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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 19/27-2

11:15 a.m., April 19, 2019

2. Colombia—2019 Article IV Consultation

Documents: SM/19/77 and Correction 1; and Correction 2; and Supplement 1; SM/19/78

Staff: Faruqee, WHD; Kramarenko, SPR

Length: 45 minutes

Executive Board Attendance

D. Lipton, Acting Chair

Executive Directors	Alternate Executive Directors
D. Mahlinza (AE)	
M. Raghani (AF)	
G. Lopetegui (AG)	
	G. Johnston (AP)
A. Tombini (BR)	
	Y. Zhao (CC), Temporary
L. Villar (CE)	
	G. Vasishtha (CO), Temporary
	S. Benk (EC)
H. de Villeroché (FF)	
	K. Merk (GR)
S. Gokarn (IN)	
	C. Collura (IT), Temporary
	Y. Saito (JA)
J. Mojarrad (MD)	
	F. Al-Kohlany (MI), Temporary
	R. Doornbosch (NE)
T. Ostros (NO)	
	L. Palei (RU)
M. Mouminah (SA)	
	A. Muslimin (ST), Temporary
	P. Trabinski (SZ)
	O. Haydon (UK), Temporary
	P. Pollard (US), Temporary

G. Tsibouris, Acting Secretary
V. Sola, Summing Up Officer
A. Lalor / M. Gislen, Board Operations Officers
L. Nagy-Baker, Verbatim Reporting Officer

Also Present
Communications Department: M. Candia Romano. Legal Department: K. Kwak. Monetary and Capital Markets Department: F. Boumediene. Strategy, Policy, and Review Department: V. Kramarenko, A. Swiston. World Bank Group: J. Araujo, C. Savescu. Western Hemisphere Department: H. Faruqee, E. Fernandez Corugedo, A. Husain, D. Shen, F. Toscani, J. Yepez Albornoz.

Alternate Executive Director: H. Razafindramanana (AF). Senior Advisors to Executive Directors: F. Fuentes (BR), S. Keshava (SA), W. Kuhles (GR), R. Morales (AG), T. Ozaki (JA). Advisors to Executive Directors: M. Albert (FF), A. Arevalo Arroyo (CE), S. David (AP), T. Gade (NO), S. Harutyunyan (NE), M. Ismail (AE), R. Lopes Varela (AF), M. Mehmedi (EC), Y. Minoura (JA), G. Nadali (MD), A. Tola (SZ).

2. COLOMBIA—2019 ARTICLE IV CONSULTATION

Mr. Villar submitted the following statement:

On behalf of the Colombian authorities, we would like to thank the mission team for its insightful and comprehensive report, as well as for the open and constructive discussions during the Art. IV consultation with Colombia. We broadly agree with the staff's analysis and recommendations but would like to expand on some of the key issues discussed.

Recent Developments

The Colombian economy has faced four important shocks in the last few years: First, the drop in international oil prices in 2014 implied a sharp decline in the value of exports, induced a sharp depreciation of the currency and involved fiscal revenue losses for the central government of around 3 percentage points of GDP. Second, a severe drought in 2016 added to the effects of the currency depreciation and led inflation up to 8 percent in August 2016, well above the 3 percent target set by the central bank. Third, the peace agreement reached with the biggest guerrilla group in America signed in 2017—after 55 years of war—allowed for a very important decline in violent deaths and created a space for urgent development in rural areas but, from the point of view of fiscal accounts, also implied short-run macroeconomic challenges, particularly through public expenditure commitments. Finally, but not least, the collapse of the Venezuelan economy—which used to be Colombia's second main trading partner for non-commodity exports and a traditional destination of Colombian emigration—implied a dramatic contraction in exports and the largest immigration process that Colombia has ever experienced. According to most estimates, more than 1.2 million people have moved from Venezuela to Colombia during the last five years, most of them in the last 18 months. Nearly 30 percent of those immigrants are Colombians that emigrated to Venezuela in previous decades.

Despite those shocks, Colombia has been able to manage a process of economic adjustment in an orderly manner. Annual inflation in March 2019 was 3.2 percent, very close to the central bank target. After a period of economic activity deceleration, which however did not imply negative rates of growth in any recent year, GDP growth is recovering and is expected to reach 3.6 percent in 2019. With regards to the balance of payments, the current account deficit—which had reached 6.3 percent of GDP after the collapse in oil prices in 2015—is down to 3.6 percent of GDP in 2018 and is expected to remain below 4 percent of GDP and be mostly financed by foreign investment in 2019 and the following years.

Following the fiscal rule, the central government deficit has systematically gone down since it reached 4 percent of GDP in 2016. It was 3.7 percent in 2017 and 3.1 percent in 2018. The target for 2019 is to reduce it further, to 2.7 percent. Compliance with a decreasing fiscal deficit every year is more remarkable as corporate taxation has been reduced to stimulate the economy and enhance competitiveness.

IMF staff is forecasting a fiscal deficit of 3 percent of GDP in 2019, slightly higher than the one expected by the government, although still lower than its level in 2018. The difference between the government's number and the staff's report projection arises from the accounting of revenues that the government is planning to get from privatizations and which would be used to pay non-recorded liabilities, such as those associated with judicial sentences that are not currently included in the official public debt figures. As far as such operations would improve public balance, my authorities consider that they should not be considered as increasing the deficit.

Monetary Policy, Exchange Rate and International Reserves

The Colombian central bank follows a well consolidated inflation targeting regime that has proved its effectiveness. With inflation close to the target and with well-anchored expectations, monetary policy has played a moderately accommodative role. In fact, after a cycle of reductions in the policy interest rate during 2017 and the first half of 2018, such rate has been kept at 4.25 percent since mid-2018. The authorities agree with staff that a future adjustment towards a more neutral stance should be data dependent and carefully calibrated.

Consistent with the inflation targeting regime, exchange rate flexibility is significant. Still, after a depreciation of more than 50 percent that followed the collapse in international oil prices of 2014, the peso has shown remarkable stability. In September 2018, the central bank announced a program to accumulate international reserves through a market-based mechanism and small monthly amounts that do not disrupt the smooth functioning of the foreign exchange market. It is important to mention that the level of international reserves is well above the ARA metric used by the Fund. Even so, the central bank considers that accumulating additional reserves will allow for an even more comfortable level and provide room to gradually reduce reliance on the FCL with the IMF.

However, my authorities do not necessarily share the staff's recommendation for "a modestly faster pace of reserve accumulation," as it could affect expectations and disrupt the so far well-behaved exchange rate market. The central bank follows a clear methodology to assess international reserve adequacy that depends on a periodic quantification of international liquidity risk. Any change in the pace of international reserves accumulation will depend on such an assessment.

My authorities also want to restate that the monetary effect of any dollar accumulated in international reserves is automatically sterilized as far as the monetary framework is based on the use of the short-term interest rate as the instrumental variable. Sales and purchases of domestic securities by the central bank are undertaken according to market conditions to keep the short-term interest rate at the level set by the central bank board of directors.

Fiscal Policy

As described in detail in the Staff's Issues Paper, in December 2018 the Colombian government obtained Congress approval for a financing law that is expected to yield additional revenues in 2019, especially from an expansion of VAT and higher rates on dividend and personal income taxes. The same law reduced the tax burden on corporations, mainly through lower corporate income tax (CIT) rates, an input credit for VAT on capital goods and crediting municipal taxes. These measures are expected to have a static cost in terms of lost revenue from 2020 onwards, but the staff models estimate that their direct impact on investment and economic activity will boost GDP growth by 0.2 pp over ten years.

Together with tax reform, public expenditure austerity will allow the government to adhere to the fiscal rule, which in turn implies a continued process of reduction in the central government deficit as a share of GDP towards a structural steady state deficit of 1 percent of GDP that is expected to be attained by 2023. According to the fiscal rule law, the Fiscal Rule Consultative Committee (FRCC) can allow for adjustment in the yearly deficit target according to the output gap cycle and to the evolution of exported commodity prices (mainly oil), relative to their long-run level. In addition to these considerations, the FRCC considered in its 2019 meeting that the short-term fiscal impact of the Venezuelan migration merited some allowances, bearing in mind that it is a temporary situation that in the long run can have positive effects on potential GDP and fiscal revenues. The adjustment made on the fiscal rule in relation to the fiscal costs of the Venezuelan migration followed the criteria proposed by the IMF's staff mission in terms of its temporariness and of a well-defined path to recover the original deficit path in the medium run. Under these conditions, the FRCC and the government agreed that the central government deficit would be 2.7 percent of GDP in 2019, down from 3.1 percent in 2018.

As mentioned before, the staff report is forecasting a deficit of 3 percent of GDP for 2019, a number that is slightly higher than the one used by the FRCC and the Colombian government. The difference arises from the accounting of expected revenues from privatization, which the government plans to use to improve the public balance, especially through paying non-recorded liabilities, such as those associated with judicial sentences that are not currently included in official public debt figures.

Going forward, my authorities agree with staff on the need to increase tax revenues. The original financing law project contained many of the measures recommended in paragraph 25 of the staff report, which unfortunately were not approved in its entirety by Congress. The Colombian government is, however, confident on the possibility of obtaining very important gains from a more efficient tax administration and is already introducing sweeping reforms within the tax administration office that are expected to yield results soon.

Along the same lines, although recent developments in oil markets are having a better-than-expected impact on government revenue, our authorities will continue working towards stricter cost and investment discipline to improve the profitability of Ecopetrol—Colombia's national oil company—and incentivizing activity of private oil companies, which will be key for better prospects in public revenues.

Our government is receiving technical assistance from the Fund that will help Colombia to enhance public spending efficiency, mainly through improving the budgetary process and subsidy focalization.

Moving forward, authorities are committed to the structural deficit path in accordance with the fiscal rule. The combination of tax administration gains, expected recovery in economic activity and expenditure efficiency, will guarantee that public debt indicators will follow the required—and projected—downward path.

Financial Policy and Supervision

After a period of credit growth deceleration and deterioration in credit quality, especially in the commercial credit sector, credit growth is expected to increase and NPL to gradually decline. The financial sector is strong and financial supervision has been undertaking important reforms in line with previous recommendations of IMF missions. In particular, the Conglomerates Law approved in 2017 is being implemented and the financial supervisor (SFC) is also advancing in the regulatory reform towards the Basel III capital and liquidity standards. Our authorities are committed to continue strengthening regulation and supervision and have asked the IMF for a new FSAP mission, which would be particularly relevant for this purpose

Structural Policies and OECD Accession

As stressed by staff, Colombia has made impressive progress in reducing poverty and inequality over the past fifteen years. My authorities are committed to continue advancing in that process as reflected in the national development plan that is under Congress consideration, in which much emphasis is given to reducing regional disparities, strengthening the rule of law, closing infrastructure gaps, promoting entrepreneurship, fighting informality and improving the mechanisms for targeting public subsidies. The Colombian authorities are also aware of the enormous fiscal costs, extremely poor coverage and lack of progressivity of the current pension system and are taking steps towards an integral reform that would be presented to Congress no later than 2020.

In May 2018 Colombia was invited to become a full member of the OECD. Accession to such organization will reinforce the institutional framework and enhance the quality of policies in the same direction as the goals presented in the National Development Plan.

Exchange Restriction and the Hydrocarbon and Mining Sectors

A final word on a non-material issue that unfortunately has been present in Art. IV reports on Colombia during many years. Colombia requires all exporters to sell the proceeds from their exports in the exchange market or to register them if holding them in accounts abroad. There is one exemption for the hydrocarbon and mining sectors, where foreign companies that wish to do so have the possibility of paying some of their domestic operations in foreign currency and are not required to transfer abroad the amounts derived from their domestic sales of oil, gas or services in Colombian local currency.

My authorities are convinced that this especial regime does not constitute an exchange restriction, and that it does not affect the functioning of exchange rate markets in any significant way. Removing it may imply unnecessary difficulties for foreign companies that are already operating in Colombia.

Mr. Tombini, Mr. Saraiva and Mr. Fuentes submitted the following statement:

We thank staff for the comprehensive set of papers and Mr. Villar for his informative statement. After suffering several substantial exogenous shocks that led to an extended slowdown during 2015-2017, economic activity in Colombia is steadily recovering on the back of strong domestic demand and supported by a balanced policy mix. Opportune monetary policy measures have brought inflation back to target anchoring inflation expectations and allowing a more supportive stance recently. Meanwhile, a broadly neutral fiscal stance has safeguarded public finances and is projected to put public debt-to-GDP ratio in a downward trajectory. Notwithstanding the promising recovery and the solid macroeconomic fundamentals, more significant and sustained progress in addressing key structural issues is warranted to increase potential growth, boost competitiveness and improve social outcomes.

Authorities' commitment to fiscal sustainability should be supplemented by reforms to broaden the tax base and boost revenue. The introduction and adherence to a Medium-Term Fiscal Framework (MTFF) and a fiscal rule have strengthened the soundness and credibility of fiscal policy in Colombia. In this context, we note the divergence between staff and the authorities on the expected impact of the enacted Financing Law on tax revenue. The authorities believe that by stimulating investment and, ultimately, real GDP growth, tax revenues will raise. However, considering the limited impact of tax administration reforms, the revenue losses associated with the lower corporate tax burden may require additional compensatory measures to preserve public infrastructure investment and social spending. Additionally, reducing the complexity of the tax system is critical to boost non-oil revenue and reduce evasion.

Colombia remains well equipped to withstand external shocks. While the current account deficit is projected by staff to remain moderately elevated into the medium term, Colombia's flexible exchange rate regime and considerable reserve buffers – complemented by FCL access –provide adequate leeway to facilitate adjustment to external shocks and preserve macroeconomic stability. Furthermore, even considering the prospects of strong import growth and flat export performance, the current account deficit has been comfortably financed by stable foreign direct investment and diversified portfolio flows. Nonetheless, high gross financing needs raise the risks associated with a possible sharp tightening in global financial conditions and higher volatility in oil prices, which must be closely monitored to avoid further strain on public finances.

The steadfast implementation of the National Development Plan (NDP) is critical to raise potential output. Colombia's path to income convergence with advanced economies requires a strong commitment to removing structural bottlenecks to lift productivity growth, innovation and external competitiveness. The plan also sets the guidelines to tackle widespread labor informality, critical to improve the quality of labor inputs and raise its contribution to total factor productivity. The timely execution of the 4G program should complement the NDP by narrowing the infrastructure gap to support the growth strategy and achieve more equitable development across regions. Progress towards higher economic diversification is also key to secure more sustainable, consistent and widespread development.

Venezuelan migration flows continue to pose considerable short-term challenges for fiscal policy. Notwithstanding the potentially positive impact on labor markets and growth, the escalating commitment to provide humanitarian support to Venezuelan refugees is building up considerable pressure on the provision of public services in Colombia. Furthermore, heightened uncertainty in Venezuela might accelerate migration outflows, which could provoke stronger than expected spillovers and higher fiscal costs in recipient countries. Against this background, we support the authorities' decision to add flexibility within the fiscal rule by adjusting the deficit target path to accommodate spending pressures from the migration shock, while preserving the integrity of the fiscal anchor and the medium-term structural balance objective.

Mr. Psalidopoulos and Ms. Collura submitted the following statement:

We thank staff for a clear set of papers and Mr. Villar for his helpful buff statement. We largely share the staff's assessment and offer some comments for emphasis.

We welcome the authorities' continuous commitment to financial and macro-economic stability. Supported by a strong macroeconomic framework and appropriate policies that have been broadly consistent with the Fund's advice, Colombia continues to recover from the 2014-2016 terms of trade shock. While we see that risks are on the downside, we positively note that staff forecast growth above potential also in the medium term. The implementation of the peace agreement and structural reform efforts will be necessary to seize this outcome, and to make further progress on inclusiveness.

Colombia is providing a remarkable response to the severe humanitarian crisis in Venezuela, by receiving more than 1.2 million migrants from Venezuela and providing them humanitarian support, as well as integration in the labor market. In light of the associated high fiscal costs, we support the use of the flexibility within the fiscal rules along the lines recommended by the Fiscal Rule Consultative Committee. Staff offer an interesting analysis of the impact of migration on potential output. We find the higher impact of migration in the short-term somewhat counterintuitive, considering on one hand the needed time and efforts for migrants to integrate, and on the other, the relatively high unemployment rate in Colombia, currently at 9.7 percent. Staff’s comments would be welcome.

The fact that the current account deficit is projected to remain elevated is a risk factor. The robust portfolio inflow is a positive indicator of investors’ confidence; however, it makes Colombia even more sensitive to the risk of financial tightening. In light of the window of opportunity provided by the US accommodative monetary stance in 2019, we see merit for a slightly faster pace of reserves accumulation to keep reserves adequate as suggested by staff. Yet, we note the divergent views of the authorities on this issue, and we would appreciate more pros and cons analysis from staff, also considering the arguments provided by Mr. Villar in his buff. Over the medium term, it will be important to reduce external deficits; in addition to the expected rise of public savings, increasing non-oil exports and boosting external competitiveness are key.

Finally, we welcome that the draft National Development Plan properly addresses productivity, efficiency and corruption; in this respect, we take positive note of the staff’s approach to get indications for the structural reform priorities for Colombia, by considering both the impact on total factor productivity growth and the public support for specific reforms. At the same time, we encourage progress to close the infrastructure gap, and to protect public investment and social spending, in particular by identifying compensatory measures to offset the less revenues stemming from the welcome reduced tax burden on corporations.

Ms. Levonian and Mr. Weil submitted the following statement:

We thank staff for their comprehensive, yet concise report, and Mr. Villar for his helpful buff statement. Staff's assessment of the fiscal and growth impacts of Venezuelan migration, including sensitivity analysis, was most welcome and represents a best practice for future AIV reports for countries facing migratory pressures or other important spillovers.

We are encouraged by the pace of the Colombian recovery and support the overall positive tone of the report. However, Colombia faces acute fiscal pressures from migration and continues to suffer from stagnant productivity growth. Beyond oil price volatility, Colombia is at risk from a sudden tightening of global financial conditions and a reversal of the capital flows that finance its relatively wide current account deficit. In such a risk environment, Colombia continues to be well served by its Flexible Credit Line (FCL), although the pace of reserves accumulation under the Reserve Accumulation Program suggests that a gradual exit could be contemplated (holding risks constant). In the near term, the priority should be to use the fiscal policy space provided under the fiscal rule and to boost revenues to accommodate the influx of Venezuelan migrants. In the longer term, the authorities should focus on structural policies to enhance productivity and increase the potential of the economy.

We fully support the authorities' decision to use fiscal space at the sub-national level to address the health, education, and early childhood care costs imposed by the Venezuelan migration shock. It is unfortunate that the escape clause of the existing fiscal rule seems insufficiently flexible to accommodate this type of fiscal shock, which should be the policy intent. Moving forward, the authorities may want to revisit the fiscal rule to ensure that it provides the flexibility required to temporarily deviate from the fiscal anchor. In addition, given the overall negative revenue impact of the 2018 Financing Law, the authorities should consider ways to boost revenues in the near term, including though PIT and VAT broadening. Expenditures could also be better targeted through reformed fuel subsidies.

Structural reforms focused on training and education could boost overall labor productivity and foster inclusive growth while also better integrating Venezuelan migrants into the workforce by reducing skills mismatches and growth of the informal sector. On the structural side, it will also be important to tackle governance and corruption issues as well as the barriers to the timely execution of major infrastructure projects.

Despite recent progress, there remain important gaps in financial inclusion. Lagging bank account ownership in rural regions and a worsening consumer credit gap point to serious financial inclusion issues. While taking note of the authorities' intention to bridge these gaps with digital solutions, alternatives to address the un/under-banked and those without access to credit should also be explored given delays in the implementation of telecommunications infrastructure projects. What are the drivers of the sharp decline in commercial and consumer credit since 2016-17?

Mr. Johnston and Mr. David submitted the following statement:

We thank staff for their comprehensive set of reports and Mr. Villar for a buff statement that added a lot of helpful information. We commend the authorities for their sound policies, structural reforms and pursuit of peace which have led to stable growth and improved social indicators, and facilitated Colombia's entry into the OECD. We broadly agree with the thrust of the report and make the following comments.

Given vulnerabilities to oil price and other shocks and with the ongoing refugee challenges, it is important that Colombia continues to build resilience and buffers with the appropriate policy mix. We agree with the focus on increasing tax revenue, especially from the non-oil sector, and improving spending efficiency. We however note the Government's small governing majority which limits its ability to legislate revenue measures along the lines staff are proposing (and which failed to find support as part of the 2018 Financing Law). We see merit in the authorities' decision to use flexibility in the fiscal rule to accommodate spending pressures associated with the humanitarian support for refugees and migrants. As the special issues paper notes, migration from Venezuela also benefits Colombia in the medium term through increasing the labor force and generating domestic demand. Since strong migration has and will continue to be a key driver of growth in Colombia, could staff advise how the growth rate of GDP per capita has been tracking and what it is forecast to be?

We note the proposed program of the central bank to accumulate international reserves. We commend the authorities for this plan which will boost external buffers and help Colombia phase out access to the Flexible Credit Line as and when that is appropriate. We also commend the authorities' efforts to improve the regulatory framework of the financial sector. Implementing the Conglomerates Law and convergence towards Basel III capital and liquidity standards would strengthen financial stability and enhance transparency. We note that over half the 13 financial conglomerates have their holding companies based outside Colombia. What arrangements or relationships does the Colombian financial supervisor (SFC) have with the supervisors of conglomerates with holding companies based overseas?

We support recommendations for further productivity-enhancing structural reforms to promote inclusive growth and enhance competitiveness. These include reducing non-tariff barriers, better targeting subsidies, closing infrastructure gaps, attending to skills mismatches and improving governance. In this regard, we look forward to the Government's approval of the new four-year National Development Plan that aims to boost productivity, improve efficiency and fight corruption.

Mr. Doornbosch and Ms. Harutyunyan submitted the following statement:

We thank staff for the comprehensive report and Mr. Villar for the informative buff statement. We welcome Colombia's very strong policy frameworks and the track record of sound macroeconomic policies, supported by the authorities' adherence to the structural reforms. We are encouraged by Colombia's high and stable economic growth accompanied by declining poverty and inequality rates after the trade shock in 2014. Looking ahead, the risks remain tilted to the downside mainly due the weaker global growth, tighter financial conditions and heightened uncertainty in Venezuela. We broadly agree with staff's appraisal and would like to offer the following points for emphasis.

Colombia's well-executed policies and persisting positive outlook is encouraging. The economic recovery has gained momentum despite the heightened risk, anchored by continued policy support, stronger domestic demand and a more stable political environment. Notwithstanding this, we are concerned that due to increased migration from Venezuela, the external imbalances have widened and will remain elevated over the medium-term. As staff points out in the report, risks are tilted to the downside, notably on the external side. Sluggish infrastructure spending and construction pose additional risks on the domestic side.

Structural fiscal policy reforms are instrumental to reducing public debt and preserving capital spending. We stress the importance of further revenue mobilization and increased expenditure efficiency to safeguard key public investment and social spending. Notwithstanding the numerous tax reforms and the measures introduced in the 2018 Financing Law, the share of tax revenues to GDP remains low in Colombia with only a marginal increase over the medium-term. In this regard, we would like to ask staff to elaborate on the issue and explain whether additional tax policy measures are being discussed to increase the tax to GDP ratio over the medium-term. We also find the watering down of the initial revenue-raising measures by Congress regrettable. We encourage the authorities to intensify their tax administration efforts to offset the estimated revenue losses underlined in the report. We would also like to highlight that the accelerating migration flows from Venezuela pose additional fiscal challenges. As such, we support the FRCC's recommendation to reduce the fiscal deficit with moderate flexibility over the next few years.

Structural reforms are crucial to promote inclusive growth and enhance external competitiveness. While the Colombian authorities have made substantial progress on the structural front, further efforts are needed to close the infrastructure gaps, strengthen governance and the rule of law, and reduce informality and corruption. In this regard, we welcome the four-year National Development Plan (NDP) as a strategic roadmap aimed at increasing equity via the pillars of entrepreneurship and legality. In addition, productivity enhancement and efficiency improvements outlined in the NDP are well taken. We welcome the measures underlined in the NDP to improve the coordination between agencies to cope with the migration flows from Venezuela. We look forward to the approval of the plan by Congress in May 2019, as envisaged in the report.

We would also like to highlight that the Colombian banking system remains stable and well capitalized. We are encouraged by the implementation of the Conglomerates Law and Basel III capital and liquidity standards aimed at strengthening the regulatory framework.

Finally, we support staff's recommendation on the non-approval of the retention of the exchange restriction arising from the special regime for the hydrocarbon sector.

With these remarks, we wish the Colombian authorities all the success in their future endeavors.

Mr. Mouminah, Mr. Alkhareif and Mr. Keshava submitted the following statement:

We thank staff for their well-written set of reports and Mr. Villar for his informative buff statement. We are in broad agreement with the staff's conclusions and policy recommendations and would limit our remarks to a few issues.

We welcome the strengthening of economic recovery, underpinned by very strong policy frameworks, prudent macroeconomic management, and reforms. Indeed, we are pleased that growth has strengthened while inflation has eased, and inflation expectations are anchored near the central bank's target. Furthermore, we note with satisfaction that despite the economic slowdown since 2014, poverty and inequality measures kept declining and financial inclusion improved. We are also encouraged that implementation of the peace agreement is progressing on most fronts, but it will be important to guard against any setback to the process.

We are encouraged by the decision to use flexibility within the fiscal rule in a well-defined manner to face the migration shock while preserving the medium-term structural balance objective. Given the spending pressures, allowing the deficit to widen in 2019 and gradually reducing it over the medium term are sensible steps to safeguard the fiscal framework. In this regard, we are encouraged that public debt will steadily decline from about 52 percent in 2018 to about 40 percent of GDP in 2024. The analysis on the 2018 Financing Law in the Selected Issues paper brings attention to prospective revenue shortfalls. Here, we echo staff recommendation on the need to raise structural tax revenues through further tax reforms and strengthening tax administration to avoid detrimental cuts in public investment and social spending. The authorities should also pursue spending efficiency gains, including stronger investment project selection and evaluation, in line with the Expert Commission's recommendations.

We agree that the central bank's reserve accumulation program announced in September 2018 is an appropriate step to maintain external buffers. This will help in meeting the authorities' objective of offsetting reduced FCL access with their own reserves. In this context, the authorities should aim for a modestly faster pace of reserve accumulation without disrupting the market, as recommended by staff, to help keep the ARA coverage at the current level.

We welcome staff's assessment that banks remain well capitalized, and that credit growth is expected to increase and NPLs to gradually decline in line with the economic recovery. We are also reassured that the Conglomerates Law, approved in 2017, is being implemented and the financial supervisor, SFC, is also advancing Basel III capital and liquidity standards. These are important steps to strengthen the stability of the financial system. The Report on the Observance of Standards and Codes on FATF Recommendations for AML/CFT was published on November 15, 2018.

However, we missed in the staff report any coverage of follow-up measures on priority recommendations. Staff comments would be appreciated.

Finally, addressing infrastructure gaps, tackling labor market informality, reducing skills mismatches, and promoting entrepreneurship are some of the important priorities to raise productivity and potential growth. In this connection, we look forward to the approval of a new 4-year National Development Plan. Given the need for increasing pension coverage and progressivity in a fiscally sustainable manner, we hope that pension reform will be a priority in the period ahead.

With these remarks, we wish the authorities further success.

Mr. Ostros and Mr. Gade submitted the following statement:

We thank staff for their reports and Mr. Villar for his informative buff statement. We commend the authorities for their efforts in pursuing a strong macro-policy framework and encourage the authorities to continue broadening the strong policy framework into areas of taxation and pension reform, guided by the National Development Plan. Colombia has in recent years experienced stable and high growth rates, and orderly economic adjustment. Key social indicators have improved as a result. In addition, Colombia has benefitted from having access to the Fund's Flexible Credit Line (FCL). The series of external and internal shocks that Colombia has faced in recent years shows the importance of a strong economic policy framework, as well as access to the FCL, with both supporting market confidence in a time of overall global financial tightening and the collapse of the Venezuelan economy. We broadly agree with the staff appraisal and add the following comments for emphasis.

Policies pursued within a strong policy framework and in a credible way serves Colombia well and macro-imbalances are gradually reduced. We note that Colombia still has a double deficit on the fiscal and current accounts. This is against the background of a non-negligible level of external debt, although financed to a large extent by foreign direct investments. While noting that there may be some fiscal pressures from the collapse of the Venezuelan economy and migrant flows from Venezuela, the fiscal adjustment path takes place within a credible framework. Similarly, the recovery in domestic demand while exports are exposed to external shocks may increase the current account deficit. This is mitigated by the composition and stability in capital flows, good financing conditions for the sovereign, as well as sound monetary and financial sector policies. As a result, the central bank is accumulating reserves.

We encourage the authorities to continue its reform initiatives and encourage adoption and implementation of the national development plan. We note that the national development plan is under Congress consideration. We appreciate Mr. Villar stating that much emphasis is given to reducing regional disparities, strengthening the rule of law, closing infrastructure gaps, promoting entrepreneurship, fighting informality, and improving the mechanisms for targeting public subsidies. In addition, we are encouraged to see that the authorities are pursuing tax reform and are planning to table a pension reform before 2020.

On financial sector policies, we particularly welcome the ongoing implementation of Basel III. We note that NPLs have risen during recent years, and while they are still on average at a manageable level and on average well-provisioned. Also, most banks are well-capitalized. However, should NPLs be concentrated, we encourage the authorities to address NPLs more forcefully as the credit expansion gains pace. To this end, we encourage the SFC to be vigilant on problem assets – especially as the full implementation of Basel III is a gradual and lengthy process in many jurisdictions.

Access to the Fund's Flexible Credit Line (FCL) has likely added to market confidence during the recent series of shocks to the Colombian economy. While we believe the FCL is designed for temporary use, its existence has served Colombia well during an extended period of time and a series of external and internal shocks – the oil price slump in 2014, a drought in 2016, fiscal expenditure commitments as part of the peace agreement in 2017, and now the collapse of the Venezuelan economy, and more generally, global financial tightening. We welcome that the central bank considers that accumulating additional reserves going forward will allow for an even more comfortable level and provide room to gradually reduce reliance on the FCL as stated in Mr. Villar's buff statement.

The benefits of Colombia having a strong policy framework was evident in the recent series of global financial tightening and differentiated market reactions across the globe. We encourage the authorities to continue this path of strong policy frameworks.

Mr. Benk and Mr. Mehmedi submitted the following statement:

We thank staff for the comprehensive reports, and Mr. Villar for his informative buff statement. The authorities' strong macro-fiscal policies as well as the robust policy framework in place have served Colombia well and have ensured solid economic growth. Poverty and inequality indicators have declined, financial inclusion has improved, and the peace agreement's emphasis on rural development has given an impetus to the authorities' efforts to reduce income inequality across regions. Nonetheless, external imbalances have widened and the sizable and persistent migration from Venezuela has taken a toll on public finances. We commend the authorities for shouldering the heavy burden of hosting the migrants and note that donor support may be needed to help the authorities alleviate fiscal costs. Going forward, strengthening fiscal buffers and achieving a more inclusive and balanced growth will also require further progress with the implementation of macro-financial policies and structural reforms. In this vein, we agree with Mr. Villar's assertion that Colombia's accession to the OECD will reinforce the institutional framework and enhance the quality of policies. We share the thrust of staff's appraisal and advice and would like to provide the following comments for emphasis.

Rebuilding fiscal buffers will entail implementing structural tax measures to boost non-oil revenue and these efforts should be guided by the authorities' medium-term fiscal framework (MTFF). In view of the narrowing output gap, elevated public debt, and increasing current account deficit, the central government should reduce the fiscal deficit over the medium term in line with the MTFF. Nonetheless, we concur with the authorities' flexible approach within the fiscal rule, allowing the headline deficit to widen in line with migration-related spending pressures. However, should the migration-related costs be lower than projected, the authorities should correct the deviation in the deficit target. While the approved 2018 Financing Law contains important elements, including an increase in tax progressivity and a potential boost in investment, we are concerned about the revenue shortfalls created by the law and the missed opportunity to address the other shortcomings of the tax regime, including the narrow tax base and preferential tax treatments. Against this backdrop and to safeguard key spending over the medium term, concerted efforts are needed in boosting non-oil revenue by implementing structural tax measures, including by streamlining different tax regimes, reducing exemptions and deductions, phasing out subsidies, and enhancing the very low VAT efficiency. Staff's comments on the rationale behind the frequent changes to Colombia's tax regime in the last six years are welcome.

Monetary policy should remain data-dependent while the prompt implementation of the Basel III standards will further enhance financial sector resilience. Given the prevailing negative output gap, monetary policy should remain accommodative in the near term to safeguard the recovery and insure against heightened downside risks, and then move gradually to neutral territory if GDP and credit strengthen as expected. It is reassuring that Colombia's financial system remains well-capitalized, liquid, and profitable and we appreciate the authorities' efforts in implementing the Conglomerates Law and Basel III capital and liquidity standards which will further strengthen the regulatory framework, including by enhancing risk management and preventing conflict of interest. Going forward, these reform efforts need to be complemented by measures to improve loan classification and restructuring practices. Staff's comments on whether the house prices continue to be misaligned relative to fundamentals and whether the authorities are envisaging adjusting the property valuation system, are welcome.

The expeditious implementation of the structural reform agenda, underpinned by the National Development Plan, is essential to increase potential growth, improve productivity, boost innovation, and propel Colombia to high-income status. In this context, the focus should be on enhancing the business environment, reducing corruption, and boosting productivity by reducing the regulatory burden, strengthening the rule of law, and protecting property rights. At the same time, addressing the infrastructure gaps, improving incentives for technology adoption, enhancing human capital and reducing skills mismatch are essential components of the authorities' efforts to enhance medium-term growth and diversify the economy away from oil.

Mr. Saito, Mr. Ozaki and Mr. Minoura submitted the following statement:

We thank staff for the comprehensive and informative papers and Mr. Villar for his helpful statement. It is encouraging that Colombia's growth is gaining momentum, supported by very strong policy frameworks and well-executed policies. We also welcome that Colombia was invited to become a full member of the OECD last year, reflecting high and stable growth over the past decade underpinned by strong policies. Nevertheless, Colombia's economy continues to face downside risks, including sharp tightening in global financial conditions and rising protectionism, as well as additional near-term fiscal costs stemming from a further acceleration of migration inflows from Venezuela. Moreover, weak productivity growth has been a long-standing concern. Do staff assess that the risk-balance for Colombia is tilted more to downside, compared to last year's Article IV? Against this background, appropriate mix of macroeconomic policies as well as structural reforms remain instrumental to support the recovery and raise productivity. As we broadly agree with the thrust of the staff's appraisal, we will limit our comments to the following points:

Fiscal Policy

Given robust domestic demand, a narrowing output gap, and an elevated current account deficit, adhering to the fiscal rule remains appropriate to place public debt firmly on a downward path over the medium term. Having said that, amid uncertainty around migration flows from Venezuela, we agree that it is important to avoid crowding out key public investment and social spending programs. While staff recommended that the escape clause could be considered under strict conditions to safeguard the 2018 Medium Term Fiscal Framework (MTFF), the authorities explored the legal option of adjusting the deficit target in the existing rule, instead of invoking the escape clause. Could staff elaborate on fundamental differences and pros-cons between the two approaches?

Going forward, we encourage the authorities' efforts to lift tax revenues and improve spending efficiency to avoid undesirable cuts in public investment and social spending. Regarding the impact of the 2018 Financing Law on tax revenues, we see some differences of the views between staff and the authorities, while staff agree that the Law could boost medium-term growth. We would appreciate it if staff could elaborate more on differences of the views on the impact of the Law on growth and revenues.

Monetary and Financial Sector Policy

We welcome that inflation remain close to target with anchored inflation expectations and agree with staff that accommodative monetary policy stance remain appropriate given weak credit growth and the prevailing negative output gap. As staff pointed out, monetary accommodation should be gradually removed as GDP and credit strengthen as expected.

We positively take note that NPLs gradually decline in line with the economic recovery and banks remain well capitalized. We also welcome that the financial supervisor (SFC) is implementing the Conglomerates Law and Basel III capital and liquidity standards, in line with previous staff advice. Going forward, the SFC should remain alert and proactive to ensure that problem assets continue to be sufficiently provisioned for.

Structural Reform

In light of Colombia's stagnant productivity growth, structural reforms remain instrumental to foster inclusive growth and enhance external competitiveness. It is encouraging that the draft national Development Plan

(NDP) rightly emphasizes entrepreneurship and improvements to the business environment to strengthen Colombia's cost competitiveness. Looking beyond the NDP, justice and pension reforms remain priorities, as they would have a large positive effect on productivity and enjoy relatively broad public support. While we appreciate the staff's explanations in Annex VI, we welcome staff's elaboration on shortcomings of the current systems and difficulties in previous attempts.

Mr. Geadah and Mr. Al-Kohlany submitted the following statement:

We thank staff for the comprehensive set of reports and Mr. Villar for the informative buff statement. We commend the Colombian authorities on their strong policy framework and well-executed policies. Following a recovery last year, growth is expected to gather momentum, supported by a moderately accommodative monetary policy, higher fiscal spending, and migrants from Venezuela.

The Colombian authorities' humanitarian response to the Venezuelan migration is commendable. Effective implementation of the measures set in the National Development Plan to improve coordination between agencies would further improve the efficiency and effectiveness of the authorities' response. In this connection, we welcome staff's analysis of the macroeconomic effects of migration (Annex III). Staff show a positive impact of migration on potential growth in 2019-2024. Does the current level of migrant integration into the labor force support staff's assessment? We also note staff estimates of the near-term fiscal costs of migration flows, particularly on education and health, and we welcome additional information on why the estimated humanitarian, housing, security, and water and sanitation costs are set at zero (table, page 54).

We agree on the importance of keeping a neutral fiscal stance in 2019 and turning more restrictive thereafter, which will put public debt firmly on a downward path. Achieving the necessary fiscal consolidation over the medium term consistent with the authorities' fiscal framework will be challenged by migration related costs and the expected decline in tax revenue due to the 2018 financing law. To this end, we support linking the flexibility in applying the fiscal rule to the migration shock—and defining a fixed period and deficit path—in order to preserve the rule's credibility. Looking ahead, we concur with staff that absent additional tax revenues and increased spending efficiency, the fiscal tightening required by the fiscal rule could result in cuts in key public spending. Addressing tax compliance challenges will be crucial to maximize the expected yields from any revenue reform measures. In his buff statement, Mr. Villar points to a slightly lower fiscal deficit expected by the government than forecasted in the staff report, owing to a difference in revenue receipts from privatizations.

Colombia's current account deficit widened slightly in 2018, as recovering demand spurred imports while non-oil exports remained sluggish. FDI continued, and capital inflows remained robust, notwithstanding stress in other emerging markets during 2018. We support staff's recommendation to reduce external deficits and contain the buildup of net foreign liabilities over the medium term. The flexible exchange rate should continue to serve as the primary mechanism for adjustment against external shocks. Colombia's adequate reserve and FCL access act as additional buffers. To this end, the authorities' Reserves Accumulation Program (RAP) will pave the way toward gradually reducing reliance on the FCL, and we welcome the authorities' commitment in the buff to implement the RAP through a market-based mechanism and small monthly amounts that will not disrupt the smooth functioning of the foreign exchange market.

Ms. Pollard and Mr. Vitvitsky submitted the following statement:

We appreciate staff's Article IV report on Colombia and the Selected Issues papers. This chair has consistently praised Colombia's overall strong and inclusive economic growth record, underpinned by very strong macroeconomic policies. Indeed, Colombia's economy is one of the few in the region in 2018 where growth accelerated and is projected to increase further in 2019. We broadly concur with staff's appraisal in the Article IV.

We commend the authorities for their response to the inflow of Venezuelan migrants. In Annex III, staff helpfully outlined their approach to calculating the substantial economic and fiscal impact of the migrant shock. We agree with staff that adjusting the fiscal deficit path—within the confines of the fiscal rule framework—is an appropriate approach.

More broadly, although we acknowledge the authorities' strong commitment to the fiscal rule, we are concerned that adhering to the fiscal rule may become increasingly challenging over time in the absence of a significant increase in economic growth. The government's major fiscal reform initiative proved more difficult to negotiate with Congress that might have been expected. In the near term, we urge that the government make efforts to realize fiscal savings that are within its authority, including inefficient spending, including the areas that staff have identified such as energy subsidy reform for the wealthiest households and stronger investment project selection and evaluation.

As raising growth should be Colombia's key objective, staff's analysis on relatively low total factor productivity (TFP) growth points to the need to implement structural reforms to boost potential growth. In this context, we agree with staff that the draft National Development Plan (NDP) serves as a roadmap for supporting productivity growth. We particularly welcome the plan's focus on anti-corruption efforts, including preventive measures to improve transparency. We also support staff's call to review non-tariff barriers, including the efficiency of procedures to export and import, which can help reduce trade costs and the potential for corruption.

The flexible exchange rate has helped Colombia adjust to external shocks. However, we support the Central Bank's reserve accumulation program, in preparation for a possible reduction of the Flexible Credit Line (FCL), and we appreciate that it has been conducted through a market mechanism in small amounts, as indicated in Mr. Villar's buff statement. We agree with the authorities that a faster pace of accumulation is unnecessary.

We support the authorities' plan to reduce FCL access and eventually exit the FCL arrangement. A gradual FCL phase-out would be a positive reflection of Colombia's structural improvements and increased resilience to negative shocks. We recognize that Colombia's high share of foreign ownership in local public debt securities leaves it vulnerable to swings in market sentiment. We appreciate staff's Annex IV on capital inflows, though would welcome more insight on risks. How diversified is the portfolio of holders? Is there absorptive capacity in the local market if there was a sell-off by external investors?

Finally, we would appreciate clarification from staff on the difference in views with the authorities on the exchange restrictions in the hydrocarbon sector.

Mr. Mahlinza and Mr. Ismail submitted the following statement:

We thank staff for the informative report and Mr. Villar for the insightful buff statement.

Economic recovery in Colombia is gaining momentum, underpinned by sound macroeconomic policies, strong private consumption and investment, and dissipated political uncertainty following the presidential election. In addition, the authorities' efforts in successfully managing a process of economic adjustment under challenging conditions are commendable. Notwithstanding, increasing migration inflows, lower global growth amid rising protectionism, and abrupt tightening in global financial conditions pose significant downside risks to growth prospects. We broadly agree with the staff's appraisal and provide the following comments for emphasis.

Sustained fiscal consolidation will be important to build fiscal buffers needed to accommodate higher spending pressures. In this vein, we commend the authorities for maintaining a neutral fiscal stance, and going forward, we see merit in the authorities' decision to use flexibility within the fiscal rule to accommodate the fiscal costs of the Venezuelan migration. At the same time, we urge the authorities to improve spending efficiency, including through reforming energy subsidies and strengthening investment project selection and evaluation. With the projected shortfalls in revenues emanating from the implementation of the 2018 Financing Law, implementation of structural measures to safeguard social spending and public investment would be necessary.

The accommodative monetary stance remains appropriate to bolster economic recovery with inflation close to target. Nevertheless, should the projected increase in credit growth materialize, the authorities should stand ready to tighten monetary policy. Further, we encourage the authorities to continue with the reserves accumulation program to insure against external shocks that could be triggered by sudden tightening in the global financial conditions. In this respect, we note the differences between staff and the authorities on the pace of reserve accumulation and urge continuous dialogue on this matter.

We positively note the emerging recovery in credit growth supported by an investment uptick. In this respect, we see merit in the gradual convergence of capital and liquidity requirements towards Basel III standards, which would help strengthen the financial regulatory framework without hampering credit growth. In addition, we view the introduction of the Conglomerates Law as an important step towards strengthening financial stability and mitigating risks associated with Colombian banks' exposure to Central America.

While substantial progress has been made in reducing poverty and inequality, further structural reforms would be necessary to foster inclusive growth and competitiveness. We are encouraged by the emphasis in the

National Development Plan (NDP) on entrepreneurship and improvements to the business environment. Further, improving governance, fighting informality, and improving the business environment would be important to enhance inclusive growth and external competitiveness. We would therefore urge the authorities to move quickly towards implementation of the Plan, once approved in May 2019.

Mr. Mojarrad and Mr. Nadali submitted the following statement:

Strong fundamentals, robust policy frameworks, and sustained implementation of sound policies have helped Colombia improve key social indicators over the past decade and adjust to a large terms-of-trade shock and, more recently, the trade and migration shocks associated with the situation in Venezuela. After a significant slowdown through 2017, GDP growth is recovering strongly, and inflation is close to target amid a narrowing output gap. While declining from its peak in 2015, the still elevated current account deficit is comfortably financed by stable FDI and portfolio flows, and reserve coverage is adequate by ARA metrics. The authorities deserve credit for skillful economic management that has helped Colombia maintain favorable access to international capital markets and earn OECD membership. Downside risks to the outlook, however, call for continued efforts to fine tune the policy mix, further strengthen financial sector regulation and supervision, and speed up structural reforms to boost competitiveness and promote export diversification. We concur with the thrust of staff appraisal.

Fiscal consolidation in line with the fiscal rule remains necessary to build buffers, reduce public debt, contain external imbalances, and maintain investor confidence. The authorities' decision to modestly relax near-term deficit targets within the existing rule while adhering to the medium-term structural deficit goal of 1 percent of GDP by 2023 is appropriate to respond to the migration shock while preserving the integrity of the fiscal anchor. We note the suspension of fiscal rule under the current legal framework when the escape clause is invoked and wonder if the authorities are open to revise the fiscal rule's contingency framework to handle exceptional shocks in the future. Staff comments are appreciated. Given spending pressures from migration and likely revenue shortfalls from the Financing Law, we see merit in strong efforts at improving revenue mobilization, including eliminating preferential regimes in CIT, broadening the PIT and VAT bases, strengthening tax administration, along with improved spending efficiency, including better targeting of energy subsidies, to help safeguard priority social and infrastructure outlays.

The moderately expansionary monetary policy remains appropriate to support the recovery, given close-to-target inflation, anchored inflation expectations, a negative output gap, and weak credit growth. The policy stance should remain data-dependent and be well-communicated. If, as expected, the recovery gains momentum later this year, we agree that the central bank should shift to a tightening bias to move policy to neutral territory. The flexible exchange rate remains the first line of defense against external shocks and should be backstopped by further sterilized reserve accumulation to maintain coverage at an adequate level and reduce FCL access, as intended.

The banking system remains adequately capitalized, liquid, and profitable, with somewhat elevated but well-provisioned NPLs. Transition to the new regulatory framework, including the introduction of the Conglomerates Law and Basel III capital and liquidity standards, bodes well for continued financial stability. Given the need to prevent credit supply bottlenecks, we endorse the gradual implementation of additional capital buffers. Close monitoring of banks' modified loan portfolios is also warranted to help avoid buildup of excess credit risk and delayed recognition of asset deterioration. We welcome the authorities' continued commitment to strengthening financial sector regulation and supervision, as indicated by Mr. Villar in his helpful statement, and support their request for a new FSAP mission.

The authorities' structural reform agenda, embodied in the National Development Plan (NDP), provides a strategic roadmap to enhance productivity and competitiveness and boost inclusive growth. Work should continue to upgrade physical and human capital, improve the business climate, expand access to credit for SMEs and start-ups, increase female labor force participation, review non-tariff barriers, and strengthen governance and the rule of law. Priority should be accorded to reforming the legal system, which remains an area of concern for economic agents, is estimated to have the strongest impact on TFP growth, and commands relatively high public support. We agree on the need for pension reform to improve coverage and equity while enhancing financial sustainability of the system. We note that the NDP provides measures to improve coordination amongst agencies to address the migration flows and appreciate staff further elaboration.

Mr. Gokarn submitted the following statement:

We thank staff for their informative reports and Mr. Villar for his helpful buff statement.

Despite having to deal with a series of shocks over the past few years, from declining oil prices to a large number of migrants from Venezuela, the Colombian economy has been performing relatively well. Growth is expected to reach 3.6 percent in 2019 and stay at that level for the next five years, with a moderately negative output gap over that period. Despite this, however, inflation is not expected to accelerate beyond 3 percent. The fiscal situation, with the deficit for 2019 expected to be 3.3 percent of GDP, raises some concerns, but this is projected to decline significantly over the next five years. One persistent vulnerability is the current account, with the deficit expected to persist at close to 4 percent of GDP until 2024.

With the short to medium term outlook appearing quite stable, we commend the Colombian authorities for their effective macroeconomic management. However, the report indicates several structural challenges. Poverty is relatively high for an OECD member at almost 27 percent; unemployment is also a challenge at 9.7 percent; and the Gini coefficient at over 50 points to relatively high inequality. Against this backdrop, we broadly concur with staff's assessment, which emphasizes action on the structural problems and make the following points for emphasis.

On the fiscal front, while several reform measures are ongoing, the report highlights the shock that large-scale immigration has created for public finances. We appreciate the disciplinary effect of the fiscal rule and note the difference of opinion on the appropriateness of adjustments required to deal with immigration. Could staff elaborate on reasons for their recommendation being considered superior to the authorities' approach? On the structural front, reforms of the tax system, both in terms of rates and enforcement are key to achieving the fiscal consolidation that the baseline forecasts project. Notably, these forecasts expect a sharp decline in the fiscal deficit beginning next year. This would require very high capacity within the system to implement fiscal reforms. Could staff comment on the basis of this expectation and elaborate on initiatives taken to enhance capacity?

As regards monetary policy, staff is in agreement with the current moderately expansionary stance. This may be inconsistent with the negative output gap but could be justified by the anticipated inflation trajectory and well-anchored expectations. We positively note the central bank's willingness to change their stance as inflation indicators warrant.

The current account deficit is expected to persist at relatively high levels. The authorities emphasize the impact of the Venezuelan situation on non-oil exports from Colombia. There are few indications that exports to other markets will accelerate sharply in the short term. Staff rightly emphasizes structural measures to enhance competitiveness, but these will take time to have an impact. Meanwhile, the economy remains vulnerable to global developments on the trade front, including their implications for commodity prices. We agree with the assessment that somewhat faster reserve accumulation could provide a more reliable buffer, but it is also necessary to look for opportunities to quickly expand exports. Could staff comment on opportunities to accomplish this?

The structural reform agenda proposed by staff is indeed ambitious. We welcome the authorities' commitment to this set of reforms, as reflected in both the content and the governance mechanism built into the NDP. Effectively implemented, this should boost the authorities' ability to enhance the peace dividend stemming from the agreement of 2017.

Finally, it would be reasonable to say that the likelihood of success of a structural reform program is enhanced when it is initiated in an environment of macroeconomic stability. Colombia broadly fulfils that condition and we wish the authorities all success in their future endeavors.

Mr. Agung and Mr. Anwar submitted the following statement:

We thank staff for the insightful set of reports and Mr. Villar for his informative buff statement. We commend the authorities for their sound macroeconomic and structural policies that have contributed to Colombia's recovery in the recent period. In 2018, growth strengthened, and inflation remained close to target. Going forward, the outlook is favorable, but downside risks remain high, including from weaker-than-expected global growth and a sudden sharp tightening of global financial conditions. The key policy challenge for the authorities is to strengthen economic sustainability, while containing widened external imbalances. The authorities' policy mix should be geared towards rebuilding fiscal buffers, maintaining monetary accommodation, and implementing structural and policy reforms to further strengthen economic and financial resilience. As we broadly share the thrust of staff's assessment, the following comments are made for emphasis.

While a moderately expansionary monetary policy stance is warranted to support robust domestic demand, policy rate decisions should continue to be data dependent, carefully calibrated, well communicated, and avoiding any policy surprises. Given anchored inflation expectations, negative output gap, and weak credit growth, we share staff's recommendation that in the near-term monetary policy should remain accommodative to safeguard the recovery and insure against heightened downside risks. However, should the recovery in credit and GDP materialize as expected, monetary accommodation can be gradually withdrawn, and Central Bank should shift to a tightening bias towards the second half of the year to move monetary policy to neutral territory. We take positive note that the central bank's reserve accumulation program has strengthened international reserves well above ARA metrics without disrupting the smooth functioning of the foreign exchange market. This is a welcome effort to prepare for a possible gradual reduction in FCL access.

A broad-based strategy to raise structural tax revenues and enhance spending efficiency is essential to build fiscal buffers and maintain investor confidence. We concur with staff that tax revenues should be gradually built up through tax reforms to help safeguard key public investment and social spending to support inclusive growth. We note the differing views between staff and the authorities on the projected revenue losses from the financing law, which contributes to a higher fiscal deficit estimated by staff compared to the one projected by authorities. We would appreciate it if staff could provide more context on the evolving discussion and pragmatic suggestions to take things forward. We encourage authorities to make further spending efficiency gains in line with the expert commission's findings, including energy subsidy reform and stronger investment project selection and evaluation. We support the authorities' efforts to improve tax administration, including stronger sanctions, to complement the structural fiscal adjustment efforts whilst safeguarding future spending priorities. We also welcome the Fiscal Rule Consultative Committee (FRCC)'s recommendation to use flexibility within the fiscal rule to modestly relax the deficit target over the next few years and to handle exceptional shocks in the future.

Structural reforms remain crucial to boost inclusive growth and improve external competitiveness. We commend the authorities for making impressive progress in reducing poverty and inequality over the past fifteen years. We welcome the draft National Development Plan (NDP) to alleviate structural bottlenecks and we look forward to its approval by Congress in the near future. We take note that authorities expect substantial productivity gains from measures taken in the NDP due to a combination of structural reforms and investment programs which in turn contribute to a further lowering in poverty as job creation rises. We welcome authorities' efforts to put emphasis on entrepreneurship and improve the business environment to strengthen external competitiveness. We also encourage authorities to advance pension reform in a manner that improves progressivity and coverage while ensuring sustainability of pension benefits.

With these comments, we wish Colombia and its people every success in their future endeavors.

Mr. Lopetegui and Mr. Morales submitted the following statement:

We thank staff for a well-written report and Mr. Villar for his helpful buff statement. We commend the Colombian authorities for successfully addressing consecutive shocks in the last few years, namely the 2014 decline in oil prices, the 2016 severe drought, the fiscal cost of pacification following the signing of a peace agreement with the largest guerrilla group in 2017, and the impact of the collapse of the Venezuelan economy, a major destination of Colombian exports, as explained by Mr. Villar.

Colombia's economy has continued to recover, demonstrating resilience, policy consistency, and a solid framework for macroeconomic policies. Growth is expected to pick up to 3.6 percent in 2019, supported by rising consumption and rebounding investment. This recovery in economic activity has been accompanied by inclusive policies that have translated into improved social indicators, including rural development policies in the framework of the peace agreement aimed at reducing inequality across regions. Sluggish non-oil exports combined with higher domestic demand explain a moderate widening of the external current account deficit to 3.6 percent of GDP, well below the levels reached after the 2014 collapse in oil prices, as explained by Mr. Villar.

We agree with staff that adhering to the fiscal rule remains appropriate. The recent tax reform and the government's commitment to contain expenditure will allow a narrowing of the central government deficit over time. At the same time, we concur with the authorities that the impact of the unprecedented Venezuelan migration on fiscal balances should be accommodated in the fiscal framework, because of its temporary negative impact on current expenditure arising from humanitarian help, emergency health care outlays, and access to education for Venezuelan families' children, as described in Annex III of the staff report (we would like to see a replication of this type of analysis in other countries affected by this migration shock). We agree that invoking the escape clause for the first time in the context of the fiscal rule's contingency framework could lead to credibility costs, and that the flexible approach approved by the authorities following recommendations by the Fiscal Rule Consultative Committee (FRCC) is highly preferable. This approach entails a modest and temporary relaxation of the headline deficit path in 2019-2020, with the trajectory of the deficit to be monitored by the FRCC with the view of adjusting the path as the migration shock is absorbed by the economy and narrowing the fiscal deficit towards 2023-24 below what was envisaged in the 2018 Medium-Term Fiscal Framework.

The 2018 Financing Law would raise tax revenues in the short term, but some of its provisions may complicate the envisaged medium-term fiscal tightening that would ensure a downward public debt path. The approved gradual reduction in corporate income taxes and larger VAT credits on capital goods rightly aim at boosting private sector investment over the medium term but should be complemented by a strong commitment to contain expenditure and improve efficiency in public finance management. In this regard, we welcome plans to continue technical assistance from the Fund on improving public spending practices, introduce stricter cost and investment discipline in Ecopetrol, and strengthen tax administration, as announced by Mr. Villar.

Inflation has remained stable around its target thanks to consistent monetary policy. Monetary policy has remained accommodative as economic activity recovered, with the central bank maintaining the policy interest rate at 4.25 percent since mid-2018. Capital inflows have been robust, and reserves remained adequate within the ARA metric range. In addition, Colombia's flexible exchange rate, reserve buffers, and FCL access continue to cushion the effect of external shocks, as illustrated in the Annex IV of the staff report. The authorities agree with staff that if the economic recovery materializes, monetary accommodation can be gradually removed. However, we fail to see the need for a further increase in international reserves advocated by staff, especially given that their own assessment is that reserves are adequate and that the central bank follows a transparent and market-friendly mechanism to accumulate international reserves that avoids foreign exchange market disruptions. Does staff have reservations about the central bank methodology to accumulate international reserves? What is the reason for staff's extra caution given the authorities policy commitments and track record?

Credit growth is expected to pick up to support the rebound in investment. However, NPLs remain elevated. While we understand that low-quality loans are well provisioned, we would welcome staff's comments on what sectors have been mostly affected by the deterioration in loan quality and the prospects of loan recovery. This will be key in determining the expected increase in the banks' willingness to resume commercial lending, which has experienced a contraction in the last two years according to Figure 6. On regulatory upgrades, we welcome the implementation of the Conglomerates Law and Basel III, and the envisaged adoption of a net-stable-funding-ratio requirement. However, we would appreciate if staff could explain the rationale to exclude intangible assets from the definition of assets subject to capital requirements, as described in paragraph 29.

We encourage the authorities to take decisive steps to raise productivity growth. The recent invitation by the OECD to Colombia to become a full member should be used as an opportunity to redouble efforts to consolidate structural reform. Steps to raise productivity include narrowing the infrastructure gap, improving the business environment and enhancing governance. In this regard, the draft National Development Plan, expected to be approved by Congress in May 2019, contains important measures that would improve incentives for technology adoption, discourage informality, upgrade evaluation of standards, cut red tape, enhance transparency and strengthen enforcement of sanctions of corrupt practices. On a related point, we encourage the authorities to enact pending legislation to protect whistleblowers and regulate lobbying activities.

Mr. Ronicle and Mr. Haydon submitted the following statement:

We thank staff for their report and Mr. Villar for the informative buff statement.

We commend the authorities on the positive direction of the Colombian economy. Economic growth increased in 2018, despite a difficult emerging markets context, and is expected to accelerate again in 2019. This prosperity is being widely shared – poverty and income inequality are falling, and the peace agreement stands to reduce regional inequalities. We welcome the commitment from the authorities to prioritize equality and firm formality, as defined in the National Development Plan (NDP) for 2018-22. We agree with staff that structural reforms remain instrumental to foster inclusive growth and enhance external competitiveness. Finally, while the Financing Law may not be a panacea, it is nonetheless a positive step towards improving Colombia's relatively low levels of revenue collection.

We limit our further comments to a few specific points relating to migration pressures:

We agree with staff that the authorities' decision to modestly relax their fiscal targets, in order to meet the fiscal costs of Venezuelan migration, is defensible. The extraordinary nature of the migration shock (the "fastest growing refugee crisis in the world" according to the UNHCR and World Bank) means there is a low risk of setting a precedent. This judgment seems to have been validated by the muted market reaction. It is right that the authorities use existing flexibility within the fiscal rule before invoking the escape clause. Naturally, if additional spending were to compromise the medium-term fiscal framework, this may erode credibility and increase risks to the wider economic sentiment. As such, we support staff's recommendations to limit the deviation from the fiscal rule and communicate a well-defined plan to resume the path to medium-term structural balance.

We agree with the authorities that there is considerable uncertainty around the magnitude of migrant flows from Venezuela, and welcome the Fund's sensitivity analysis. We feel, however, that a more detailed analysis could give the authorities a further tool for planning and engaging on actions to rebuild fiscal space. What assumptions are driving the higher and lower scenarios for Venezuelan migration? And could staff provide more detail on the implications for fiscal indicators (and the fiscal rule)?

A key parameter is the extent to which migrants will return to Venezuela when the political and economic situation changes. The more optimistic forecasts for Venezuela's economy generally rely on the assumption that a high proportion of recent emigrants will go back to Venezuela. We would welcome staff's views on how different rates of return migration might influence Colombia's economic and fiscal indicators.

Staff suggest that international support should be provided for Colombia's highly commendable policy responses and relief measures to assist the Venezuela crisis, and we agree. The UK was one of several contributors to a US$31.5 million grant from the Global Concessional Financing Facility (GCFF). This will be used as budget support for Colombia's efforts to facilitate access to jobs and basic social services for Venezuelan migrants and refugees, as well as the communities that are hosting them.

Finally, we understand that the Colombian authorities applied to the GCFF in part to avoid the perception that ordinary Colombians were bearing the costs of the Venezuela crisis on their own. We would be interested in staff's perspectives on the political economy impact of these additional spending pressures within the country – for example, will this sort of political narrative undermine efforts to increase tax collection in Colombia?

Mr. Merk and Ms. Kuhles submitted the following statement:

We thank staff for the comprehensive set of reports and Mr. Villar for his informative buff Statement. We broadly agree with staff's assessment.

Supported by prudent macroeconomic policies, strong policy frameworks and sound fundamentals, the economic situation in Colombia is overall favorable. Colombia's strong policies, flexible exchange rate and reserve buffers are the best instruments to guard against downside risks if they were to materialize. Considering the current account deficit and the related build-up in net foreign liabilities as well as downside risks to the outlook, continued vigilance is needed.

Colombia faces some challenges regarding its fiscal stance. We agree that fiscal consolidation should continue to reduce headline deficits in line with the fiscal rule. As increasing migration flows from Venezuela are putting a strain on public finances, we see merit in the authorities' view to use the flexibility embedded within the existing fiscal rule's framework to accommodate this shock. This is also reasonable given the commitment to the medium-term structural balance objective to preserve the integrity of the fiscal anchor. In this context, we would appreciate further comments on staff's rationale for recommending to invoke the escape clause rather than using the flexibility within the existing fiscal rule. Staff mentions that using the escape clause would imply suspending the fiscal rule altogether and could set a precedent with potential adverse credibility costs for the fiscal framework.

In addition, structural reforms to enhance spending efficiencies and to increase revenues are essential to avoid undesirable cuts in public investment and social spending. In the absence of reform efforts, spending inefficiencies, red tape and tax evasion could affect growth and poverty reduction negatively. On the spending side, efficiency needs to be improved, e.g. through a reform of energy subsidies as well as a better, transparent selection and evaluation of investment projects. With regard to the revenue side, we take note that increasing revenue mobilization could reduce the fiscal deficit.

On monetary policy, we take positive note that headline inflation is again very close to target and inflation expectations appear to be firmly anchored. Furthermore, we welcome the central bank's assertion that monetary policy will continue to be data dependent and that the accommodating stance will be gradually withdrawn if credit and economic growth recover as expected.

The foreign reserve position appears overall solid. We acknowledge that reserves are currently adequate according to the ARA metric and the efforts to strengthen international reserves. We echo staff's call not to approve the retention of the exchange restriction arising from the special regime for the hydrocarbon sector.

Finally, on the financial sector, we take positive note of the decline in NPLs. We welcome the implementation of the Conglomerates Law and of the Basel III capital and liquidity standards, as these promote stronger supervisory standards. On a more specific point, we wonder whether the redefined weights for the risk weighted assets and the positive effects this has on banks' capital ratios will still be appropriate in case of a downturn.

Colombia's low productivity growth is a major impediment for higher potential growth. We therefore agree with staff that reforms to improve competitiveness and productivity deserve particular attention. In this context, we welcome the initiative for the National Development Plan (NDP), which is envisaged to be approved in May 2019.

Mr. de Villeroché, Mr. Castets and Ms. Albert submitted the following statement:

We thank staff for their report and M. Villar for his valuable buff statement. We commend the authorities for the prudent management of the policy-mix in a context of several shocks in the last years and note that the economic rebound is gaining steam. In the short term, dealing with the massive migration flow from Venezuela is a major challenge. In this context, adapting flexibly the fiscal policy is legitimate. On the structural front, we welcome the National Development Plan (NDP) and see improvement of infrastructures and reduction of informality as key factors to boost lagging productivity and increase growth inclusiveness, as inequalities remain particularly elevated, among the highest in the region, and poverty still significant at 26.9 percent. We share the thrust of staff's analysis and recommendations and would like to add the following comments:

Outlook and Risks

The rebound of growth should continue in the coming years, driven by sustained internal demand. We note that the external position is moderately weaker than the level consistent with medium-term fundamentals and desired policies. Indeed, the current account continues to reflect the lack of dynamism of non-oil exports. Could staff elaborate on how the country could boost non-oil exports? We thank staff for the useful annex dedicated to the impact of migration from Venezuela on the economy. We note that the baseline scenario is based on an assumption of no net inflows after 2020, and we appreciate the sensitivity analysis as uncertainty surrounding the future flow of migration is very high. Absorption of migrants into the labor market is another major assumption of the baseline and warrants an appropriate integration. Could staff detail the policies that should be developed to ensure the integration into the labor market? The impact of the immigration will also be uneven according to regions. Moreover, we agree that oil volatility remains a risk to monitor closely considering the high impact identified in the RAM.

Fiscal Policy

We encourage to adapt flexibly the fiscal position to absorb the migration shock and to foster tax revenues. We note from the buff statement that the original financing law project was not approved in its entirety by Congress. It aims to reduce the complexity of the tax system and we note that staff assesses that it should have a positive effect on growth (by 0.2 percent of GDP). It should help to improve tax revenues this year but will then provoke a decrease over the next years (-0.6 percent of GDP in the long run). This trend might prove unsustainable to accommodate the development and social needs, while the fiscal rule will call for more tightening. As the tax revenues is especially low (14 percent of GDP against 17.7 percent in the region), we fully concur with staff that mobilizing additional tax revenues appear as the most adequate way forward, with an important role for the revision of tax exemptions. For the next review, it would be helpful if staff could detail its recommendations on tax measures that would raise additional revenues while enhancing the progressivity of the tax system. Could staff elaborate on the reform of energy subsidies? On the expenditures side, we support staff recommendation to be flexible to absorb the costs due to the migration shock about 0.4 percent of GDP next year and which should decline to 0.1 percent of GDP in 2024. As uncertainty about migration movements and thus fiscal costs remain high, FRCC should monitor closely the situation.

The rapid increase in foreign investors' participation in the local currency debt market should be monitored as the share of the NFPS debt held by non-residents is identified as above its risks benchmark in the DSA and could create a risk of sudden capital outflow when global financial conditions will further tighten.

Monetary and Financial Sector

The monetary policy appears appropriate and we encourage the authorities to finalize the implementation of the Conglomerates Law and Basel III. The monetary stance helped to maintain inflation in the target band and inflation expectations well-anchored. In the future, we concur with staff that if sustained growth performances materialize, a gradual monetary tightening could be suitable. The financial sector appears resilient, with NPLs well provisioned, and we welcome the on-going implementation of the

Conglomerates law, which reflects the past FSAP recommendations, as well as Basel III standards.

We note that reserves, at 118 percent of the ARA metric (including commodity buffer) are considered as adequate and FCL, which participated to the resilience of the country, provides an additional buffer equivalent to 27 percent of the ARA metric. However, the baseline shows that reserves without FCL would be under the reserve adequacy range after 2021 (Annex V), and we understand that the Central Bank's reserve accumulation program will help to add some buffers to be prepared "for a potential reduction of the FCL". Could staff precise its assumption about the speed of the warranted reserve accumulation, and if it should offset completely the phasing out of the FCL buffer in its view?

Structural Reforms

We consider structural reforms as a priority, notably to reduce the still high levels of poverty and inequality, and welcome the NDP adopted by the authorities to improve inclusive growth. In this regard, and given the macrocriticality of inequality and poverty in Columbia, we would have appreciated more attention on those aspects in the report. Moreover, we consider the reduction of informality as an important mean to ensure greater inclusiveness. We also note the importance of the improvement of legal system, through impartiality of courts and legal enforcements of contracts, as mentioned in Annex VI. We welcome the progress made to tackle corruption and improve governance of state-owned enterprises. As TFP remains close to the 1990 level, we consider that achieving the 4G infrastructures program, which has suffered from delays, should participate to boost potential growth. Could staff provide some details about the calendar of the realization of the 4G infrastructures and to which extent it relies on international financing and local banks?

Mr. Trabinski and Mr. Tola submitted the following statement:

We broadly concur with staff's assessment of the current economic situation in Colombia, including the main challenges that the country is facing and the policy recommendations. We commend the authorities for their efforts in addressing the current challenges related to the acceleration of migratory flows. Looking ahead, the authorities' main task will be to adjust fiscal policy to cater for costs associated with migration, while remaining on the path of fiscal consolidation in line with the 2018 Medium Term Fiscal Framework (MTFF). In the long term, progress with structural reforms embodied in the

National Development Plan (NDP) will be paramount to achieve a sustainable and more inclusive growth.

We share staff's view that a certain flexibility within the fiscal rule is warranted against the background of the migration shock. At the same time, strong commitment to the fiscal rule should be preserved. The MTFF and the fiscal rule have helped Colombia to weather the terms of trade shock of 2014-2016. However, flexibility within the rule to handle migration-related costs is reasonable if the medium-term structural balance objective is safeguarded. Other countries' experiences in applying the escape clause could be helpful in the decision to find a balance between the need to support confidence in the fiscal anchor and the need to effectively smooth the fiscal shock resulting from migration. In this context, we would appreciate staff's opinion on other options the authorities could follow to introduce the necessary amount of flexibility without harming the credibility of the fiscal rule.

A quick return to the medium-term fiscal path requires firm implementation of fiscal structural reforms to broaden the tax base. The new Financing Law has introduced some changes to income taxes, but as they only affect a small number of taxpayers, revenues will increase only moderately. Hence, broadening the tax base remains a priority, same as the elimination of tax exemptions and deductions. Moreover, making tax administration more efficient through inter alia new IT systems, training and introducing adequate performance incentives could further improve tax collection.

Increasing spending efficiency calls for a better coordination between the relevant institutions. The authorities' commitment to improve spending efficiency is reflected in the NDP. A close coordination between the Ministry of Finance and the National Planning Department is necessary to reduce the fragmentation of the budgetary processes. In this vein, the proposal to unify the operational and investment budgets constitutes a step in the right direction. However, it appears that the NDP will ultimately not include the unification of the operational and investment budgets. Could staff comment? Moreover, it is important that reforms not only focus on the national but also on the subnational level, where a large part of spending takes place and where capacities are limited.

We welcome the authorities' efforts to increase reserve accumulation as a buffer against external shocks and in view of a possible reduction in FCL access. Building external buffers is important given the large share of the current account deficit financed by capital inflows. However, we note staff's suggestion that the current pace of accumulation may not be enough to keep ARA coverage at the current level. Could staff advise on possible alternative ways the Central Bank could follow to accelerate the reserve accumulation without disrupting the markets?

Mr. Palei and Mr. Snisorenko submitted the following statement:

We thank staff for the helpful set of papers and Mr. Villar for his informative buff statement. After a series of substantial exogenous shocks, the Colombian economy continues to recover. Last year growth strengthened to 2.7 percent, and it is expected to improve to about 3.6 percent in 2019. After a spike in the previous years inflation has declined to the target level. At the same time, external imbalances have widened while the risks have heightened and remain tilted to the downside. We broadly agree with the authorities and staff on the need for further improvements in monetary and fiscal frameworks, as well as more ambitious structural reforms.

In the fiscal area, economic recovery is conducive to more expeditious fiscal consolidation in line with the fiscal rule. While we appreciate the arguments in favor of flexible implementation of the fiscal rule in response to temporary shocks, we are concerned that the steady state fiscal target remains out of the authorities' reach for a number of years. The length of the period, in our opinion, calls for more ambitious steps toward fiscal resilience. The authorities should rebuild the fiscal buffers in response to a number of heightened risks in the global environment and regionally. Furthermore, given that the Colombian economy is resource dependent, we believe that the fiscal rule itself may deserve re-evaluation with a view to strengthen the fiscal buffers. Are there any discussions in the expert community on the possible need for recalibrating of the fiscal framework in Colombia?

Further improvements in the tax system remain among the key priorities, given that the tax revenue is still low compared to the peers. The recently adopted Financing Law rightly addresses some of the shortcomings in the tax system by increasing PIT and reintroducing the wealth tax, while reducing the corporate tax burden. According to the SIP, the authorities' measures may boost somewhat medium-term growth through increases in private investment. We are concerned, however, that these changes will likely curb tax revenues from 2020 onwards. While the overall effect of the Financing Law is uncertain, further measures to widen the tax base, reduce preferential regimes, and improve tax administration are critical. In this respect, we would be interested in comparisons of C-efficiency in Colombia not only with its regional peers, but also with other emerging market economies and the OECD countries. Staff's comments would be appreciated.

On the monetary policy, we agree that, at this stage, slightly accommodative policy stance is appropriate. Further policy decisions should continue to be data dependent and to ensure the withdrawal of stimulus as the output gap closes. In the previous Article IV report staff noted that the central bank's communication could be significantly improved. Could staff elaborate on any changes in this area and the current state of the monetary policy communication in Colombia?

We are encouraged by the introduction of the Conglomerates Law and implementation of the Basel III capital and liquidity standards. We agree with staff that this is an important step towards preserving financial stability that will further strengthen the financial regulatory framework and improve its transparency.

We support the authorities' decision to launch the international reserves accumulation program. The program is designed in a way that minimizes the impact on the spot exchange market and allows to maintain short-term interest rates at their target. An accurate communication policy is paramount to assure market participants that interventions are neutral towards a specific exchange rate direction. While the current pace of accumulation is enough to maintain the reserve coverage at the adequate level, it may be accelerated. If we recall correctly, on several occasions the Colombian authorities have already announced their intention to exit the FCL. We note from the buff statement that the authorities now refer to a potential reduction in reliance on the FCL. Did the authorities reconsider their plans?

We welcome the draft National Development Plan aimed at fostering inclusive growth and enhancing competitiveness. It is rightly focused on enhancing productivity, improving efficiency, enhancing the business environment, fighting informality, strengthening the rule of law, and reducing corruption.

We support staff's suggestion to prioritize the reforms to the legal system, as outlined in Annex VI, as improvements to the legal system are not only estimated to have the strongest economic impact, but also have the highest public support.

Mr. Raghani, Mr. N'Sonde and Mr. Lopes Varela submitted the following statement:

We thank staff for their report and selected issues paper and Mr. Villar for his detailed and informative buff statement.

We very much welcome the Colombian authorities' sound macroeconomic policies as well as the accomplishment of the peace deal. That have helped accelerate the economic recovery and boost market confidence. However, the strong domestic demand is expected to continue fueling large imports and current account deficits. In addition, a weak external environment and tighter global financial conditions continue to pose risks to the outlook. We, therefore, encourage the authorities to preserve their robust policy framework and fundamentals by swiftly pressing on needed fiscal and structural reforms with the view to achieving steady and sustainable growth.

We broadly concur with staff's appraisal and policy advice and would like to emphasize the following points.

Sustained fiscal reforms remain crucial to achieve budget targets and put the public debt on a downward path. We take note that the fiscal deficit declined to 3.1 percent of the GDP in 2018 and the goal to achieve a target of 1 percent of GDP by 2022 consistent with the fiscal rule. Nevertheless, we encourage the authorities to consider further tax reform measures to preserve fiscal sustainability and the credibility of the fiscal rule, should the risks related to migration flows and the potential decline in revenue from the new Financing Law materialize. In this regard, policy actions should focus on increasing tax revenue and improving expenditure efficiency, including by ending preferential tax treatment for businesses, broadening the tax base for personal income taxes and VAT, and improving tax administration. On spending, we encourage the authorities to pursue policies in line with the recommendations of the expert commission that will help better target energy subsidies on the most vulnerable groups, strengthen project selection and evaluation, and promote the use of public procurement guidelines. We would appreciate an update on the impact on Colombia's public finances from the recent migration shock?

Commendable progress has been made in strengthening the monetary policy framework which helps maintain inflation within targets. The accommodative stance which started in mid-2018 has enhanced Colombia's economic recovery and remains appropriate. However, we concur that tightening the monetary conditions may be necessary if and when the expected recovery occurs, and price stability is undermined. We also agree that the flexible exchange rate continues to be the first layer of protection against external shocks and in helping build international reserves. On financial and external resilience, it is not clear from the report how the authorities are planning to contain the build up of net foreign liabilities without jeopardizing the economic recovery underway. Are macroprudential options envisaged? Staff comments are welcome.

Colombia's banking system remains well capitalized and resilient. We commend the authorities for the measures to strengthen financial sector regulation and supervision in line with the previous FSAP recommendations, including the ongoing implementation of the Conglomerates Law and Basel III capital and liquidity standards. Nevertheless, the authorities should continue to remain vigilant to ensure a smooth transition to these new laws while monitoring carefully the still elevated NPLs and loans portfolio to preserve financial stability.

Further structural reforms remain essential to enhancing Colombia's growth potential. The authorities are to be commended for the notable progress made in terms of poverty reduction and inequality over the last decade. The transformation agenda in the 2018−22 National Development Plan (NDP) would certainly support their efforts in diversifying the economy and further unleashing growth. We encourage the authorities to steadfastly implement the plan, which should also contribute to strengthening the economy's resilience to external shocks and improving competitiveness. We would appreciate further elaboration on measures being envisaged in skills training and innovation to boost productivity. Moreover, pension reforms, the removal of non-tariff barriers, and the scaling up of public investments to address infrastructure gaps should help support inclusive growth.

With these remarks, we wish the Colombian authorities success in their endeavors.

Mr. Sun and Ms. Zhao submitted the following statement:

We thank staff for the comprehensive set of papers, and Mr. Villar for the informative buff statement. Supported by a sound policy framework, Colombia's economic recovery is gaining momentum amid heightened risks. Against a backdrop of a narrowing output gap, elevated current account deficit and fiscal uncertainties around the migration shock, the policy mix should be geared towards supporting recovery and containing external imbalances, while allowing for some flexibilities under the fiscal rule. We broadly concur with staff's appraisal and would like to limit our comments to the following points.

Adhering to the fiscal rule remains important, but given the uncertainty surrounding migration flows, some flexibility may be warranted. We welcome the authorities' efforts to explore options for adjusting the deficit target under the existing rule to accommodate the spending pressures from the Venezuela migration shock. We encourage the Fund to undertake further research in this area, including the broader effects of migration on the economy.

We agree with staff that structural reforms are key to boosting inclusive growth and improving external competitiveness. We welcome the emphasis of the draft National Development Plan on entrepreneurship and business environment to strengthen cost competitiveness. Continued focus on closing Colombia's substantial infrastructure gap is needed to reduce transport costs. In this regard, we note that the 4G infrastructure program has progressed slower than expected but take positive note of the actions the authorities have taken to address the issue.

In the near-term, with inflation close to target, anchored inflation expectations and weak credit growth, monetary policy should remain accommodative to safeguard the recovery amid heightened downside risks. Going forward, monetary policy decisions should continue to be data-dependent and well-communicated. In the meantime, to strengthen Colombia's resilience, we welcome the central bank's efforts to accumulate reserves to mitigate external shocks.

With these remarks, we wish the authorities every success in their policy endeavors.

The Acting Chair (Mr. Lipton) made the following statement:

Our agenda item is the 2019 Article IV consultation with Colombia. Before turning to the Board, I wanted to say a few words about Colombia's efforts to respond to the humanitarian crisis in Venezuela. As a frontline country, Colombia has taken in more migrants from the Venezuelan crisis than anyone else, over a million and a half already at the end of last year, mostly arriving just last year. This amounts to about 3 percent of Colombia's total population, an increase over just a few years. Colombia has been providing humanitarian relief and economic support, working to provide healthcare and education and grant labor rights for people coming in, helping them resettle. This is a challenge for policymakers. Perhaps we can have some conversation about how they are managing the budgetary pressures that this engages; and this is a subject that will return and is relevant for other countries as well. I wanted to make these comments to point out this element of the situation in Colombia.

Mr. Villar made the following statement:

I would like to start by thanking Mr. Faruqee and his team for a complete set of documents and for the open and constructive discussions with the Colombian authorities. I would also like to thank all Directors for their thoughtful comments as reflected in the gray statements.

My authorities broadly agree with the staff's analyses and recommendations as well as on the challenges for the coming years. The economy has faced important shocks, starting with the sharp drop in oil prices in 2014. More recently, the collapse of the Venezuelan economy is clearly the most important one. Colombia is now experiencing the largest immigration process that the country has ever seen. More than 1.2 million people have arrived from Venezuela during the last 5 years, most of them in the last 18 months.

Despite these shocks, Colombia has been able to manage a process of economic adjustment in an orderly manner. Annual inflation is close to the central bank target, while GDP growth is recovering and is expected to reach 3.6 percent in 2019. The current account deficit is still relatively high, but it is mostly financed by foreign investment. The financial sector is strong, and financial supervision has been undertaking important reforms in line with previous recommendations of Fund missions. Moreover, my authorities are committed to continue strengthening the relations and supervision and have asked the Fund for a new Financial Sector Assessment Program (FSAP) mission, which will be particularly relevant for this purpose.

Consistent with the inflation-targeting regime, Colombia has a flexible exchange rate that has served the economy well. Still, after the depreciation of more than 50 percent that followed the collapse in oil prices, the Colombian peso has shown remarkable stability since 2016. In September 2018, the central bank announced a program to accumulate international reserves through a market-based mechanism and small monthly amounts that do not disrupt the smooth functioning of the foreign exchange market. It is important to mention that the level of international reserves is well above the Assessing Reserve Adequacy (ARA) metric used by the Fund. Even so, the central bank continues accumulating additional reserves that would allow for an even more comfortable level and would provide room to gradually reduce reliance on the Flexible Credit Line (FCL).

Of course, the challenges ahead are important, and risks are not negligible. On the fiscal front, my authorities concur with the staff on the need to continue converging toward a long-run structural deficit of 1 percent of GDP set in the fiscal rule of law. Since 2016, the deficit has been shrinking every year, and it is expected to continue doing so in the years to come. Due to the fiscal costs associated with the Venezuelan immigration, the Fiscal Rule Consultative Committee used the flexibility provided by the rule to adjust the target previously set for 2019. However, I would like to stress that the new target still implies a reduction in the deficit compared to 2018.

Going forward, the foreseen fiscal adjustment is more challenging as corporate taxation has been reduced to stimulate the economy and enhance competitiveness. My authorities agree with the staff on the need to increase tax revenues. The regional financing law project contains many of the measures recommended in the staff report, which unfortunately were not approved in their entirety by congress. The development government is, however, confident about the possibility of obtaining important gains from a more efficient tax administration and is already introducing sweeping reforms within the tax administration office that are expected to yield results soon. Also, the Fund is providing technical assistance that will help Colombia to enhance policy spending efficiency to improve the budgetary process and to subsidy focalization, mainly in the fuel and electricity sectors.

As stressed by the staff, Colombia has made impressive progress in reducing poverty and inequality over the past 15 years. My authorities have committed to continue advancing in that process as reflected in the national development plan that is under consideration in congress. Accession to the OECD, which was granted in May 2018, will reinforce this institutional framework and enhance the quality of policies in the same direction.

I will stop here, reiterating my personal gratitude and the gratitude of my authorities to the mission team and to all the Directors for their engagement.

Mr. Raghani made the following statement:

I thank the staff for their high-quality report and selected issues paper and for their responses to the questions raised by Directors. We also thank Mr. Villar for his informative buff statement and for his insightful introductory remarks.

We have issued a gray statement and would limit our remarks to the following points for emphasis. We commend the authorities' sound macroeconomic policies that have changed the course of economic development in Colombia for the best and boosted market confidence in the context of challenges related to migrant flows, as mentioned in the Acting Chair's introductory remarks and in Mr. Villar's preliminary comments.

As risks remain elevated, we see merit in preserving the robust policy framework and fundamentals through further structural reforms to place Colombia on a pace for stable and inclusive economic growth. Like other chairs, we concur on the importance of preserving fiscal sustainability and the credibility of the fiscal rule through the implementation of planned tax reforms that will help provide needed fiscal space for capital and social spending. Measures to increase the spending efficiencies are also of paramount importance to safeguard priority spending. We also appreciate the staff's response that the most recent information on migration flows are broadly in line with the staff's estimates of fiscal costs based on December 2018 data.

Finally, we commend the authorities for the steps taken to strengthen financial sector regulation and supervision. We encourage them to continue to enact the Conglomerates Law and Basel III standard to ensure stability in the banking system. We appreciate the staff's assessment of the low risk that the expected buildup of net foreign liabilities would pose to domestic financial stability. With these remarks, we wish the authorities the best in their future endeavors.

Mr. Tombini made the following statement:

As Mr. Villar has highlighted, Colombia has faced four substantial exogenous shocks in the past few years: the plunge in oil prices; severe droughts; the fiscal demands associated with the peace agreement; and the most important one, as Mr. Villar mentioned, the collapse of the Venezuelan economy, resulting in a fall in exports and unprecedented immigration flows. Given the magnitude of those shocks, the performance of the Colombian economy has been remarkable. Even as growth decelerated, inflation spiked, and the current account deficit widened. Those outcomes are commensurate with a healthy assimilation of such a sequence of sizable shocks, attesting to the robustness of the macroeconomic framework and the appropriateness of the policy response. Furthermore, I assume that the support given by the FCL also played a constructive role.

Second, we have seen a reshaping of the global outlook in the past few months. Six months ago, the main risk was associated with a tightening of the global financial conditions. In the last quarter of 2018 and the beginning of this year, however, global deceleration surprised on the downside. With the responses of the Federal Reserve, the European Central Bank (ECB), and the Chinese authorities, deceleration was reined in, and a window of easy financial condition has opened, including for emerging market economies.

As Colombia remains vulnerable to external shocks, especially given its gross external financing needs, we welcome the authorities' decision to build up international reserves. Further accumulation of reserves will help the phasing out from the FCL, as mentioned by Mr. Villar, but we underscore that such a transition should be contingent on the evolution of risks. In other words, there should be no specific thresholds or deadlines for reducing access to the FCL. On the other hand, I concur with the staff that the current global juncture may allow for a somewhat more aggressive stance in building up reserves and that the authorities should carefully consider the possibility of seizing such an opportunity if local market conditions also allow.

Third and finally, Colombia is the neighboring country that has been most affected by the economic collapse in Venezuela. I agree with the approach taken by the Colombian authorities to use the flexibility under the fiscal rule to accommodate the extraordinary fiscal costs associated with those migration flows. I wonder, however, whether deterioration in the refugee crisis beyond what is currently expected could be covered by the same mechanism or if it would require resorting to the escape clause. The staff's comments are welcome.

With this, I wish all the success for the Colombian authorities in their future endeavors.

Mr. Lopetegui made the following statement:

I want to emphasize a few points from our gray statement. First and foremost, we want to commend the authorities for skillful macroeconomic management, which has led to resilience of the Colombian economy, as demonstrated by successfully navigating consecutive shocks in the past few years. I echo the words by Mr. Tombini. Amid the shocks, the Colombian economy has continued growing, while social indicators have improved, including due to rural development policies in the framework of the peace agreement aimed at reducing inequality across regions. Inflation has remained stable around the target recently thanks to consistent monetary policy. While the external current account deficit is projected at 3.6 percent and may be regarded as on the high side, capital inflows, especially FDI, have been robust. Reserves remain adequate, and Colombia’s flexible exchange arrangement and FCL access continue to cushion the effects of possible external shocks.

In the fiscal area, we agree that adhering to the fiscal rule remains appropriate. The recent tax reform and the government’s commitment to contain expenditure will allow another window of the central government deficit over time. This being said, enhancing tax administration and further broadening the tax base may be necessary in due course to avoid compression of capital expenditures.

We concur with the authorities’ approach to cushion the impact of the Venezuelan immigration. In this regard, we like the analysis in Annex 3 of the report, and would like to see similar analysis conducted in other countries affected by shocks. We believe that the flexible approach approved by the authorities following recommendations of the Fiscal Rule Consultative Committee is highly preferable to using the escape clause, because this could have led to credibility costs.

On monetary policy, we note there is broad agreement. We still fail to see the need to increase international reserves faster—as advocated by the staff—especially given their assessment of the reserves as adequate and given that the central bank follows a transparent and market-friendly mechanism to accumulate international reserves that avoids foreign exchange market disruptions.

Moreover, as noted by Mr. Villar, the central bank conducts a periodic evaluation of liquidity risk based on which changes in the pace of reserve accumulation may be adopted in the future.

Finally, we encourage the authorities to take decisive steps to raise productivity growth. The recent invitation by the OECD to Colombia to become a full member is an opportunity to redouble these efforts to consolidate structural reforms. Steps to raise productivity include narrowing the infrastructure gap, improving the business environment, and enhancing governance. In this regard, we welcome the initiatives included in the national development plan expected to be approved by congress this year.

Mr. de Villeroché made the following statement:

Let me start by saying that Colombia had strong macroeconomic policies, and that delivered good results. As highlighted, the country has faced the oil and commodity shock 2½ years ago now and now is facing a humanitarian crisis but has kept strong macroeconomic policies and delivered stability. I would like to underline that we see the FCL as having played a role in terms of bringing stability to the country. Sometimes we had difficult debates in this Board on precautionary instruments, but I see a strong case to acknowledge that it has been very helpful for this country.

My second point is on the humanitarian crisis that Colombia is facing. We welcome the use of flexibility in fiscal rules to accommodate the fiscal shock associated with this crisis. We have one question, a message of caution. Nobody knows how long this crisis will last, and the experience in many humanitarian crises is that they last much longer than expected when they start. I understand that the baseline is based off the idea of a temporary shock, and considering the important uncertainty surrounding the situation in Venezuela, we encourage the staff to continue to work on a more permanent track in terms of immigration. If one listens to the United Nations High Commissioner for Refugees (UNHCR), for example, they say that displaced groups of persons usually stay between 7 to 10 years in host countries; this has implications for the labor market and how we open the labor market.

My third point is on the growth model. Colombia achieved important success in terms of reducing poverty, but it remains high at 27 percent, and moreover, we see very high levels of inequality in Colombia. According to the World Bank, 40 percent of the wealth is received by the top 10 percent, and Colombia has one of the highest levels of inequality in Latin America. We would like to underline this challenge and ask staff if it could pursue some more work on inclusiveness.

Mr. Palei made the following statement:

We welcome the authorities' policies in many areas. we support the intention to accumulate additional foreign exchange reserves. We also commend them for the conduct of a responsible monetary policy based on a flexible exchange rate and also for their financial sector reforms.

We note that many Directors agreed with staff, and I should probably say the authorities, on the need to significantly strengthen the fiscal framework and the fiscal rule itself. We recognize that the authorities did face significant shocks over the past five or six years. There was also uncertainty about the nature of those shocks, whether they were temporary or persistent, if not permanent. However, the fact is that there was always a reason to maintain a significantly larger deficit than the one chosen for the fiscal rule. The reasons change; the shocks change; but the gap between the actual deficits and the norm remains rather large.

The credit rating agencies, including the Standard & Poor's and Moody's, have already highlighted the weaknesses of the fiscal framework at the end of 2017 and the beginning of last year and downgraded the ratings or adjusted the outlook toward a negative outlook. They also stated publicly very recently that the adopted changes in key taxes fell short of market expectations. I believe that the staff estimated that these changes are likely to further reduce the tax revenue by about 0.7 percentage points over a period of three or four years. This seems like a relatively large shortfall given the very low level of tax revenues in Colombia.

Other alarming signs in the fiscal area are illustrated by a low level of so-called C-efficiency and the significant deterioration in this area over the past six or seven years. The staff provided additional comparisons on page 5 of the written responses to Directors' questions. Over time, the C-efficiency in Colombia has actually deteriorated compared to the average for emerging market economies. The gap between the emerging market economies and Colombia seems to grow over time, which is a worrisome sign.

All of this makes us think about the fiscal developments and the prospects in Colombia, and in this respect we welcome the authorities' plans to create a an independent fiscal council, and to revise the fiscal rules contingency framework, as explained by the staff.

On the targeted fiscal deficit, I note that other countries, especially commodity exporters such as Colombia, have more ambitious fiscal targets embedded in their fiscal rules. I also see some room for additional discussion of whether a fiscal deficit of about 1 percent is an appropriate fiscal target in the medium-term.

On the effects of migration, I welcome the staff's analysis. I believe that we have discussed similar issues in the report on Poland. Poland faced a huge surge in migrants inflows over the past three years, from about 1 percent to about 5 percent of the labor force, so we encouraged additional analysis in the case of Poland, and also we support staff providing additional analysis and monitoring of these issues in Colombia.

Finally, I noted that among the reform priorities, the legal reforms stand out. I have not read this working paper on Brazil. I intend to read it, but it is an interesting analysis. I do not quite understand where the data come from, except for public opinions from Latino Barometer, but we will take a look at these reforms and note that the rule of law is a priority area in Colombia. We wish the authorities success in additional reforms in this area.

The staff representative from the Western Hemisphere Department (Mr. Faruqee), in response to questions and comments from Executive Directors, made the following statement:[1]

I will limit my remarks to three topics. The first is open migration and its effects; then I will discuss the fiscal rule, and then end on reserve accumulation. I will defer the questions on the FCL to the follow-up Board meeting that we will have in May.

On migration, we received questions about the staff assumptions, alternative scenarios, and our findings, and updates. I want to stress that the work that the team has done for Colombia was preliminary. One could think of this as almost a pilot case in Latin America. The Western Hemisphere Department plans to do some follow-up work to look at migration and fiscal spillovers in a broader set of countries, so we hope to extend the work that we have done for Colombia, revisit the analysis that we have done in this case, but also extend it to other countries in the coming months.

In terms of the analysis itself, when we think of the migration shock in Colombia's case, we assumed in our analysis the frontloaded time profile. There are some questions about the timing of the different effects, and that is an important assumption to bear in mind. We saw an acceleration in the data in terms of migration flows in 2018, and in the staff's baseline assumptions we expect a similar level of flows for this year. But as several Directors have pointed out, there is wide uncertainty around the pattern of flows going forward, and that is what motivated the sensitivity analysis that we put in the report, and we gave some further details in our written responses.

In terms of understanding the baseline effects for migration, given the quality of the data that we were able to find, collected by multiple Colombian agencies, we were able to use a production function approach to look at the supply-side effects of migration. We had enough information on things like the demographic profile of migrants, the working age composition, as well as

[1] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

participation and employment rates, the level of formality, informality, in terms of their employment decisions. We are not sure we will get that richness of data for other countries when we expand our analysis, but we certainly will make our best effort. In the case of Colombia, we were fortunate enough to have that information, and that is what informed much of the analysis in the report.

In terms of the economics, we approached the impact of migration in the short run in terms of an adjustment cost story—one in which we see dampened effects on GDP, and we saw a fair bit of evidence of this in the data, and I am happy to elaborate on that. In terms of our view, the supply-side effects grew stronger over time. In the near-term they are not as strong, but as frictions become less binding, we thought the impact on potential GDP would be stronger.

On the demand side, we also took the information that we were able to collect, and there we thought the effects would be more immediate in terms of the a higher number of households in Colombia as a result of the migration shock; and also through the fiscal accounts, public demand at the estimated fiscal cost of about half percent of GDP for 2019, which is close to what the authorities have in their estimates. I am happy to elaborate if there are any follow-up questions.

There was a question on updates of the impact of migration on public finances. We have provided some details in our written responses. We have a few months of data so far this year, and if we extrapolate that for the rest of the year, we are broadly tracking close to what we have—the half percent, maybe a little bit higher than that so far this year. But, again, that is just with two months of data.

I should mention that with respect to the estimated fiscal cost, in addition to the authorities' estimates there have been independent estimates that corroborate the number. The World Bank has done some estimates. One of the leading think tanks in Colombia has independent estimates that give broadly that same order of magnitude.

In one of the gray statements, there is a more difficult question about the political economy impact and how the political narrative may be affected by migration. I am not sure I am the best placed person to answer that question. I would say from staff's perspective, it is hard to know at this stage. In many ways, Mr. Villar is better placed. What I would say is that much of it will depend on where we go from here. When we think about the size and the persistence of the shock going forward, that might have a bearing on that question, but the staff does not have any particular insights in that area.

Turning to the fiscal rule, we feel that there was a broad consensus in the gray statements that introducing flexibility within the rule was reasonable and well understood given the large migration shock that we have seen to accommodate that. Directors' questions were more about the implementation with respect to the actual fiscal framework and the use of the escape clause. But before I come back to that point, it is important to take a step back and mention some of the things that did not change. The structural fiscal targets that Colombia has in its fiscal framework were not affected, so the medium-term anchor was not. What was safeguarded was not changed to accommodate the migration shock, and that is a positive sign that reinforces the credibility of the framework. That is an important anchor to the Debt Sustainability Analysis (DSA) in the report.

With respect to the modest relaxation of the headline deficit targets over the next several years, the adjustment is fairly modest. In the first few years, it is less than the amount of the fiscal costs that I have mentioned because there were some offsetting adjustments given that the economic cycle looks stronger now in Colombia. The actual amount of relaxation in the deficit target for 2019 is actually not the half percent, but 0.3 percentage points from 2.4 to 2.7 percent.

In terms of the implementation, the modest relaxation of the rule was done in a well-defined manner and close to what the staff had recommended. The staff had argued that if the authorities were to consider introducing flexibility in the rule, that it be done in a well-specified way. By that, I mean with a clear trigger, the cause, having a pre-specified period, having a modest and commensurate deviation from the fiscal rule in line with the amount of the migration-related costs, and also with monitoring. All those conditions were put forward in the recommendations of the consultative committee and adopted by the authorities. We feel that that is a strong positive in terms of the implementation.

The one issue where perhaps there were some difference between the staff and the authorities was whether the contingency framework, the escape clause, would be activated or not. Our thinking was that by doing so, one would be setting the bar very high for modification of the rule; and then once the contingency framework was activated, one would be working with a contingent rule rather than the main rule. But having said that, we understand the contingency framework was not well specified in the law, and that was a big part of the reason for the authorities' decision to introduce flexibility within the main rule.

Finally, on the question of reserves, I can clarify the staff's assessment. Colombia's reserves are within the ARA metric between 100 and 150 percent range, so by the staff's judgment, it would be deemed adequate. That is both in terms of the data and also in terms of the staff's projections over the medium-term. Table 8 of the report shows Colombia's reserves being around 130 percent of the ARA metric in 2018, coming down to just under 120 percent at the end of the medium term. When the report finds that there is scope for a modestly faster pace of reserve accumulation, what we are saying is a faster pace would be compatible with keeping the reserve adequacy ratio at its current level mechanically. That is the thrust behind the staff's advice. We have that ratio coming down over time on a conservative assumption of about US$2 billion in reserve accumulation per year over the horizon. We use historical benchmarks to help us calibrate that number.

On the mechanism itself, the way the central bank announced in September that it will accumulate reserves going forward, the staff is supportive of that mechanism itself and is not suggesting a change with respect to the way in which the reserves are accumulated. They are done through the issuance of put options on U.S. dollars, where the central bank stands ready to purchase those dollars if they were exercised by their market counterparts. We feel that has worked well; and if one looks at the numbers, Colombia is currently accumulating at a faster pace of reserves than what the staff has as its average over the medium-term horizon, albeit over a shorter window period.

Mr. Palei noted that Table 8 indicated that the staff used the ARA metric without the adjustment for commodity exporters, and that a footnote stated that the reserves would be 118 percent of the ARA metric if an adjustment for the commodity buffer was used. He remarked that in the future there was a predicted decline in trade and the ARA metric, which suggested that there was a case for faster reserve accumulation.

Mr. Villar made the following concluding remarks:

I would say that we agree with the staff on all the essential things. There are some details in which we may seem to be in disagreement, which are second order, like this point about the possibility of accelerating reserve accumulation. There is no disagreement in practice. The only point is we are accommodating. We start the process of accommodation of reserves. By any measurement, we are well above the ARA metrics. The question is whether we should change the mechanism with which we accommodate. If we announce that we will accommodate everyone more than we are doing now, it may signal things that we do not want to signal. For example, it may signal that we want the exchange rate to depreciate or we are concerned about our own level of reserves, and any of those things will be a bad signal. This is the reason why we prefer to keep the process of accommodation as it is. If the authorities see the opportunity, they will use it to accumulate more, but we do not want to commit to that process.

The Acting Chair (Mr. Lipton) noted Colombia is an Article VIII member and maintained one exchange restriction. The staff was not recommending approval of that restriction, so no decision was proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for their very strong policy framework and well-executed policy actions, that have supported economic recovery and continued progress toward reducing poverty and inequality. While the outlook remains favorable, external imbalances have widened and the economy remains vulnerable to risks, including from lower global growth, tighter financial conditions, and ongoing migration pressures from Venezuela. Going forward, Directors encouraged continued efforts to appropriately calibrate the policy mix to support recovery, enhance resilience and build buffers, while implementing structural reforms necessary to boost inclusive growth and enhance external competitiveness. Directors commended the authorities for the substantial relief and support efforts for the large inflow of migrants from Venezuela.

Directors welcomed the authorities’ strong commitment to the fiscal rule, which has served the economy well. In the context of the large migration shock from Venezuela, they supported the use of flexibility within the rule to accommodate related spending, while preserving the integrity of the fiscal anchor and the medium-term structural balance objective. Directors noted that the authorities’ commitment to fiscal sustainability should be supplemented by structural fiscal reforms to safeguard social spending and public investment. In order to boost revenue and enhance spending efficiency, they encouraged efforts to broaden the tax base, improve tax administration, eliminate preferential regimes for businesses, reform the energy subsidy and strengthen investment project selection and evaluation.

Directors welcomed the convergence of headline inflation to its target and the continued anchoring of inflation expectations. They noted that the current monetary policy stance is appropriate, but should be tightened if credit and economic activity recover as projected. Directors welcomed the central bank's reserve accumulation program as a proactive step to maintain external buffers. They noted that the flexible exchange rate should continue to be the first line of defense against external shocks, with adequate international reserves and the Flexible Credit Line acting as additional buffers.

Against a backdrop of a sound banking system, Directors commended the authorities for continued advances in financial regulation and supervision, including the steps taken to align regulation with Basel III standards over time and through the implementation of the Conglomerates Law that should further strengthen the financial system.

Directors emphasized the need to continue with structural reform implementation. They noted that further efforts are needed to improve the business environment, reduce trade barriers, address skills mismatches, close infrastructure gaps, strengthen governance and the rule of law, and reduce corruption. A pension reform that improves coverage and progressivity should also remain a priority. Directors welcomed the National Development Plan's focus on many of these issues and called for its steadfast implementation.

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

APPROVAL: April 16, 2020

JIANHAI LIN
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Outlook and Risks

1. Do staff assess that the risk-balance for Colombia is tilted more to downside, compared to last year's Article IV?

- Overall, the external risks Colombia faces are more to the downside than at the time of last year's Article IV. The Fall 2018 and Spring 2019 WEOs judged that downside risks to global growth have increased, and the Fall 2018 and Spring 2019 GFSRs judged that near-term risks to global financial stability have risen. Analysis in the Spring 2019 GFSR also shows that financial conditions facing emerging markets have tightened relative to a year ago (see Figure 1.2.4), which implies a higher-risk environment for Colombia.

Venezuelan Migration

2. Since strong migration has and will continue to be a key driver of growth in Colombia, could staff advise how the growth rate of GDP per capita has been tracking and what it is forecast to be?

- In 2018, real GDP per capita grew by 0.3 percent as migration flows accelerated. In 2019-2020, GDP per capita growth is expected to increase to around 1 percent. In the medium run, GDP per capita growth is expected to reach 2.8 percent, as the migrant population gets fully integrated into the labor force and productivity stops being a drag to growth.

3. We find the higher impact of migration in the short-term somewhat counterintuitive, considering on one hand the needed time and efforts for migrants to integrate, and on the other, the relatively high unemployment rate in Colombia, currently at 9.7 percent. Staff's comments would be welcome

- The growth impact early on is due to the timing and magnitude of the shock which is front loaded. In staff's baseline scenario, the migrant inflows occur in 2018-20 and recede thereafter. Based on household surveys, migrants are mostly of working age (66 percent) and exhibit high labor force participation rates (77 percent). The employment rate of migrants stands at 82 percent. Against this backdrop, our estimates suggest that employed workers will increase by around 400,000 in 2019 alone (raising potential growth by one percentage point). Reflecting short-run adjustment costs, however, the contribution of employment is offset by a reduction in the contribution of TFP due mainly to skills mismatches. TFP is likely to be less of a drag to growth after 2020, as migrants become more fully integrated in the economy.

4. We would welcome staff's views on how different rates of return migration might influence Colombia's economic and fiscal indicators.

- Given the uncertainty involved around expected migration flows, the alternative scenarios provide a range of estimates of the economic effects and fiscal costs. As the scenarios show, different migration flows would affect potential growth in the near term (unless migration flows grew at a faster pace throughout the projection period). The fiscal costs would also change in roughly in proportion with the change in migration flows.

5. What assumptions are driving the higher and lower scenarios for Venezuelan migration?

6. And could staff provide more detail on the implications for fiscal indicators (and the fiscal rule)?

- The higher migration scenario assumes that the economic and social crisis in Venezuela will intensify further, causing migration flows to double in 2019 and 2020. Inflows decline thereafter, and completely recede by 2024.The migration reversal scenario assumes a rapid resolution to political and social conflicts in Venezuela, with net migration flows becoming negative from 2020 until 2024 (with about 140,000 Venezuelans returning to their home country each year).
- In terms of net fiscal costs compared to the baseline, the higher migration scenario implies that costs roughly double whereas they are roughly half in the migration reversal scenario as the costs are broadly proportional. An exception to this relates to humanitarian costs which are zero in staff's baseline but would remain in the higher migration scenario. In terms of the fiscal rule, the Fiscal Rule Consultative Committee has mentioned that it will monitor the migration shock on a regular basis and could adjust the headline deficit path in response.

7. Does the current level of migrant integration into the labor force support staff's assessment?

8. We would appreciate an update on the impact on Colombia's public finances from the recent migration shock?

- Staff assessment on the integration of Venezuelan migrants is based on the latest publicly available data from the authorities which reports participation and employment rates. These data correspond to December 2018.

- Latest available information on total migration flows in Colombia indicates flows of around 90 thousand in January and of around 70 thousand in February (i.e., about 960 thousand in annual terms for 2019). This is slightly higher than staff's assumptions (700 thousand). All in all, given information based on two months, this would imply fiscal costs broadly in line or somewhat above staff's current estimate.

9. We would be interested in staff's perspectives on the political economy impact of these additional spending pressures within the country – for example, will this sort of political narrative undermine efforts to increase tax collection in Colombia?

- Staff will respond to this question during the Board meeting.

10. We welcome additional information on why the estimated humanitarian, housing, security, and water and sanitation costs are set at zero (table, page 54).

- The fiscal costs associated with humanitarian, housing, security and water and sanitation costs are less than 0.05 percent of GDP (shown with rounding in the table). The authorities' estimated costs in US$ are for humanitarian care are around US$100 million, for housing around US$80 million, water and sanitation US$30 million and security US$35 million.

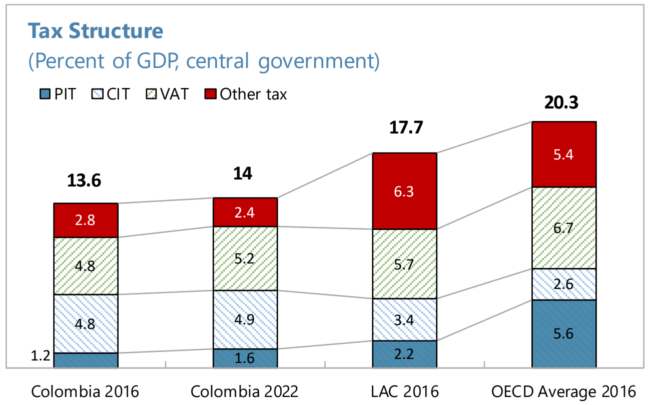
11. Could staff detail the policies that should be developed to ensure the integration into the labor market?

- The authorities have put forward several policies to help integrate migrants into the labor market such as regularization of migrants that have entered Colombia illegally or overstayed their temporary permits, by granting two-year working permits that can be extended. Permits provide access to social security and job centers, allows setting up companies, and helps validate education and professional qualifications of migrants. The authorities are also providing support for childcare and early learning. Staff welcome these measures.

Fiscal Policy

12. In this regard, we would like to ask staff to elaborate on the issue and explain whether additional tax policy measures are being discussed to increase the tax to GDP ratio over the medium-term.

- Page 14 of the staff report provides some details on tax revenues against peers as of 2016 for the central government. Colombia collects relatively low revenues with respect to personal income taxes (PIT) and VAT due to narrow bases. Staff's projections show relatively flat revenues to GDP. Higher revenues are projected as the recovery continues and the output gap closes, and from earlier tax reforms (2014 and 2016). These gains are offset through staff's assessment that the 2018 Financing Law would lose revenue after 2019.



Sources: OECD Database and IMF staff calculations.
Note: Colombia data is estimated by Fund staff.

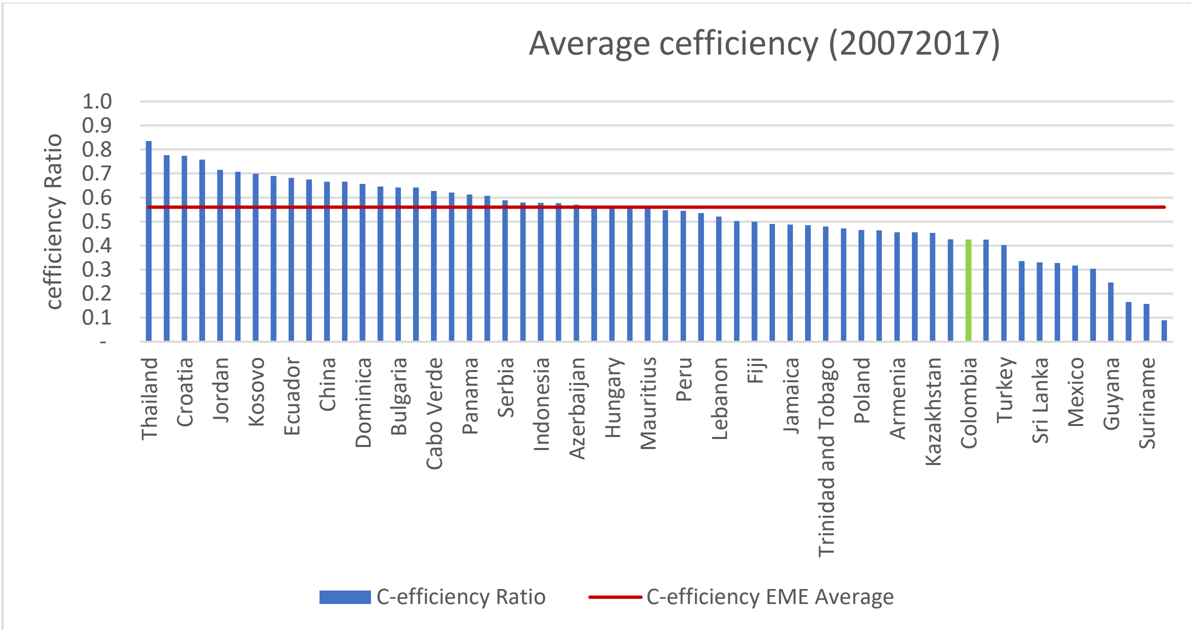
- The authorities expect gains due to more efficient tax administration and higher potential output in response to the 2016 tax reform and 2018 Financing Law.

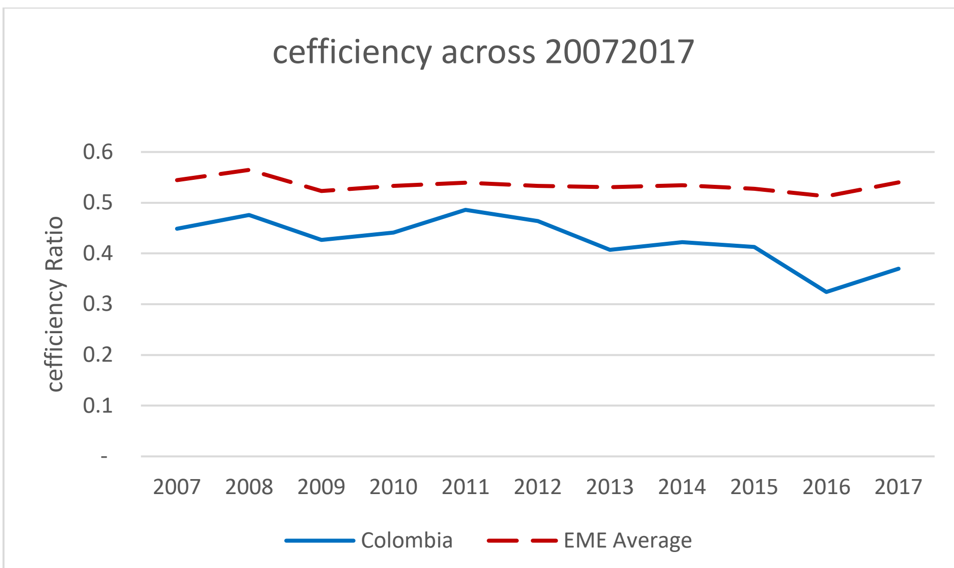
13. ***Staff's comments on the rationale behind the frequent changes to Colombia's tax regime in the last six years are welcome.***

- There have been four changes to the tax code since 2012 (reforms of 2012, 2014, 2016 and the Financing Law of 2018). These changes stem from various reasons—including to lower the burden on labor taxes to reduce informality; to lower the burden on corporates and increase revenues from indirect taxes and excises; to increase income progressivity; and to modernize international taxation and introduce anti-abuse measures; and to offset the oil revenue losses in response to the oil price fall of 2014-16.

14. ***In this respect, we would be interested in comparisons of C-efficiency in Colombia not only with its regional peers, but also with other emerging market economies and the OECD countries. Staff's comments would be appreciated.***

- The figures below provide further information. Based on staff estimates, C-efficiency in Colombia is lower relative to other EM countries.





15. ***Regarding the impact of the 2018 Financing Law on tax revenues, we see some differences of the views between staff and the authorities, while staff agree that the Law could boost medium-term growth. We would appreciate it if staff could elaborate more on differences of the views on the impact of the Law on growth and revenues.***

16. ***We note the differing views between staff and the authorities on the projected revenue losses from the financing law, which contributes to a higher fiscal deficit estimated by staff compared to the one projected by authorities. We would***

appreciate it if staff could provide more context on the evolving discussion and pragmatic suggestions to take things forward.

- The authorities' and staff's estimates of the static revenue losses due to the financing law are roughly the same. The differences in views pertain to the dynamic effects associated with the tax reform. The authorities' project higher economic growth effects, sufficient to offset the static revenue losses. Staff's projections of additional 0.2 growth are not sufficiently large to offset the static revenue losses. Staff recommends additional tax reforms to increase tax revenues over the medium term.
- Staff's higher headline deficit in 2019 reflects privatization proceeds, which under the authorities' cash-based accounting can be deemed as revenues. Staff does not envisage higher headline deficits relative to the authorities thereafter.

17. Notably, these forecasts expect a sharp decline in the fiscal deficit beginning next year. This would require very high capacity within the system to implement fiscal reforms. Could staff comment on the basis of this expectation and elaborate on initiatives taken to enhance capacity?

- Staff's projections are based on the authorities' strong commitment to adhere to the fiscal rule. The current baseline is for deficit reduction due to a reduction of structural expenditures as tax revenues are projected to be relatively stable. The largest expenditure reduction is on capital expenditure and energy subsidy reform is also expected to reduce expenditure. If revenues were to increase, expenditure cuts could accordingly be avoided. The authorities believe that sufficient gains can be attained through more efficient tax administration and higher growth.

18. Could staff elaborate on the reform of energy subsidies?

- Following a request from the authorities, staff have provided technical assistance (TA) on energy pricing reforms—notably, on fuel and electricity subsidies. The recommendations from the TA mission include for the fuel sector: 1) changing the price setting and smoothing mechanisms and 2) reducing disparities between border regions. For the electricity sector the recommendations include: 1) verification of distribution and retailers' declarations to ensure subsidies are going to eligible households; 2) gradually improve on the current targeting mechanism of price subsidies, and 3) strengthen current social assistance programs to eventually replace price subsidies by cash transfers.

19. While staff recommended that the escape clause could be considered under strict conditions to safeguard the 2018 Medium Term Fiscal Framework (MTFF), the authorities explored the legal option of adjusting the deficit target in the existing

rule, instead of invoking the escape clause. Could staff elaborate on fundamental differences and pros-cons between the two approaches?

20. ***We appreciate the disciplinary effect of the fiscal rule and note the difference of opinion on the appropriateness of adjustments required to deal with immigration. Could staff elaborate on reasons for their recommendation being considered superior to the authorities' approach?***

21. ***In this context, we would appreciate further comments on staff's rationale for recommending to invoke the escape clause rather than using the flexibility within the existing fiscal rule. Staff mentions that using the escape clause would imply suspending the fiscal rule altogether and could set a precedent with potential adverse credibility costs for the fiscal framework.***

- Staff will respond to these questions during the Board meeting.

22. ***We note the suspension of fiscal rule under the current legal framework when the escape clause is invoked and wonder if the authorities are open to revise the fiscal rule's contingency framework to handle exceptional shocks in the future. Staff comments are appreciated.***

23. ***In this context, we would appreciate staff's opinion on other options the authorities could follow to introduce the necessary amount of flexibility without harming the credibility of the fiscal rule.***

- Fiscal Rule Consultative Committee (FRCC) has recommended that the fiscal rule's contingency framework (Article 11 of the Law) be revised to define the following: nature of the shock; the requirements to invoke a temporary escape clause; the criteria to determine fiscal limits/restrictions and to determine the maximum period over which deviations from the rule will be permitted. Staff welcomes these recommendations.

24. ***Are there any discussions in the expert community on the possible need for recalibrating of the fiscal framework in Colombia?***

- To further strengthen the fiscal framework several steps are being considered. The National Development Plan proposes the creation of an independent fiscal council to replace the FRCC. Staff also notes that the expert commission on spending recommended modifications to the Royalties system (Sistema General de Regalias) in distributing the royalties obtained from oil, gas and mining to subnational governments. In terms of the fiscal rule itself, staff notes the FRCC's recommendations for modifying the contingency framework (see answer above).

Monetary and Exchange Rate Policies

25. Could staff precise its assumption about the speed of the warranted reserve accumulation, and if it should offset completely the phasing out of the FCL buffer in its view?

26. Yet, we note the divergent views of the authorities on this issue, and we would appreciate more pros and cons analysis from staff, also considering the arguments provided by Mr. Villar in his buff.

27. We note from the BUFF statement that the authorities now refer to a potential reduction in reliance on the FCL. Did the authorities reconsider their plans?

- Staff will respond to these questions during the Board meeting. A mid-term review of the FCL would be discussed at the board on May 20th.

28. On financial and external resilience, it is not clear from the report how the authorities are planning to contain the build up of net foreign liabilities without jeopardizing the economic recovery underway. Are macroprudential options envisaged? Staff comments are welcome.

- Staff's assessment is that the current account deficit is being comfortably financed by foreign direct investment and portfolio inflows and this is expected to continue. Through the medium term, deficits at these levels would lead to a build-up in net foreign liabilities to GDP. It is staff's understanding that macroprudential options are not being considered in Colombia to address either the size or composition of net inflows, given that their direct impact on the types of inflows Colombia is receiving would be small. Foreign borrowing by the domestic financial or non-financial sectors is not increasing rapidly, and risks to domestic financial stability are currently low.

29. Could staff elaborate on any changes in this area and the current state of the monetary policy communication in Colombia?

- Over the past 12 months, there have been no monetary policy surprises and the dispersion of market views on the outlook for monetary policy has narrowed, suggesting that communication has improved. The number of policy decision meetings was reduced (from 12 to 8) to better align them with key data releases and there has been adherence to the blackout period in communications before meetings.

External Sector

30. ***We appreciate staff's Annex IV on capital inflows, though would welcome more insight on risks. How diversified is the portfolio of holders? Is there absorptive capacity in the local market if there was a sell-off by external investors?***

- The 2018 FCL report contained staff analysis on the composition of non-resident investors in local currency government debt. Updated information provided by the authorities finds that concentration risk among the largest holders has fallen. The main change is in terms of investor type which has modestly shift toward pension funds and insurance firms and away from mutual funds, which is seen as a positive for stability of the investor base. The domestic investor base has also become more diversified, with significant participation from pension funds, commercial banks, insurance companies, public trust funds, and other government institutions, and the share of portfolios dedicated to TES by the largest domestic investors is currently within historical ranges.

31. ***We agree with the assessment that somewhat faster reserve accumulation could provide a more reliable buffer, but it is also necessary to look for opportunities to quickly expand exports. Could staff comment on opportunities to accomplish this?***

32. ***Indeed, the current account continues to reflect the lack of dynamism of non-oil exports. Could staff elaborate on how the country could boost non-oil exports?***

- As in past Article IV consultations, staff has emphasized the importance of closing infrastructure gaps, improving inspection processes and the handling of goods at ports, reducing the dispersion in tariffs to reduce input costs for exporters, and reviewing non-tariff barriers. While the impact of most of these steps would occur over time, progress on the 4G infrastructure agenda should help reduce transport costs and improve shipping times in the near term. Measures included in the draft National Development plan to more generally reduce the regulatory burden and streamline business procedures should also help reduce export costs.

33. ***Could staff advise on possible alternative ways the Central Bank could follow to accelerate the reserve accumulation without disrupting the markets?***

34. ***Does staff have reservations about the central bank methodology to accumulate international reserves? What is the reason for staff's extra caution given the authorities policy commitments and track record?***

- Staff analysis in Annex V suggests that from a technical standpoint, modestly faster reserve accumulation may be possible by increasing the amount of options auctioned on a monthly basis, or alternatively by increasing the frequency of auctions to weekly or every second week with a lower amount per auction (and thus smaller amounts exercised at any given time, which should limit market impact), but adding up to a higher overall monthly amount.

Financial Sector

35. What are the drivers of the sharp decline in commercial and consumer credit since 2016-17?

36. While we understand that low-quality loans are well provisioned, we would welcome staff's comments on what sectors have been mostly affected by the deterioration in loan quality and the prospects of loan recovery.

- The slow-down in credit growth 2016-17 largely followed the slowdown in the economy and credit demand.
- All types of credit experienced a deterioration in quality in 2017-18, but the corporate credit portfolio was the most affected. The electricity, mining and transportation sectors recorded the largest increases in NPLs, partly due to idiosyncratic factors.

37. However, we would appreciate if staff could explain the rationale to exclude intangible assets from the definition of assets subject to capital requirements, as described in paragraph 29.

38. On a more specific point, we wonder whether the redefined weights for the risk weighted assets and the positive effects this has on banks' capital ratios will still be appropriate in case of a downturn.

- Technical capital will be redefined to exclude intangible assets, which is in line with Basel iii guidelines. In addition, the definition of risk-weighted-assets (RWAs) will be redefined with risk-weights consistent with Basel iii guidelines. The new definition of RWAs better accounts for the quality and risk-level of assets, which will lead to a more appropriate capital requirement during downturns.

39. What arrangements or relationships does the Colombian financial supervisor (SFC) have with the supervisors of conglomerates with holding companies based overseas?

- The SFC cooperates with these supervisors both through working groups and bilaterally following memorandums of understanding for cooperation and information sharing.

40. Staff's comments on whether the house prices continue to be misaligned relative to fundamentals and whether the authorities are envisaging adjusting the property valuation system, are welcome.

- Growth in house prices moderated in 2017 as excess inventory in certain segments and the economic slowdown weighted on the housing market. Prices have started to modestly grow again in line with economic fundamentals. Looking forward, excess supply remains, particularly in the high-income segment, which should limit price growth. Meanwhile mortgage NPLs remain low at around 3 percent.

41. The Report on the Observance of Standards and Codes on FATF Recommendations for AML/CFT was published on November 15, 2018. However, we missed in the staff report any coverage of follow-up measures on priority recommendations. Staff comments would be appreciated.

- The authorities have been working towards implementing the recommendations addressed in the AML/CFT Mutual Evaluation Report and have taken a number of actions in recent months. These include measures in the Conglomerates Law (Law 1870 of 2017) for supervising conglomerates, the Financing Law (law 1943 of 2018) which includes provisions against tax evasion and money laundering, in Law 1941 of 2018 which creates the Coordination Center Against the Finances of Organizations of Transnational Crime (Centro de Coordinación Contra las Finanzas de Organizaciones de Delito Transnacional y Terrorismo). Additionally, a working group to improve coordination between all the parties involved in fighting AML has been set up.

Structural Reforms

42. Looking beyond the NDP, justice and pension reforms remain priorities, as they would have a large positive effect on productivity and enjoy relatively broad public support. While we appreciate the staff's explanations in Annex VI, we welcome staff's elaboration on shortcomings of the current systems and difficulties in previous attempts.

- In the Colombia pension system, a publicly-run defined benefit pillar co-exists and competes with a privately-run defined contribution pillar (individual accounts). Competition between the two systems is an important structural concern. In addition, low coverage and regressivity are two key weaknesses of the Colombian pension system. Only about one third of the pension-age population receive a contributory pension and about one half of pension-age population is below the poverty line. The relatively high contribution threshold (years of contribution required) also limits the number of contributors eligible for a pension. For the few eligible, the replacement rate in the public system is relatively generous (70−100 percent) and benefits mostly the rich with about half of the implicit subsidy (difference between contributions and pension benefits received) being received by the top income quintile.

- On the justice system, the large backlog of cases and uncertainty created due to long delays are major constraints. As in all countries, pension and justice reforms are complex undertakings which require substantial public consultation and buy-in given the wide-ranging implications. Encouragingly, the Colombia authorities are committed to presenting a pension reform to Congress by the end of this year.

43. **We note that the NDP provides measures to improve coordination amongst agencies to address the migration flows *and appreciate staff further elaboration***

- As set out in the authorities' strategic document on the policy response to the large-scale migration in November 2018, a coordinating agency within the Presidency will be set up to help guide the response given it involves many agencies across the regions and within the national government. Strategic clarity on the policy response will also help facilitate coordination.
- The transformation agenda in the 2018−22 National Development Plan (NDP) would certainly support their efforts in diversifying the economy and further unleashing growth. We encourage the authorities to steadfastly implement the plan, which should also contribute to strengthening the economy's resilience to external shocks and improving competitiveness.

44. We would appreciate further elaboration on measures being envisaged in skills training and innovation to boost productivity.

- In the area of innovation, important measures proposed in the NDP include strengthening R&D and direct support to individual firms to adopt new technologies as well as facilitating access to finance for investment, for example through the deepening of the corporate bond market. In terms of direct support, an example is the creation of so called "Productivity Factories" which will provide firms with information and advice and incentives for technology adoption. In terms of skills adoption, an effort to strengthen the availability and relevance of technical training and a longer-term effort to revamp the national qualifications framework and the labor market information system are important initiatives.

45. However, it appears that the NDP will ultimately not include the unification of the operational and investment budgets. Could staff comment?

- Discussions about the NDP are ongoing in Congress. Staff sees scope for considering unifying the budget process between the central government, royalties' system, and investment budget to improve consistency and to better integrate medium-term programs. We will assess the reforms to the budget process once there is clarity with respect to the final version of the NDP.

46. Could staff provide some details about the calendar of the realization of the 4G infrastructures and to which extent it relies on international financing and local banks?

- As of December 2018, 15 4G infrastructure projects reached financial closure. Local banks account for slightly over one-third of available financing. The remainder is split between international banks, internationally issued bonds and debt funds (total share of over 40 percent for those three) and the Colombian infrastructure investment bank and other small sources. The authorities envisage another 14 financial closures over 2019-20, roughly doubling the current level of financing. In terms of progress in construction execution, a number of projects are far advanced with completion rates over 90 percent, but many others are still at a relatively early stage.

47. Finally, we would appreciate clarification from staff on the difference in views with the authorities on the exchange restrictions in the hydrocarbon sector.

- The special foreign exchange regime for branches of foreign corporations that operate in the hydrocarbon sector gives rise to an exchange restriction because the branches- legal residents of Colombia- cannot buy foreign exchange beyond the amounts that they can show results from their sales in Colombia, even if they show that they need additional amounts to make bona fide current international payments. It is not a new policy and it was first determined to give rise to an exchange restriction in the 2002 Article IV Consultation. It was eased in 2005 but continues to limit access to the foreign exchange market to the branches to which the regime applies. The fact that the regime is optional is not a basis for exemption from the obligation under Article VIII, Section 2(a), as this obligation is for the benefit of the multilateral system of payments in respect of current transactions as a whole, and not of particular parties, and hence, cannot be contracted away by members. The staff and the authorities have extensively discussed in the past the jurisdictional concerns arising from the regime, and options for the removal of the exchange restriction. No understanding has been reached however on a plan for its removal and therefore staff does not recommend that this measure be temporarily approved.