportunity the authorities should discontinue multiple currency practices, exchange and trade restrictions, and bilateral payments arrangements. Though welcome, the measures already planned might not be sizable enough to have a meaningful impact.

Both in the exchange and trade system and in the fiscal and monetary sector, gradualism had done Colombia more harm than good, Mr. Romuáldez considered. More often than not, under a gradualist approach, adjustment efforts were rendered ineffective or inadequate because they were overtaken by events that nullified the effect of the small gains already achieved, a particularly obvious feature of Colombia's exchange system during the past few years.

He welcomed the recent approval by the World Bank of a US$300 million loan for Colombia to promote trade and export diversification, Mr. Romuáldez said.

Close collaboration between the Fund and the Bank in assisting Colombia's efforts toward adjustment and growth, if successful, could contribute to correcting the perception of the Fund among the Colombian

body politic. He would appreciate an update on the status of the World Bank loan and the trade policy adjustments that it was meant to support. He commended the Fund management and staff as well as the Colombian authorities for having been careful to ensure that the integrity and independence of the Fund were preserved as much in the wording of the proposed decision as in the envisaged process of implementation.

The change proposed by Mr. de Maulde in paragraph 1 of the proposed decision on the Fund's monitoring of Colombia's economic program was questionable, Mr. Romuáldez pointed out, because the wording to be deleted came from the cited letter of the authorities. As to the proposed decision on the release of documents, he accepted the explanation given by the Director of the Legal Department and could agree to approving the decision unchanged.

Mr. Polak explained that his support for the proposed decision on monitoring was limited to the present individual, highly unusual case. There was no question that Colombia's performance during 1982, 1983, and the first half of 1984 had not been good and that the remedial steps that the authorities had attempted to take during that period had been far from adequate.

Only after significant losses in external reserves and a slowdown in private capital inflows had the authorities made an effort to arrest the deterioration in the external account, although it had not been reversed, Mr. Polak recalled. Regrettably, the authorities still demonstrated insufficient readiness to implement needed adjustments in domestic demand. In 1984, the public sector deficit had remained as large as in 1983, while net assets of the Banco de la Republica had continued to rise almost as fast; net credit to the public sector by the Banco de la Republica had risen considerably faster in 1984 than in 1983. At a time of 18 percent inflation, salaries in the Central Administration had been increased by 22 percent. Although the authorities had accelerated the depreciation of the peso, as late as April 1985 it had still been 15 percent above the rate that they regarded as adequate.

In the second half of 1984, Mr. Polak observed, the authorities had taken steps toward a comprehensive stabilization program, including major fiscal measures affecting both revenue and expenditure, with strong wage policies for the public sector and a much tighter credit policy. Moreover, the decision to start reducing trade and payments restrictions could be seen as a vote of confidence by the authorities in the effectiveness of the other measures that they had adopted. Those measures and the ones planned by Colombia should qualify the country for an arrangement with the Fund in the upper credit tranches. Of course, the authorities had not requested such an arrangement, but he agreed with Mr. Kafka that there was no reason why the Fund should be more lenient in appraising Colombia's progress merely because the authorities had not requested access to Fund resources.

Nonetheless, Mr. Polak continued, he had noted three instances of greater leniency toward Colombia than seemed warranted. First, if the authorities had requested an 18-month stand-by arrangement extending to the end of 1986, there would almost certainly have been a provision for a major review in 1986, which would have provided an opportunity for the Board to examine policies not subject to performance criteria. Second, the paper contained practically no indications of the content of the 1986 program. Third, although the exchange rate for the peso was a crucial variable, the plan to achieve a particular real effective rate was not made a performance criterion. Those deviations from the standard stand-by arrangement raised doubts about whether the Fund would have accepted the identical program if Colombia had requested Fund resources for the entire 18-month period. To dispel any such doubts, it was especially important that the 1986 program, to be negotiated later in the current year, be absolutely solid, so that the performance criteria might be broader than those used so far, perhaps including the exchange rate. The program should also be more precise about fiscal performance, contain adequate assurances on realistic pricing of goods and services sold by public sector enterprises, and set forth a clear program for liberalization.

According to paragraph 3 of the proposed arrangement for Fund monitoring of Colombia's economic program, the authorities would be advised by the Managing Director after the end of each quarter whether the performance criteria set forth had been observed, Mr. Polak noted. Did that provision apply to the second quarter of 1985? Would fulfillment of the entire set of performance criteria for end-June 1985 affect the first disbursements to be made by the banks?

On page 1 of EBS/85/149, Supplement 1, the staff had said that quarterly statements on the observance of the performance criteria would serve as the basis for periodic drawdowns under the credit facility, Mr. Polak concluded. On page 15 of EBS/85/149, in contrast, the staff had written that disbursements of new commercial financing, to be made quarterly, were contingent upon Colombia's compliance with the targets of its economic program, which he took to mean the quantitative targets referred to in paragraph 3(a) of the proposed decision rather than the provisions on exchange restrictions, multiple currency practices, and bilateral payments agreements referred to in paragraph 3(b). Had the banks therefore reserved the freedom of action to ignore infringements of the provisions in paragraph 3(b)? To avoid any misunderstandings, it might be advisable for the Fund, in its messages to the Colombian authorities, simply to state without specification that all performance criteria had or had not been fulfilled.

Mr. Clark recalled that the earlier efforts by the Colombian authorities--in 1982/83--to bring the economic situation under control, while a step in the right direction, had fallen short of what was needed; the intensification of adjustment measures was therefore welcome. However, the economy was especially vulnerable to developments beyond the authorities' control, notably in the world coffee market and in the markets for nontraditional products such as oil and coal. Those three commodities

together accounted for about 75 percent of the projected increase in Colombia's exports up to 1990; given the uncertainties involved, the adjustment targets might not be sufficiently ambitious. Moreover, even if the authorities met all their medium-term targets, Colombia's total debt and debt service ratio would decline only marginally by 1990 from the current high levels.

The projected decline in the consolidated public sector deficit depended largely on revenue increases, while both current and capital expenditures would fall only slightly as a percentage of GDP, Mr. Clark observed. To be successful, new revenue measures would require a strengthening of tax administration, and he supported the authorities' request for technical assistance from the Fund in that area. However, he was unclear how far the proposed 8 percent import surcharge was consistent with the authorities' intention to dismantle the complex system of exchange and trade restrictions, particularly as the authorities were also aiming at adjusting the exchange rate. He wondered how long the surcharge was expected to remain in force, and, when it was removed, how the authorities planned to replace the lost revenue.

A significant increase in Colombia's interest payments as a percentage of GDP reinforced the need for the authorities to maintain control over other discretionary areas of expenditure, Mr. Clark suggested. He would be interested in learning how the authorities proposed to carry out their intention of extending the 10.5 percent limit on salary increases in the Central Administration to the rest of the public sector, given the prevalence of collective bargaining and the 20 percent increase in minimum wages in the private sector. On capital expenditures, what proportion was devoted to the development of coal and oil, and what scope therefore existed for making economies in other capital expenditures in the future?

Reductions in the public sector deficit, and lessened reliance on the banking system for financing it, should help to curb the growth of domestic credit, Mr. Clark considered. Monetary restraint would be particularly important in preventing the downward adjustment of the peso from pushing up domestic inflation and triggering a new upsurge in capital flight. A shift in the net balance of short-term capital transactions was projected to contribute one third--and the capital account as a whole two thirds--of the overall improvement in the balance of payments in 1985.

World coffee prices were assumed to rise by an average of 8.5 percent a year over the medium term; however, the actual figures for the first quarter of 1985 showed that they had remained unchanged from 1984, Mr. Clark noted. In addition, oil prices were weakening, and great uncertainty existed about the future course of international interest rates. It therefore did not seem implausible to envisage financing gaps for Colombia of some 2 percent of GDP a year, as was suggested in the less optimistic of the scenarios in the paper, a possibility that made it even more important for the authorities to encourage an expansion of nontraditional exports. He hoped that, while adjusting the exchange rate to achieve adequate competitiveness by the end of 1985, the authorities would substantially reduce the present battery of exchange and trade restrictions.

Concerning the arrangement to monitor Colombia's economic program, the case of Colombia was exceptional and should not be considered a precedent, Mr. Clark remarked. Beyond that, as the release of Fund documents was to be an integral part of the arrangement, the Fund should reach an explicit, precise decision indicating which banks were going to receive the documents and what information would be contained therein. Otherwise, the Board might encourage an unhelpful vagueness about who should have access to Fund documents more generally. Were copies of Article IV consultation reports going to be sent to all banks in the lending syndicate or only to members of the consultative committee? Finally, could the staff explain exactly what the Fund's commitments would be in the event that the present arrangements for enhanced surveillance broke down?

Mr. Fujino commented that economic imbalances in Colombia, although perhaps initially induced by external factors, had been aggravated by inappropriate domestic policies during the early 1980s. An ambitious development plan coupled with the authorities' desire to counter the recession had led to unsustainable growth in fiscal expenditures: the resulting fiscal deficit had brought about an expansion of credit; the current account had plunged into substantial deficit; and capital flight had ensued. Adjustment policies introduced since 1983 had not been strong enough to reverse those trends, although economic activity had rebounded slightly in 1984. For Colombia's great potential over the medium term to be realized, it was essential that no further imbalances be created. Strict adherence to the present program would be particularly important, as any slippage would critically impair the confidence of the international community.

Although lower than the increase in 1984 and lower than the projected inflation rate in 1985, the 10.5 percent salary increase for employees of the Central Administration was still on the high side, Mr. Fujino considered. Also worrying was the 20 percent increase in minimum wages approved by Congress for 1985. Although much lower than in neighboring countries, the inflation rate was still high by international standards and could accelerate further if the exchange rate depreciated, as envisaged under the program. Wage and salary restraint had to be reinforced, at least in 1986.

Under the program, current revenue of the public sector was expected to increase by 2.3 percent of GDP, Mr. Fujino said. Although such an increase might not be inconceivable, given the tax reforms introduced in recent years, capital expenditure projected for 1985 remained high, only 0.1 percent of GDP lower than the peak reached in 1984, an unusual feature for a country eligible to draw in the upper credit tranches. If revenue fell short of the target, there would still be ample room for an expenditure reduction, even though a cut in current expenditure would be preferable to one in capital expenditure. He urged the authorities to adhere to the fiscal target, the foundation of the program.

He endorsed the credit restraint envisaged under the program and urged the authorities to continue to provide adequate interest rate incentives for the growth of domestic savings, Mr. Fujino observed. Furthermore, the proposed strengthening of the financial position of local commercial banks must not entail unwanted monetary expansion.

Colombia's export potential was going to be enhanced as the new coal mines and oil fields began production, Mr. Fujino noted. However, the country's vulnerability to developments in world prices for coffee, coal, and petroleum, as well as to changes in international interest rates, underscored the need for cautious economic management over the medium term.

He appreciated the World Bank's active participation in development projects, which had been highly successful in Colombia, Mr. Fujino continued. In the current year, the Bank would be providing loans for export diversification and trade, which, together with other measures in the program, would be instrumental in accelerating the removal of exchange and trade restrictions. In view of the important role played by the World Bank in Colombia, collaboration between the Fund and the Bank was particularly appropriate and should be strengthened.

The most desirable course would have been to conclude a standard stand-by arrangement, Mr. Fujino went on. In the face of the strong wish of the authorities to avoid any sort of stand-by arrangement, however, the second-best solution might have been to conclude an arrangement similar to that of enhanced surveillance. Moreover, judgments by the Board about whether a program would have qualified for use of the upper credit tranche or whether any deviations that occurred were minor or self-reversing, thus justifying a waiver under a stand-by arrangement, would expand the responsibility of the Board beyond that normally taken under enhanced surveillance.

Although the case of Colombia was exceptional, he was still concerned that it might create a precedent that commercial banks would cite in similar future cases and that the Fund would become increasingly involved in debtor-creditor relationships, Mr. Fujino concluded. On that point, he supported the suggestions made by Mr. de Maulde. In view of the importance of supporting Colombia's adjustment efforts and securing the necessary financing from creditor banks, he would reluctantly go along with the proposed decision to monitor the economic program.

Mr. Zecchini recalled that in 1984 the Colombian authorities had adopted some corrective measures, which, however, had lacked the necessary vigor. Although economic activity had picked up moderately after three years of slow growth, the economy had continued to register high inflation as well as large imbalances in the external current account and the public budget. It was commendable that the authorities intended to carry out a comprehensive economic program that should put the country in a more viable financial position in the medium term. They should pursue without hesitation their stated aims in the fields of public finance, fixed investment, external competitiveness, and liberalization of the trade and exchange system.

One of the authorities' principal objectives was to reduce the fiscal deficit, Mr. Zecchini noted. They had concentrated their efforts on the revenue side, while planning to reduce current and capital expenditures only marginally. However, as there might be some uncertainty about the increase in fiscal revenue, owing to the possibility of greater tax evasion following the tax increases, the Government should stand ready to take additional corrective measures affecting both revenue and expenditure in order to keep the deficit within its programmed limits. On the revenue side, measures such as the 8 percent surcharge on the value of imports, introduced in December 1984, were normally regarded as inconsistent with a Fund program, as they tended to change the nature of imbalances in the economy instead of suppressing them. The new surcharge helped to increase revenue while inducing new distortions in the system of relative prices both within the Colombian economy and in relation to other economies. Furthermore, a stronger effort was still called for to check the expansion of current expenditure so as to improve the functional structure of overall expenditure.

The question of the degree of monetary stringency that was inherent in the program and its coherence with the ultimate goals of economic policy could be examined from two distinct but complementary perspectives, namely, the reduction of inflation and the enhancement of external competitiveness, Mr. Zecchini continued. Under the first view, if the present real level of interest rates--18 percent--was taken as an indicator of monetary restrictiveness, monetary policy would appear to be stringent enough. Yet, the answer would be rather uncertain if the growth of domestic credit to the private sector was considered: it was expected to grow by 22.6 percent, in line with the projected growth of nominal GDP, and liabilities of the financial system to the private sector were expected to grow at the same rate. It was difficult to reconcile the relatively high real cost of credit and its projected rise with the expected increase in the demand for credit. He assumed that no subsidies were employed to reduce the actual cost of credit. Thus, he would infer a relatively low responsiveness of private credit demand to the level of and expected increase in real interest rates. Other things being equal, such a view would be justified if the private sector were convinced that it could easily transfer those financial costs as well as increases in them into output prices, implying in turn that monetary policy appeared relatively accommodating, and that the inflation rate seemed unlikely to decelerate. Indeed, increases in both the GDP deflator and the consumer price index were projected to accelerate during 1985. In brief, he doubted whether monetary policy was sufficiently restrictive to achieve a significant slowdown in the 1985 inflation rate, which was needed but not envisaged in the program.

Fiscal and wage policies would have to take up the burden created by an insufficiently restrictive monetary policy, Mr. Zecchini remarked. Given the limits and the lags involved in the budget process, incomes policy had to play a larger role. However, he was disappointed to see that wage policy had the same degree of gradualism as monetary policy, with minimum wages--presumably a leading factor in overall wage changes--rising at a rate equal to that of inflation.

As for the interaction between monetary policy and external competitiveness, for three years the Colombian authorities had been struggling with the perverse effects of a spiral of continuous peso depreciations that had led to additional cost-price increases, leading in turn to further depreciations, Mr. Zecchini observed. The authorities appeared to have only a limited capacity to lower the real effective exchange rate on a long-lasting basis to levels consistent with a restoration of Colombia's external competitiveness, partly because of the accommodating stance of monetary policy for several years. If the authorities were to stop the spiral and improve external competitiveness permanently, they would have to exert much tighter controls on the expansion of credit and monetary aggregates. In other words, depreciations of the nominal exchange rate for the peso should not be an easy substitute for firm monetary management: rather, the latter should complement the former. That approach could lead to higher real interest rates and larger inflows of capital, or at least a halt to capital outflows. It would be important for the authorities to prevent capital movements induced by higher real interest rates from leading to changes in the nominal exchange rate that were inconsistent with the desired depreciation of the real exchange rate.

Greater monetary stringency to control domestic demand could also be advocated if the opening of the internal market to external competition were carried out before improvements in the competitiveness of the Colombian economy had been achieved, Mr. Zecchini said. Despite recent liberalization measures, Colombia's trade and exchange system remained restrictive, and the authorities would have to make considerable progress in the immediate future to comply with the requirements for the Fund's moral support of the program. More generally, there was a need for control over domestic absorption to be firmer than envisaged in the program if the authorities were to achieve the balance of payments targets for the medium term. The programmed improvement in the external account was contingent on a strong performance in the trade balance, particularly in exports of a few primary products; the central scenario was based on increases in both the relative price of coffee and the volume of oil and coal exports. However, such increases appeared optimistic compared with the negative trends that had characterized those markets for the past three years. Therefore, the authorities should draw up contingency adjustment measures should their optimistic assumptions fail to materialize.

The systemic implications of the program would be better analyzed at a later date, Mr. Zecchini remarked. Pending the results of that discussion, he regarded the case of Colombia more as an isolated experiment that as a precedent. Two questions were pertinent. Would Colombia have qualified for the use of Fund resources under the proposed program? Should the Fund establish such a direct relationship with the banking community as it would under a normal stand-by arrangement? He would answer the first question affirmatively, although, in their letter dated May 27, 1985, the authorities had not included a formal pledge to implement the program fully. Furthermore, there were neither clear indications about the economic policies to be followed in 1986--which in a stand-by arrangement would have already been spelled out--nor firm commitments on

the continuity of the adjustment effort in subsequent years until Colombia's external debt position had improved. Moreover, the text of the proposed decision should include an explicit desclaimer by the Fund of any responsibility to the commerical banks.

As to the second question, the problem with the direct relationship between the Fund and the banks hinged upon a much broader problem of the degree of substitutability that the Fund wished to establish between the stand-by arrangement under consideration and the standard arrangement for use of Fund resources, Mr. Zecchini said. The Fund should not aim at a perfect substitutability between the two types of arrangements. Therefore, the Fund should refrain from sending to the banks the letter in Annex I of EBS/85/149, Supplement 1. Moreover, as the Fund was to perform, and ought to perform, only the function of a monitoring agency, it should not be involved in negotiations for assembling the critical financial mass nor ask the banks directly for written confirmation on that point. It was the responsibility of the Colombian authorities to secure the necessary external financing and give assurance on that point to the Fund.

Finally, the issue of how much information the Fund should provide indirectly to the banks had implications for the confidentiality that should surround Fund work as well as for some areas of uncertainty in the Fund's assessment, Mr. Zecchini concluded. Instead of allowing transmittal of the entire staff report, the Board should decide that Colombia could transmit an abridged version of the report, prepared by the Fund and including a description of the main statistical data and policies as well as the Fund's appraisal, which should reflect not only the staff assessment but also the substance of the conclusions reached at the present discussion. Transmittal of that document would be at the discretion of Colombia, which would act according to its agreements with the banks.

Mr. de Groote explained that he could go along with the proposed decision for the Article IV consultation with Colombia but had difficulty in concurring with the proposed monitoring arrangement because of the problems that it raised for the Fund's jurisdiction and procedures. Executive Directors were being asked to deal with the application of a new policy before having agreed to it in principle. It was difficult to determine whether the proposed decision should be regarded as a precedent; he did not see why the Board should reject other cases with similar characteristics, once good reasons had been found for accepting the present case. Was it even legally possible for the Board to accept that the decision could not become a precedent for similar cases in the future? He doubted the legality and wisdom of a decision whereby the Board would renounce the possibility of taking a similar decision in similar circumstances. Indeed, exceptions to the law changed the law and became the law.

At first sight, the inauguration of suitable policies, entirely supported by the financial resources of commercial banks, might appear to be an attractive alternative to a Fund-supported program in Colombia, Mr. de Groote continued. However, the financial support granted by the Fund in the context of adjustment programs would have served to assist

Colombia in coping with the often painful effects of measures to be adopted in the early stage of the adjustment program, on the basis of an official opinion by the Fund on the program's validity. Such an opinion was an expression of the Fund's jurisdictional power in matters related to balance of payments adjustment and underlying policies. Therefore, the magnitude and the phasing out of the financial support provided by the Fund would have taken into account the strength and burden of Colombia's adjustment efforts. Even if the resources provided by the Fund were modest in comparison with the financial flows from comercial banks, they had a normative and therefore unique role to play that could not be replaced by other sources.

He tended to agree with the staff that enhanced surveillance should be limited to situations in which it assisted the member in restoring normal access to foreign borrowing, Mr. de Groote said. Enhanced surveillance and related procedures should be considered only in order to help member countries that already had a strong record of adjustment while still having to restore their external creditworthiness.

The arrangement worked out for Colombia went in the opposite direction and appeared to serve the country's interest no better than a stand-by arrangement would have done, Mr. de Groote observed. In fact, it could be a first step toward a further deterioration in the country's relationship with foreign creditors and, accordingly, toward greater Fund involvement in the country's economic problems if the optimistic prospects under the present program were not fully realized, for reasons that might be beyond the authorities' control. Unlike regular Fund programs, the proposed arrangement contained no provision for the modification of performance criteria according to changes in economic circumstances. Thus, the Colombian authorities would have to monitor economic developments closely and try to anticipate a possible deterioration in the external environment in order to stay in line with the program's criteria.

Indeed, Mr. de Groote remarked, he wondered whether it might have been possible to conclude an arrangement in the upper credit tranches with Colombia, with the understanding that the country would make a commitment not to draw on its Fund resources unless unforeseen circumstances emerged, in which event the Fund would have had to concur with the requested drawing. Such an arrangement could have been renewed for a number of years. It would have better preserved the jurisdictional powers of the Fund, while allowing greater flexibility in the adjustment of performance according to circumstances. It would also have better protected Colombia's own interest. Undoubtedly, commercial banks would have geared their own conditionality to the timing and targets of the program supported by the Fund, permitting, in Colombia's interest, a closer consideration of changes caused in part outside the authorities' sphere of action. He would surmise that Colombia would be caught by the inflexibility of the arrangements with the banks, because it would have erroneously judged the alleged rigor of an arrangement with the Fund.

As the primary concern of Executive Directors should be to assist Colombia to restore normal relations soon with foreign creditors, and as those relations would be harmed if the Fund did not accept the proposed monitoring arrangement, Mr. de Groote went on, Directors should give the authorities guidance on policy implementation. Colombia's recent progress in restoring a sound balance of payments position was impressive: in 1985, the trade balance was projected to show a small surplus; in three years' time, the current account deficit could be cut in half. Nonetheless, Colombia's debt situation would remain worrisome for the medium term, as the debt service ratio was expected to peak in 1985 at 46 percent and to decline only to 41 percent by 1990. Those figures were substantially higher than the ones for most countries that had recently faced debt service problems. Moreover, Colombia's external situation would remain extremely sensitive to factors beyond the authorities' control. Should price developments for Colombia's three major export products-coffee, coal, and petroleum--or the course of international interest rates turn out to be slightly less favorable than projected, the country might well come under heavy financial strain in the near future.

Given those risks and the absence of flexibility in the authorities' arrangement with the commercial banks, they should fully implement the policies of the present economic program in a timely manner, Mr. de Groote suggested. The authorities had already elaborated a comprehensive package of financial and monetary policies along with the continuation of a realistic exchange rate policy, but they should expedite the removal of trade and exchange restrictions, which remained excessive, even after the relaxation announced earlier in the year. Furthermore, the present exchange rate policy would be economically effective only as long as the needed allocation of domestic resources for competitive sectors was assured. A promising opportunity for achieving liberalization in a favorable climate was offered by the trade policy and export diversification loan from the World Bank programmed for later in the year and, in general, by the World Bank's intensive involvement in the country's industrial rehabilitation.

He approved of the authorities' intention not to interfere with market forces in interest rate determination and to reduce credit expansion, especially in the public sector, Mr. de Groote stated. The authorities would have to implement both policies to contain inflation and to promote efficient allocation of credit as well as an increase in financial savings. However, as inflation had peaked again in 1984 at 18 percent, the authorities might do well to envisage a policy of wage moderation for all workers, as the present wage policy covered only salaries in the public sector. Furthermore, the need for sound monetary and financial policies was evident, not only to further domestic savings but also to reduce the pace of private capital outflows. The paper on recent economic developments showed that short-term capital, including errors and omissions, had registered a net outflow of nearly US$900 million in 1984, following a net outflow of nearly US$500 million in 1983. Positive real interest rates and better economic prospects might help to reverse the trend, which had to be reversed anyway, but only if the domestic banking system were rehabilitated and confidence restored in the

Government's policies. Were the authorities' plans to exempt commercial banks from constituting provisions for bad loans in certain circumstances likely to lead to a sounder financial system?

In conclusion, Mr. de Groote explained, he could agree to the proposed decision on the monitoring arrangement only if a sufficient majority of Executive Directors emerged in its favor. The case had been overdramatized; the Board should take decisions of principle before its future actions became constrained by precedents. Furthermore, the banking community did not demonstrate equality of treatment toward all member countries of the Fund. Although Colombia was reluctant to accept an arrangement with the Fund and would be substantially aided by the banks, other countries in other areas--some with much lower per capita incomes--were performing satisfactorily under Fund programs and still had to reimburse large net amounts of their indebtedness toward commercial banks, so that they had to endure massive net outflows of banking funds. Perhaps the time had come to consider reschedulings and a restoration of bank credits for countries that performed well under Fund programs elsewhere.

Mr. Nimatallah observed that the case of Colombia was unique: first, the authorities were still at an early stage of tackling their balance of payments problems; and second, the Fund was being asked to approve and monitor an economic program without providing any of its own resources, a request that raised several important policy issues. He was prepared to go along with the proposed decision on the understanding that Colombia was a special case and that the present Board decision would not prejudice any general guidelines to be arrived at later.

The amount being borrowed by Colombia from commercial banks in 1985 was intended mainly for investment rather than for balance of payments financing, Mr. Nimatallah noted. Might it have been appropriate for the World Bank to involve itself more closely in monitoring Colombia's economic program? In addition the staff should provide more details on the proposed use of commercial bank funds.

Colombia needed to pursue strong adjustment efforts to correct the economy's deteriorating performance, Mr. Nimatallah concluded. Of particular importance were measures aimed at reducing the public sector deficit, restraining wage increases, and controlling the expansion of domestic credit. It was vital that Colombia act swiftly to enhance domestic savings and reverse capital flight; firm policies geared toward those objectives should make it possible to establish a sustainable external position during the next few years. On balance, it was appropriate for the Fund to monitor the authorities' adjustment efforts. He could support the decision, either as it stood or as amended by Mr. de Maulde.

Mr. Alhaimus said that he shared many of the concerns expressed by previous speakers on the arrangement to monitor Colombia's economic performance, but he could go along with the proposed decision. The

Colombian case was an exceptional one and could be approved on that understanding. The text of the draft decision on monitoring could also be improved along the lines suggested by Mr. de Maulde, especially with respect to the procedure for waivers.

Mr. Dallara recalled that at the discussion for the 1984 Article IV consultation with Colombia (EBM/84/148, 10/10/84) his chair had expressed concern about the gradual slippage in the country's adjustment effort and about the danger that it posed to Colombia's economic prospects and creditworthiness. The authorities' subsequent request for an early Article IV discussion and a special arrangement for monitoring the reinforced adjustment program for 1985-86 demonstrated their resolve to correct and reverse the slippage, and he welcomed those developments.

The chief policy aims in the 1984 program were broadly appropriate, involving a decline in the public sector deficit, a tightening of monetary policy through a deceleration in net domestic credit expansion, and the re-establishment of the real effective exchange rate for the peso that had prevailed in 1975, Mr. Dallara noted. The principal macroeconomic results of those policies would include the near-elimination of the overall balance of payments deficit and a significant cut in the ratio of the current account deficit to GDP. However, real growth would fall slightly, and inflation was expected to accelerate. Although the 1985 program represented an enhanced adjustment effort, he agreed with Mr. Polak that a strong continued effort, perhaps a reinforced one, would be needed through 1986 and probably beyond if Colombia were to achieve a more acceptable rate of real growth, bring down the rising unemployment rate, reverse the recent upward-creep in inflation, strengthen the balance of payments outlook, and cope with a still very large debt burden.

Colombia's external accounts had been weak for several years, Mr. Dallara observed. Current account deficits equal to 6-10 percent of GDP in each of the past four years, stagnation or decline in both coffee and noncoffee exports, and outflows of private capital approaching US$500 million in 1983 and US$900 million in 1984 had all been symptoms of serious underlying problems. Along with overexpansionary fiscal and monetary policies, the slow but steady real effective appreciation of the peso from 1987 to mid-1982 had been a major cause of balance of payments weakness, so that the reversal of the overvaluation that had already taken place and the planned achievement of the 1975 rate by the end of 1985 should contribute to creating incentives for a stronger external balance. A current account deficit of 4.8 percent of GDP in 1985 would represent a significant reduction from the previous year, but the ratio would still be rather high. By 1990, Colombia's debt service ratio would still be about 41 percent, even under the staff's medium-term scenario suggesting that a more sustainable current account deficit should be possible in coming years and that the overall balance could record a surplus in 1990, provided that appropriate incentives were maintained from capital flows.

Colombia's external position had been characterized by a wide array of trade and payments restrictions, which had proliferated in 1982-83, Mr. Dallara recalled. Until those restrictions were substantially dismantled, the authorities could not claim to have achieved a sustainable balance of payments position. He therefore welcomed the planned liberalization of import and exchange restrictions and the reduction in artificial export incentives.

The public sector deficit was to be reduced, as it had had an expansionary effect on domestic demand and probably some adverse effect on resource allocation, Mr. Dallara continued. From 1980 to 1984, the public sector had grown steadily, as had public investment relative to private investment. Thus, the ratio of total revenue to GDP had risen by more than 4 percentage points, while the expenditure ratio had risen by nearly 9 percentage points. By far the most important sources of the increase in the expenditure ratio between 1980 and 1984 had been capital expenditures and public wages and salaries. Why had public investment increased so much, and what was the outlook over the medium term?

That expansion of the public wage bill reflected a more general rise in nominal and real wages in Colombia, Mr. Dallara noted. Indeed, there had been an accelerating increase in real wages for production workers in manufacturing as well as a rapid rise in unit labor costs, developments that might help to explain the continued high rate of inflation and the steady decline in the private investment ratio since 1981. Why had the inflation rate risen in 1984, and why was it expected to rise further in 1985?

In the current year, the public sector deficit ratio was to be reduced by 2.7 percentage points to 4.9 percent of GDP, Mr. Dallara remarked; revenue increases would account for 2 percentage points of the reduction. The recent revenue measures raised questions about their effect on the simplicity of the tax system, their dependability and their effects on resource allocation and incentives for savings and investment. The draft laws already submitted and those about to be submitted to Congress for better control of public sector expenditure were welcome, as was the assistance provided by the World Bank in assessing public investment. He hoped that the 1986 adjustment program would put additional emphasis on expenditure control.

The authorities could facilitate a reversal of the excessive expansion in money and credit in recent years by reducing the public sector deficit and financing it from domestic banking sources, Mr. Dallara recommended. Net domestic credit expansion averaging 29-40 percent a year during the past five years had fueled and accommodated inflation. In 1985, the authorities would be slowing the rate of expansion of credit to the public sector to about 3 percent, while extending credit to the private sector in line with nominal income and growth; but he wondered

about the extent to which credit policy might still tend to accommodate rather than restrain inflationary pressures. On the other hand, interest rates on financial savings--at least on 90-day certificates of deposit--had become significantly positive in real terms in recent years. The authorities should vigorously respect the interest rate commitments in the new program if an adequate personal savings rate were to be maintained and large capital outflows avoided.

For cases such as that of Colombia, when the Board was asked to make a judgment about an arrangement that had no precise precedent, Mr. Dallara said, the Fund ought to develop new techniques only with considerable caution and with awareness of potential risks and benefits. Appropriately, the Fund had never been called an excessively innovative institution, but it had devoted great care and caution to examining the Colombian economy, and the benefits outnumbered the risks. Some of those risks were real, such as the difficulty in restoring autonomous flows without any provision for the transmittal of on-off lending signals, but it was perplexing that the authors of another staff paper (EBS/85/173, 7/23/85) believed that the course chosen was not the most suitable one. Under the circumstances, it was appropriate for the Fund to accept and perform the proposed monitoring role.

Mr. Goos remarked that, as the Colombian economy had deteriorated to an extent requiring a major adjustment effort--a deterioration caused mainly by expansionary fiscal and monetary policies--the authorities were correctly attempting to narrow the public sector deficit and tighten the stance of monetary policy while pursuing appropriate exchange rate policies. The projected improvements in the fiscal balance and balance of payments position appeared impressive, but he had some doubts about the adequacy and sufficiency of the program. For example, the adjustment effort was highly--if not unduly--concentrated on measures to raise public sector revenue, while public expenditure was to continue to grow in real terms. As Mr. Zecchini had noted, monetary policy was rather accommodative, with domestic credit expanding at the rate of nominal GDP. Thus, although the projected evolution of public expenditure and domestic credit would constitute a welcome slowdown in the strongly expansionary stance of previous years, there were at least three reasons why a more determined adjustment effort would be more suitable to the country's difficult external position and the program's balance of payments objectives. First, previous efforts to reduce the public sector deficit had failed because of large expenditure overruns. Second, several critical budgetary assumptions were apparently subject to uncertainty; the major objective of restraining pay in the public sector could be assured only in the Central Administration, as the authorities had no direct control over wages paid by local public entities and public enterprises. Furthermore, tax evasion seemed likely to become more widespread in response to tax increases, and a general weakness of expenditure control in the public sector had prompted the authorities to ask Congress for extraordinary remedial powers.

Third, and perhaps most important, the projected reduction in Colombia's overall balance of payments deficit would be due mainly to a strong improvement in the capital account, including a pronounced turnaround in capital flows of the nonfinancial private sector, Mr. Goos noted. That turnaround was based on the assumption, which was subject to considerable uncertainty, that investors' confidence would strengthen. Similarly, the forecast for the current account of the balance of payments seemed to be influenced considerably by a continuation of the complex, restrictive exchange and trade regulations. Accordingly, the underlying improvement in the current account might turn out to be less favorable than the figures presented by the staff might suggest. Despite support from the World Bank for trade liberalization, an early elimination of restrictions was not yet in sight. Given the program's balance of payments target, liberalization could be attained only if the adjustment effort were strengthened.

On balance, he would have preferred a somewhat more restrictive, comprehensive course of financial policy in order to provide against the various factors of uncertainty, including those revealed in the medium-term scenario, Mr. Goos said. Apart from creating room for unexpected slippages in program targets and for more decisive liberalization of the trade and exchange system, a more restrictive policy stance was also justifiable in view of the country's high debt service ratio, projected to decline by only 5 percentage points by 1990 to the still high figure of 41 percent. In any event, it would be of the utmost importance for the authorities' and the Fund's credibility to adhere strictly to the staff's recommendation that they try to achieve the revenue target for 1985 and intensify their efforts to improve control over public sector operations. He was encouraged by the authorities' commitment to adjustment, as demonstrated by many steps already taken and by the plans announced for the future, especially in expenditure control. He also welcomed the authorities' approach to interest rate and exchange rate policy.

His authorities were disappointed that the text of the arrangement presented to the Board took into account none of their concerns and requests for changes that he had expressed previously, Mr. Goos continued. Those concerns included the following main points. First, he continued to feel that Colombia was not an appropriate candidate for an enhanced monitoring arrangement; instead, it could be a candidate for a regular Fund arrangement either of a precautionary nature or involving the use of Fund resources. Second, arrangements along the lines of the one proposed for Colombia would lead the Fund in the wrong direction by creating the risk that the Fund would assume political and moral responsibilities vis-à-vis the commercial banks, with potentially serious repercussions for the Fund's ability to provide effective support to its member countries. He was particularly concerned that the arrangement provided for clear on-off lending signals to commercial banks, whereas his authorities strongly felt that the Fund should not assume the role of the banks' agent for assessing the creditworthiness of borrowing countries. Indeed, that view appeared to be consistent with the one expressed by the Chairman

in his report to the Interim Committee in April 1985, where it was stated that enhanced surveillance arrangements would not provide on-off signals to banks about the appropriateness of continuing restructuring or additional lending. Third, he would have preferred to have a general discussion on the appropriateness and the principles of enhanced surveillance arrangements before the presentation of specific and already negotiated arrangements to the Board by management, in order not to prejudge the Board's decisions.

His criticism of the proposed arrangement was not directed against Colombia, Mr. Goos emphasized. It was meant to relate exclusively to procedural aspects of a surveillance arrangement that raised basic issues of Fund policy.

Unfortunately, withholding support from the proposed monitoring arrangement might jeopardize the financing package for Colombia arranged by commercial banks, Mr. Goos noted. However, provided that the financing package would not collapse, he could support Mr. de Maulde's suggestions for amending the proposed text on the monitoring arrangement, particularly the deletion of paragraph 4. He was also attracted to Mr. Zecchini's suggestion to disclaim explicitly any responsibility of the Fund to the banks. Those suggestions would go a long way toward meeting his authorities' concerns. Moreover, as a clear second preference only, he could support the proposed decision as it stood, with the firm understanding that the arrangement should be regarded as an exceptional case that must not create a precedent for similar arrangements.

Mr. Wang expressed broad agreement with the staff appraisal and support for the proposed decision. In principle, he could endorse the proposed decision on the monitoring arrangement for Colombia, on the understanding that it was an exception and would not constitute a precedent.

Mr. Kabbaj considered that the economic adjustment program being pursued by the Colombian authorities was a comprehensive, all-out attempt to correct some of the economic slippages that had emerged during the past three years as a result of the adverse exogenous environment that has affected developing countries generally. To reduce the public sector deficit, the authorities had already undertaken revenue-boosting measures and would continue to do so, besides making further attempts to strengthen tax administration. As part of the valiant effort to achieve overall equilibrium in the balance of payments during the current year, they hoped that a continuation of the flexible exchange rate policy would fully restore external competitiveness by end-1985. In addition, they were implementing restrictive monetary and credit policies that were expected to exert downward pressure on inflation; they would pursue a flexible interest rate policy based on market mechanisms.

However, Colombia's external debt situation did not appear promising, Mr. Kabbaj remarked. The debt service ratio had doubled during the past five years and was expected to increase again in 1985, along with total external debt. Although the country's overall debt was not yet a cause

for concern, there was a need for its continued close monitoring and for further actions should the need arise. The present package did not involve rescheduling; indeed, despite the recent deterioration in the balance of payments, Colombia had been able to continue servicing its debt without any rescheduling.

In view of the deteriorating debt profile, exclusive reliance on market-related funds might impose further pressure on Colombia's debt service burden, Mr. Kabbaj continued. Nevertheless, the end-1985 limit of US$10,755 million on outstanding external debt of the public sector indicated a rapid quickening of the pace of commercial debt accumulation. Notwithstanding the optimism expressed by the staff on the capacity of the economy to withstand a further deepening of its commercially contracted debt portfolio, the Colombian case should not lead to a trend toward commercialization of the adjusment process based on cashless Fund-supported adjustment. The proposed arrangement should be the exception rather than the rule, to be viewed in an ad hoc framework only. It should not therefore be regarded as setting a precedent. Furthermore, an important ingredient in Fund-supported adjustment had always been the inclusion of Fund-related financial resources on relatively concessional terms that remained at the disposal of the requesting member country throughout the life of the arrangement.

Mr. Jayawardena regarded the proposed adjustment program as appropriate and supported the proposed decision. The proposal for the Fund to monitor Colombia's economic performance should be helpful to the country, although it should set no precedent. Finally, he wondered whether there was a way in which the Fund could convince the bankers of the importance, for the orderly functioning of the Fund, in adhering to time schedules for the provision of resources to a country.

Mr. Orleans-Lindsay observed that, despite the implementation of some adjustment measures, the Colombian economy had continued to experience large internal and external financial imbalances and rising unemployment in 1984. Although a number of factors beyond the authorities' control control had contributed to the emergence and persistence of those imbalances, their countercyclical expansionary demand policies in recent years had played an important role.

Although the emphasis being placed on reductions in the overall public sector deficit was appropriate, Mr. Orleans-Lindsay said, the targeted reduction might have been better achieved through a more balanced policy mix involving revenue-raising measures and stronger expenditure-reducing measures. As it was, public sector revenue was expected to rise by 38 percent in 1985 following a 29 percent increase in the previous year, while total expenditure was expected to grow by 22 percent, 2 percentage points higher than the inflation rate assumed for 1985. Could the authorities realize such a revenue increase in one fiscal year? As the staff had said, for the projection to materialize, the authorities would have to implement all the announced measures and also strengthen tax administration to minimize evasion. As budget expenditure had been

increasing rapidly, he would have felt more comfortable if the program had included measures to rein in expenditures, and preferably to reduce them.

The authorities had made substantial progress in reaching the desired real effective exchange rate for the peso and in restoring external competitiveness, Mr. Orleans-Lindsay noted. If maintained, that achievement should make possible both the targeted reduction of the external current account deficit and the re-establishment of external competitiveness at the 1975 level. Furthermore, the authorities had been gradually liberalizing the complex exchange system; in particular, they had shifted more than 300 import items from the prohibited list to the import permit category and had eliminated the permit requirement for 500 import items. However, they needed to do more. He was uncertain whether the progressive trade liberalization was being carried out under a realistic medium-term plan. At any rate, the authorities intended to liberalize the exchange system further in the context of the trade policy and export diversification loan from the World Bank.

As a general principle, the Fund should stand ready to provide its member countries with appropriate assistance when requested, always bearing in mind the principle of uniformity of treatment, Mr. Orleans-Lindsay concluded. However, he would have preferred for the Board to examine the case of Colombia after establishing general guidelines on the role of the Fund in assisting member countries.

The staff representative from the Western Hemisphere Department explained that, as a result of the 1984 Article IV consultation, the Colombian authorities had come to realize the need to address the problems faced by their country. The objective of the staff mission to Bogotá had thus been to evaluate the program the authorities had been elaborating. Only after that mission had the Fund begun to consider supporting the program, so that it had not been envisaged initially that the Fund was going to be extending its exercise of surveillance into 1986. It was, however, clear that the authorities intended to continue their adjustment efforts into that year. If the Board approved the proposed monitoring arrangement, the staff would conduct a review in the fourth quarter of 1985, at which time it would discuss with the authorities their policies for 1986. The staff also intended to conduct a review in 1986. Another staff mission would take place in mid-April or May of that year, at which time the forthcoming consultation would be discussed together with a review of performance under the 1986 program.

With the exception of external debt, the staff already had information on most of the performance criteria for June 1985, the staff representative continued; the authorities had complied not only with the reserve targets but also with the ceilings on total credit by the Banco de la Republica and on credit to the public sector. Moreover, the term sheet of the banks clearly indicated that the first disbursement of the new loan was conditional upon Fund endorsement of the authorities' program and Fund certification that Colombia had met performance criteria for end-June 1985.

Perhaps a little more adjustment would have been better, the staff representative acknowledged, but the degree of adjustment envisaged for 1985 would be sufficient to achieve the objective of practically eliminating the balance of payments deficit. The authorities might have to reinforce their adjustment efforts in 1986. Specifically, the staff would have preferred more action on the expenditure side, but there were some rigidities in slowing the growth of transfer payments, the bulk of which related to salaries. Moreover, interest payments could not be reduced and would indeed be growing faster in the future because of the impact of exchange rate changes. If interest payments were excluded, current expenditures were programmed to decline by about 1 percentage point of GDP.

The composition of investment in Colombia had been changing in recent years, with increased emphasis on productive projects like coal and petroleum undertaken by the Government in association with private firms, the staff representative observed. The World Bank staff agreed with both the level and the composition of the 1985 investment program: excluding investments in coal and petroleum to be made by CARBOCOL and ECOPETROL--two public sector enterprises--public sector investment was to decline as a proportion of GDP by about 0.5 percentage point. Those energy investments would be important in facilitating a strengthening of export growth in the medium term.

In view of the large increase in revenue projected under the program, the staff representative remarked, the authorities should intensify their efforts to ensure that the amount of revenue projected was actually collected. Moreover, the adoption of the import surcharge in late 1984 had reflected the fact that such a measure did not require congressional approval and could therefore be quickly introduced by the executive branch. In the future, the authorities would carry out other measures affecting both revenue and expenditure, their objective being to restructure and rationalize import duties, gradually reducing them in order to promote greater efficiency.

The projected increase in private sector credit served as an indication of the room for maneuver implicit in the program, the staff representative considered. In other words, if the limit on public sector credit were kept, and if domestic financial savings grew roughly at the rate envisaged in the program and in accordance with the reserve targets, there would be scope within the overall balance of payments targets for an expansion of up to 23 percent in credit to the private sector, a rate in line with expected growth in nominal GNP. At the same time, the growth of credit to the public sector was to fall from Col$150 billion in 1984 to Col$45 billion in 1985. Overall, there would be a sharp slowdown in monetary expansion.

The Colombian authorities had considered making a one-step adjustment in the exchange rate but had been deterred by the risk of not being able to hold the line with respect to wage policy, the staff representative recalled. Perhaps a one-step adjustment would have increased confidence

more quickly and helped bring about a reduction in real interest rates, but the authorities had decided to continue with the crawling peg at an accelerated rate. They were committed to gradually dismantling restrictions on imports but might have to consider other options in exchange rate policy if the present scheme did not yield the expected results.

Although the degree of adjustment in the capital account would exceed that in the current account of the balance of payments in 1985, the staff representative remarked, in 1984 the current account deficit had declined by Col$1 billion, reflecting principally direct import restrictions, which the authorities intended to dismantle soon. For 1984 and 1985 combined, the adjustment in the current account could be considered appropriate, as long as it continued in future years. There were obviously uncertainties, particularly regarding private capital movements, but the authorities had felt that the existence of a coordinated, comprehensive program should strengthen confidence in the private sector and reverse private capital outflows. Inflows were expected to increase, but mainly because of higher multilateral and bilateral assistance.

The exposure of foreign commercial banks in Colombia would increase by less than 3 percent in 1985 and by a further 1 percent in 1986, the staff representative explained. The authorities intended to diminish the use of commercial credit, much of which was being used to finance investment projects in coal and oil. To strengthen the position of the financial sector US$100 million, or 10 percent of the total financing package, would go to the Banco de la Republica; most of the remainder would be devoted to development projects, especially coal and oil projects. Colombia's oil reserves had doubled with the discovery of low-sulfur oil in 1984, which would make the country a net exporter. The cost of production ranged between US$3 and US$6 a barrel; a pipeline being built would lower the cost of transportation. Furthermore, an open-pit mine being developed contained coal of high quality that could be produced below the world market price. Both projects seemed likely to be profitable.

For several years, there had appeared to be little correlation between the inflation rate in Colombia and the authorities' monetary and fiscal policies, the staff representative noted. During those years, Colombia had been liberalizing the exchange regime and particularly the trade regime; built-up demand pressures had tended to flow out through the balance of payments, so that there had been a large drawdown of Colombia's foreign reserves. Together with the way in which price controls had been operating, the large drawdown helped to explain why both monetary expansion and fiscal expansion had occurred without triggering much of an upsurge in inflation. In addition, at times it had been cheaper to bring certain products, particularly food, into Colombia from neighboring countries, a practice that might also have kept down the pressures on inflation. In the future, the program envisaged a slight acceleration in the rate of inflation, because the authorities would be depreciating the exchange rate at a much faster pace and also making adjustments in domestic oil prices, electricity and water rates, and

other administered prices. A projected 22 percent inflation rate would be manageable, as the present year would be one of transition. Unfortunately, the current rate of inflation in Colombia was about 27 percent, principally because bad weather early in the year had tended to push up agricultural prices. The price index excluding food suggested that inflation had remained stable. Indeed, during the first three weeks of July 1985, prices of food items had already begun to decline in absolute terms.

Interest rates on term deposits were market determined, and interest rates on other deposit categories were subject to adjustment, the staff representative explained. Interest paid on savings in savings institutions fluctuated according to automatic adjustments based on the rate of inflation. Moreover, only some 10-15 percent of credit to the private sector was subject to interest rates controlled by the Banco de la Republica.

Regarding cooperation with the World Bank, the staff representative recalled that the previous Fund mission to Colombia had coincided with a World Bank mission. The two groups had examined together the foreign trade regime in the context of trade loans and an export diversification loan from the World Bank. Planned reductions in import and export restrictions also formed an intrinsic part of the World Bank loan. The two institutions would continue to coordinate their actions: the monitoring by the World Bank of the authorities' reduction in import restrictions would complement the monitoring done by the Fund. In addition, the World Bank would be monitoring developments in investment. The expectation was that, as the Government completed its investments in coal and petroleum, it might become possible to envisage a gradual decline in the rate of investment. For 1986, the authorities were planning to keep investment constant in dollar terms, so that it would indeed decline in terms of GDP.

At present, the real exchange rate for the peso was estimated to be at about 92 percent of the level sought for the end of 1985, the staff representative observed. So far, the progress achieved was in line with what had been planned in reaching the end-1985 target.

The staff shared the concerns expressed by some Executive Directors about the medium term, the staff representative from the Western Hemisphere Department said. Some projections might be qualified as optimistic, others as conservative; the staff had fully discussed them with the authorities, who had also had projections of their own. Private firms associated with the Government in both petroleum and coal had tended to confirm the authorities' projections: they were expecting a much higher volume of exports in both oil and coal than the staff had projected in the medium-term scenario. In view of uncertainties about the evolution of prices in energy markets, the medium-term scenario did indicate a need for the continued application of discipline, prudence, and sound financial policies.

The staff representative from the World Bank remarked that a number of agreements had been carefully worked out by the authorities, the Fund, and the World Bank, with the intention of liberalizing Colombia's import

and trade regime. In essence, the plan was to promote a basic change from an inward-looking protectionist approach to an outward-looking one, relying increasingly on market discipline to guarantee the competitiveness of exporters and the efficiency of import-substituting industries. Three key areas had been targeted--import prohibitions and quantitative restrictions, export liberalization, and tariff reform--of which the first was the most important. The program emphasized a reduction in the number of imports requiring prior licensing as well as the removal of many items from the prohibited list of imports; imports required by exporters would be moved toward automatic entry, as would those needed for spare parts and maintenance. Specific targets provided that, by the beginning of the first quarter of 1986, about 60 percent of the equivalent of 1985 imports would be on the free list.

Under the program, the disparity in tariffs that discriminated among industries would be reduced, the staff representative continued. Peak tariffs on a wide range of items had been reduced from 200 percent to 80 percent. Further actions would be undertaken to reach the average levels of the tariffs prevailing in the mid-1970s, and eventually go further.

Effective management of the exchange rate would be supported by guaranteeing access for exporters to the required imports, the staff representative noted. A number of export prohibitions that had crept into the Colombian system over the years would be eliminated. Those measures ought to lead to export growth and increasing diversification of Colombia's export base. In fact, preliminary data indicated that exports had begun to respond to the exchange rate adjustment and other policies, as noncoffee export receipts had risen by some 15 percent during January through mid-June 1985 over the previous year. The increase had taken place over a wide range of products sent to many partner countries.

The Colombian authorities had emphasized investment geared to the productive sectors, export-oriented activities, and essential infrastructure, thus postponing or redesigning investments with a longer gestation period, the staff representative from the World Bank concluded. The authorities were favoring the completion of ongoing projects over the inauguration of new ones; rather than add capacity, they wished to increase efficiency and, whenever possible, mobilize resources to expand output as rapidly as production could be reoriented toward exports and efficient import-competing goods. Continued action along those lines would provide the basis for further growth.

The Deputy Director of the Exchange and Trade Relations Department recalled that the staff would have preferred that the Colombian authorities had requested a stand-by arrangement involving access to Fund resources, which could have been accompanied, if necessary, with a statement indicating whether they intended to use those resources. The Fund had an institutional interest in fostering adjustment, however, and the monitoring arrangement being proposed was the result of the search to get as close as possible to the substance of a stand-by arrangement.

Under the procedure being considered, if the program went off track, the authorities would come under pressure to request a standard arrangement from the Fund, but the Fund was under no commitment to Colombia or the country's creditors in that regard, the Deputy Director continued. According to the procedure being proposed, the Fund would be monitoring both quantitative and qualitative criteria, as well as the authorities' undertakings regarding the exchange system. But it would be the commercial banks' decision whether or not to make successive disbursements to Colombia.

With regard to the issue of waivers, the staff wished to ensure that the arrangement would continue to assist Colombia if performance under the program remained on track in substance, the Deputy Director of the Exchange and Trade Relations Department remarked. The staff would suggest that a waiver be granted if any deviation that occurred from the program targets was clearly minor and self-reversing. There was no risk for the Fund in following that procedure; on the contrary, the danger would be to allow a minor deviation to have serious repercussions for the continued implementation of the program.

The Director of the Legal Department observed that the proposed arrangement did not involve a tripartite agreement between the Fund, the banks, and the member country. It was simply a decision by the Fund providing the Colombian authorities with certain assurances that the Fund would review the program and would make certain statements to them periodically. There would be no formal communications from the Fund to the banks, and the Fund would assume no legal commitments or responsibilities toward the banks.

Every decision taken by the Fund represented a precedent in some sense, the Director acknowledged. However, under all systems of law, a precedent applied only to the circumstances of the particular case for which it was decided. In other words, any precedent would exist only in an exceptional case of the same type as that of Colombia.

If there were any differences in wording in the various documents relating to Colombia, the wording of the decision would prevail, the Director of the Legal Department explained. The banks would have some leeway, at least for the quarterly certifications; the quantitative criteria did not relate to exchange restrictions. When again certifying at the beginning of 1986 that the program was adequate, the Fund would also have to take into account the degree of compliance with those criteria; the Fund could certify that a member was implementing a program that would qualify it for assistance in the upper credit tranches only if all the types of criteria normally included in the stand-by or exchange arrangement were being met. Finally, on the basis of the proposed decision, Fund documents would be made available to all creditor banks.

Mr. de Maulde commented that there was no tripartite agreement in the sense that the Colombian authorities, the commercial banks, and the Fund would sign the same agreement at the same time. Yet it was evident that

an agreement had been entered into between Colombia and the banks, and had been communicated to the Fund so that it might perform its part.

The Director of the Legal Department responded that there was no such agreement in legal terms between the Fund and the banks. The Fund had no official notice of the agreement between the commercial banks and Colombia, and the Fund had not in any way committed itself to the terms of such an agreement. The Fund was simply responding to a request by a member country. From a legal point of view, the Fund was not making any commitment vis-à-vis the banks.

Mr. de Groote said that it should be stated in the proposed decision that the Fund was entering no agreement with the banks. After all, a reader of the decision might have the impression that the Fund was committing itself to transmitting a red light or a green light to the banks at certain moments. The proposed decision should contain a phrase noting that none of the considerations involved constituted an agreement between the Fund and the banks.

Mr. Zecchini remarked that paragraph 6 in the Managing Director's communication on financing, where the Fund asked for written confirmation, went beyond what was envisaged: there ought to be no agreement whatsoever on a tripartite basis.

The Director of the Legal Department commented that the request for written confirmation was similar to the requests that the Managing Director had made in connection with financing under stand-by arrangements and other cases of enhanced surveillance. The banks had an agreement with Colombia and in connection with the implementation of that agreement, the Fund was asked by the member to perform certain functions. Under a stand-by arrangment, the Fund would assure the member that it could draw certain amounts over a certain period; in the present instance, the Fund would be assuring the member not that it could draw but that the Fund would review its program from time to time and would give it a statement that it could communicate to the commercial banks.

The Chairman noted that his summing up of the present discussion was not going to be transmitted to the banks. However, the decision approving the arrangement for the Fund to monitor Colombia's economic program (EBS/85/149, Sup. 3) would be sent to the banks by the Colombian authorities. He recalled that on June 21, a communication had been sent to the authorities indicating that management considered that Colombia's program would qualify for access to Fund resources in the upper credit tranches.

Mr. Polak recalled that the proposed arrangement for Colombia had been presented by various speakers, including himself, as a stand-by arrangement that happened not to have any money involved in it. As he understood it, under a stand-by arrangement, the banks relied on the Fund's decision whether a country could make drawings as scheduled and were so informed when the actual drawings were made. Under the proposal for Colombia, the Fund's messages to the authorities must indicate

whether both the quantitative criteria and the other qualitative criteria had been met, although the banks intended to limit their quarterly examinations to the quantitative criteria.

The Deputy Director of the Exchange and Trade Relations Department explained that the message to the authorities on performance under the program would relate both to quantitative criteria and to qualitative criteria: the Fund would not consider it sufficient for the authorities to have met the quantitative criteria if they had done so by breaching the qualitative undertakings. If the banks decided to apply a different, narrower, standard and look only at the quantitative criteria, that was their privilege.

Mr. Dallara said that he agreed with Mr. de Maulde that some form of tripartite understanding, if not agreement, existed in reality. A balance needed to be found between legality and reality. Would the staff or Mr. Kafka feel that including sentences in the decision that might give some legal comfort but do little more would be disruptive to the understandings reached between the banks and Colombia?

The staff representative from the Western Hemisphere Department responded that the agreements reached between the authorities and the banks provided that the first disbursement would be conditional upon the Executive Board's endorsing the program and Colombia's having met the quantitative performance criteria for end-June. In subsequent quarters, the Colombian authorities would have to continue to meet quantitative performance criteria in order to receive further disbursements from the banks. For example, the Fund would have to endorse the 1986 program and determine the authorities' compliance with the quantitative performance criteria in each quarter.

The Director of the Legal Department said that he did not favor adding a statement to the decision indicating that the Fund was not entering into an agreement with the banks; however, if the Executive Board wished, the thought could be placed in the summing up, which would be made available to the authorities, who, in any event, were fully aware that the Fund was not assuming any obligations vis-à-vis the commercial banks.

The Chairman commented that he had understood the proposed arrangement to monitor Colombia's performance to be an arrangement without the use of Fund resources but to be similar in other respects to an arrangement with the use of Fund resources. Ever since the Fund had begun in 1982 to fashion stand-by arrangements that were closely related to members' agreements with banks, the Fund had stated emphatically that if the program being supported by the stand-by arrangement did not work, the Fund itself could not be held responsible for the outcome of the agreement with banks. The rationale for including a disclaimer of Fund responsibility was therefore not clear to him.

Mr. Polak said that he agreed on that point.

The Deputy Managing Director observed that it had been emphasized again during the briefing of the banks' steering committee on Colombia that the banks had to make the ultimate credit judgment, just as they did when a program supported by a stand-by arrangement and use of Fund resources was involved.

Mr. Kafka considered that the Fund should not be making statements about what it was not doing.

Mr. Goos remarked that he saw differences between the proposed arrangement for Colombia and a regular stand-by arrangement. The main difference was that the Fund would enter into an arrangement with Colombia that had been designed with the explicit purpose of giving certain signals to the banks, whereas, under a regular stand-by arrangement involving the use of resources, the Fund was performing its normal role, leaving it up to the banks to decide whether or not they shared the assessment that the Fund made in carrying out that role. To be sure, there was a closer association between the Fund and the banks in the concerted lending operations begun in 1982. Yet that lending had been designed to meet crises and, hence, situations that justified exceptional solutions. The Fund should take into account the risk that cases like that of Colombia might spread, leading to the development of a Fund policy that would be applicable not only to debt crises but to other situations as well.

The Chairman commented that the signals being transmitted by the Fund under a stand-by arrangement were not of a different essence from the ones that the Board would be devising at the present meeting.

Mr. Zecchini considered that the case of Colombia was an experiment in Fund monitoring of a program without a stand-by arrangement, which must not be confused with a program supported by an arrangement with the Fund. As he understood it, monitoring meant giving advice in the interest of the Colombian authorities in order to facilitate an agreement between Colombia and the banks. If that was so, there was no reason for maintaining a direct relationship between the Fund and the banks, as the letter sent by the Managing Director would imply.

Mr. Clark considered that Colombia had explicitly chosen not to have an open relationship with the Fund, a decision that was bound to have certain consequences.

Mr. Kafka remarked that Colombia's relationship with the Fund was perfectly open, but the relationship was not financial. The question had been raised whether the program was not too gradual; the Colombian authorities were resolved to make the adjustments necessary to ensure success. In any event, a continuation of the arrangement in 1986 depended upon an agreement between Colombia and the Fund. Clearly, the case of Colombia did not constitute a precedent. Finally, the proposed decision represented an extremely delicate structure negotiated between the Fund and a member country; any changes might prejudice the success of the proposed monitoring arrangement.

Mr. de Maulde recalled Mr. Romuáldez's point that the phrase that he himself had proposed to eliminate from paragraph 1 in the decision was taken from the authorities' letter. For that reason, he would withdraw his proposal.

The Chairman commented that it had emerged from the discussion of paragraph 3 of the proposed decision on the monitoring arrangement that the Fund would have to be relatively precise in wording its appraisals in order to cover different aspects of the qualitative and quantitative criteria that might or might not be met. The waiver provision in paragraph 4 for deviations that were minor or self-reversing had been included because, if the Fund were forced to send a noncompliance signal in such an eventuality, it could have negative consequences for Colombia's financing.

Mr. Kafka explained that the Colombian authorities wished to have such a clause included in the proposed decision.

The Director of the Legal Department observed that the finding that any deviations from the targets were minor or self-reversing would be made by the staff, confirmed by management, as under a stand-by arrangement, and approved by the Executive Board.

The Deputy Director of the Exchange and Trade Relations Department remarked that a country in the midst of adjustment should be given enough leeway so that a minor deviation from the targets would not have consequences that were out of proportion with the extent of the departure.

Mr. Dallara said that there might be less flexibility for Colombia under the proposed decision than there would be for a member under a normal stand-by arrangement. Thus, it would be a mistake to change the wording to decrease the flexibility allowed to the authorities.

The Chairman observed that, ideally, banks should realize that a minor deviation was not a serious concern and should maintain their relations with the member. The Fund was trying to push the banking community toward evaluating risks more responsibly, not transmitting mechanical on-off signals.

The Colombian authorities had agreed to the full application of criteria and conditionalities that would have been proposed to the Board under an ordinary stand-by arrangement, but they had decided not to have recourse to financial drawings from the Fund, the Chairman recalled. The banks had been unhappy with that decision and might not have agreed to provide US$1 billion to Colombia if they had been told to make their own assessment. It was important for them to know not only that the program was of high enough quality to justify drawing in the upper credit tranches but also whether the authorities' implementation of the program was of such quality. At present, the banks were unable to make such a determination. If paragraph 4 of the proposed monitoring arrangement were deleted, Colombia's adjustment effort might derail because of an

episodic, minute deviation from the targets. As it was, the proposed agreement was less flexible than a normal stand-by arrangement because there was no modification clause.

The Deputy Director from the Exchange and Trade Relations Department explained that, in granting a waiver, the Executive Board would be making a decision equivalent to stating that adjustment was proceeding on track because it judged that the deviation was minor or self-reversing.

The Deputy Managing Director added that the waiver provision had been included because both the staff and the Colombian authorities had felt it necessary to reduce the potential brittleness of the program. As a result of that conclusion, the commercial banks had included a reference to the possibility of a waiver in the documentation circulated to all the banks concerned.

Mr. Orleans-Lindsay asked what would happen if Colombia did not provide the information required for monitoring the program effectively.

The Director of the Legal Department responded that the Fund would then be unable to carry out the responsibilities that it had assumed under the proposed decision, so that the Colombian authorities would be unable to reach the objectives that they had set when requesting the Fund to judge their implementation of the adjustment program.

Mr. Orleans-Lindsay noted that under a normal stand-by arrangement, if the program went off track, there would be no further drawings from the Fund unless the country's authorities began new discussions on the program with the Fund. He asked if that would happen to Colombia.

The Chairman observed that, when a country's program went off track, the staff and the authorities first had to make an attempt to restore its viability. If the problems were sufficiently serious, the authorities would probably have to resort to a more direct relationship with the Fund.

The Director of the Legal Department noted that the Colombian authorities had volunteered to give the Fund all the information necessary in order to carry out the purposes of the proposed arrangement. The staff could have said, in paragraph 5, "Colombia shall provide," but in that event it would have been imposing an obligation on the authorities.

Mr. Orleans-Lindsay proposed the following wording for paragraph 5: "The Fund notes the statement by Colombia that it will provide all the information and...."

Mr. Kafka observed that the proposed decision was a negotiated document. So far, the Board had followed the practice of not changing negotiated documents but of transmitting signals to the staff for future use. Furthermore, the Colombian authorities had requested the Fund to monitor the implementation of the program; it was therefore implicit that they must do what made the monitoring possible. The Fund did not have to impose an obligation.

The Deputy Director of the Exchange and Trade Relations Department explained that the word "information" meant "assessment" in the clause "in order that this information may be transmitted by Colombia to certain creditors" in paragraph 5 of the proposed monitoring arrangement.

Mr. Joyce noted that it had already been said in paragraph 1 that the Colombian authorities had requested that the Fund provide them, for communication to the creditors referred to in their letter, with the results of the Fund's initial review of Colombia's performance.

The Director of the Legal Department commented that the phrase "in order that...to certain creditors" in paragraph 5 could be omitted; it would be sufficient to rely on what had been said in previous paragraphs.

The Chairman observed that the second proposed decision in the release of documents provided an indication that the Board had authorized the Colombian authorities to circulate the relevant Fund documents. Perhaps he might mention in the summing up that the Board had noted the intention of the Colombian authorities to provide those documents to the banks.

The staff representative from the Western Hemisphere Department said that his understanding was that the Colombian authorities intended to send the complete staff report to the Chairman of the Steering Committee of the banks.

The Director of the Legal Department explained that there was no requirement for a formal Board decision on the release of such documents. However, in the light of existing rules and practices, action by the Board was necessary to permit such a release.

Mr. Zecchini remarked that such approval by the Board either formal or de facto, would represent a major departure from previous practice. Perhaps the Board could release only those portions of the staff report considered relevant for the banks. Confidential information, or uncertainties expressed in the assessments, should not be revealed to outsiders.

Mr. Joyce said that the Board should avoid authorizing in any way the transmittal by the Colombian authorities to the banks of the staff report for the Article IV consultation, even though the authorities might take it upon themselves to do so. Perhaps if the usual procedure were followed of transmitting the report in largely the same form but with a different cover page, the Fund would not be providing Article IV documents.

The Deputy Director of the Exchange and Trade Relations Department noted that staff reports for Article IV consultations contained the staff's policy assessments. The proposal being put before the Board by the Colombian authorities was that they be allowed to make available to their creditors the assessments conducted by the Fund of their program. From that standpoint, it might prove difficult to sanitize a report intended to provide an assessment of economic policy.

Mr. Zecchini said that objective data should be transmitted, but not the details of staff judgments.

The Deputy Director of the Exchange and Trade Relations Department observed that the Fund surveillance procedure was that staff reports as such would be released by member countries to the banks concerned.

Mr. Agah commented that the Board was setting a precedent that might later lead to unpredictable results.

Mr. Dallara remarked that if the Board wished to delegate to member countries the authority to release Fund documents, it should do so. If, on the other hand, the Board wished to exercise some responsibility, it should fulfill it. As the Board had already approved a similar procedure in the case of Venezuela, the case of Colombia seemed not to be a monumental precedent.

Mr. Polak recalled that in a case discussed by the Board earlier there had been a reference to the transmittal of reports with the following clause: "with such deletions thereto as may be required by policies and practices of the IMF." Perhaps those words might be included in the proposed decision.

The Chairman observed that the allusion had been to the transmittal of reports containing references to summings up of previous consultation discussions in the Executive Board.

Mr. de Maulde suggested that the Chairman might indicate that a number of Directors had expressed various opinions on the subject.

The Chairman agreed that such a procedure might be appropriate. As Mr. Zecchini had said, the Fund need not transmit the totality of the staff papers. In any event, the proposed decision on the release of documents could be omitted.

The Board indicated agreement with the Chairman's suggestion.

The Chairman made the following summing up:

> Executive Directors commended the Colombian authorities for their development of a stabilization program aimed at dealing with the country's balance of payments problem and thus helping to set the stage for sustained economic growth. Directors in general concluded that, on the basis of the authorities' economic program, Colombia would have qualified for the use of Fund resources in the upper credit tranches had such a request been presented to the Board. In view of the special circumstances of this particular case, Directors agreed on an exceptional basis to the arrangement proposed by the authorities for monitoring the implementation of the program. Most Directors recorded their

concern about the broader implications of this type of arrangement, and expressed their strong reservations about its applicability to other cases. It was understood that no precedent was to be created by the decision on Colombia. The Board would come back later to the role of the Fund in this area in a broad policy-oriented discussion.

In reviewing the main features of the adjustment program, Directors welcomed the efforts of the authorities to achieve a reduction in the overall public sector deficit of over 2 1/2 percentage points of GDP in 1985. Many Directors noted, however, that the programmed reduction in the public sector deficit relied too heavily, in their view, on increases in budget revenue which would, inter alia, require a significant tightening of tax administration. These Directors believed that fiscal policy in Colombia should rely more on restraining current expenditures. Directors therefore urged the authorities to continue to resist pressures to increase expenditures, particularly on wages and current transfers. They found encouraging the reorientation of investment expenditures toward the development of coal and petroleum production, which should help to improve the medium-term prospects of Colombia. Directors supported the efforts to curb the resort to supplementary budgets and to dismantle the revenue-earmarking arrangements.

Directors noted the authorities' intention to reduce substantially the flow of credit from the Banco de la Republica to the public sector during 1985. They observed that such a reduction depended critically on the attainment of the planned improvement in public finances. They also noted the authorities' intention to keep credit in line with economic activity and to limit the loss of net international reserves to US$75 million in 1985, compared with a decline of US$1.4 billion in 1984. In this regard, they were encouraged by the progress already made in the first half of this year in stabilizing the net international reserve position. However, a number of Directors were concerned about the projected growth of credit to the private sector even though the staff regarded the expected increase in line with nominal GDP as appropriate. Adequate credit restraint was all the more important in view of both the recent acceleration of the rate of inflation and the need for the Colombian authorities to act to strengthen confidence in the domestic financial system. Directors endorsed the authorities' policy of having interest rates reflect market forces, and recommended that the authorities act to keep interest rates on funds administered by the Banco de la Republica positive in real terms.

With regard to the balance of payments forecast for 1985, several Directors noted with some concern that it relied to a large extent on increased capital inflows and only to a modest degree on a reduction in the current account deficit. Directors

commented favorably on the policy of adjusting the value of the Colombian peso in order to restore by the end of the year the level of competitiveness that had prevailed in the mid-1970s. This action should help to stimulate the growth of nontraditional exports, which had stagnated in the recent past, and to contain the demand for imports. Directors stressed the need to continue a flexible approach to exchange rate policy, once the targeted level of competitiveness had been achieved, to ensure the preservation of a satisfactory balance of payments position without reliance on exchange and trade restrictions. In this context, it was noted that the authorities recognized the benefits arising from a system without restrictions and that they had begun to move toward liberalization by reducing the number of prohibited imports, the number of imports requiring a permit, and the minimum financing period required for imports. Directors stressed the importance of continuing efforts to dismantle the very complex exchange and trade restriction system, which had adversely affected the efficiency of the Colombian economy. Concern was also expressed by several Directors on the import surcharge measures.

Although Colombia's external debt situation appeared to be less difficult than that of many other developing countries, Directors expressed concern about the medium-term outlook. They noted that the volume of external debt outstanding as well as the projected service on this debt were likely to remain above historical levels for some time. In this context, they emphasized the importance of a continued vigorous application of prudent financial policies and an appropriate exchange rate policy as a means of improving the medium-term economic situation. At the same time, Directors were encouraged by the outlook for significant increases in exports of petroleum and coal in the medium term, which would both strengthen export earnings and contribute to the diversification of the export base. The role of the World Bank in advising on the level and composition of public investment was warmly welcomed. Directors also welcomed the financial arrangement recently completed with foreign commercial banks, which would provide resources needed to help finance the investments in coal and petroleum projects.

All in all, while Directors endorsed Colombia's economic program, a number of them questioned whether it was vigorous enough. Restraint on government expenditures should have been given more emphasis, many Directors thought. The programmed improvement in competitiveness could have been faster, the more so as it should go hand in hand with the liberalization of extensive trade and exchange restrictions. The rate of price increase had gone up, albeit due in large measure to the elimination of price repression and to the effects of weather on food supplies. There were also uncertainties regarding the medium-term external outlook despite Colombia's promotion of

exports. Moreover, it was necessary to continue to strengthen confidence in the banking system, which had come under pressure. Directors, generally, thus believed that there was no room for slippage in the program and that the authorities should stand ready to take additional adjustment measures if needed. A number of Directors expressed disappointment about the paucity of pertinent indications regarding the Government's economic program for 1986. They hoped that the authorities would pursue a comprehensive adjustment effort in that year.

Directors understood that it is the intention of the Colombian authorities to provide the commercial banks with copies of the reports prepared by the Fund staff on the economic situation in Colombia and on the developments under the country's economic program for 1985 and 1986. Some Directors expressed the view that certain adjustments might appropriately be made in the contents of the reports to be provided to the banking community, and that Directors would discuss that matter in a broader fashion during the general discussion on enhanced surveillance and relations between the Fund and commercial banks at the end of August. In particular, it was questioned whether the references in Article IV reports to the summings up of previous Board discussions should be included in the text to be conveyed to the banking community.

It is expected that the next Article IV consultation with Colombia will be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

Decision Concluding 1985 Article XIV Consultation

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-(77/73), 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/85/172. 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.

Decision No. 8039-(85/114), adopted
July 26, 1985

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 Republic 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.

Decision No. 8040-(85/114), adopted
July 26, 1985

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/113 (7/26/85) and EBM/85/114 (7/26/85).

2. JAMAICA - TECHNICAL ASSISTANCE

In response to a request from the Jamaican authorities for short-term technical assistance to review and reduce budgetary expenditure, the Executive Board approves the proposal set forth in EBD/85/188 (7/23/85).

Adopted July 26, 1985

APPROVED: April 28, 1986

JOSEPH W. LANG, JR.
Acting Secretary