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Colombia: 2001 Article IV Consultation and Second Review Under the Extended Arrangement--Staff Report; Staff Supplement; Public Information Notice and News Brief on the Executive Board Discussion; and Statement by the Authorities of Colombia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2001 Article IV consultation with Colombia and second review under the Extended Arrangement, the following documents have been released and are included in this package:

- the staff report for the combined discussion of the 2001 Article IV consultation with Colombia and second review under the Extended Arrangement, prepared by a staff team of the IMF, following discussions that ended on **January 31, 2001,** with the officials of Colombia on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on March 12, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff supplement of **March 26, 2001,** updating information on recent economic developments.
- a Public Information Notice (PIN) and a News Brief, summarizing the **views of the Executive Board as expressed during its March 28, 2001, discussion** of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.
- a statement by the authorities of Colombia.

The document(s) listed below have been or will be separately released.

Letter of Intent by the authorities of the member country
Selected Issues and Statistical Appendix paper
Technical Memorandum of Understanding

The policy of publication of staff reports and other documents by the IMF allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

COLOMBIA

Staff Report for the 2001 Article IV Consultation and Second Review Under the Extended Arrangement

Prepared by the Western Hemisphere Department and the Policy Development and Review Department

(In consultation with the Fiscal Affairs, Legal, Monetary and Exchange Affairs, and Treasurer's Departments)

Approved by Claudio M. Loser and Liam Ebrill

March 12, 2001

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EXECUTIVE SUMMARY

Colombia's economic performance deteriorated markedly in 1998/99 due to a combination of external shocks (terms of trade deterioration and the effect of turbulence in financial markets in the aftermath of the Asian and Russian crisis) and a weakening of confidence (stepped-up guerrilla activity and a further fiscal deterioration). To deal with these problems, the authorities designed a three-year stabilization program for the period through 2002 with the objective of restoring economic growth, strengthening Colombia's external position, and reducing inflation further. The program is based on exchange rate flexibility (the peso was floated in September 1999), fiscal consolidation, and a structural reform program that includes privatizations, financial sector restructuring, and a number of initiatives to strengthen efficiency and expenditure control at all levels of the public sector. In December 1999 the Fund approved a three-year extended arrangement in support of the program.

The economy has since improved and it is estimated that the program targets for economic growth, inflation, and fiscal consolidation have been achieved through 2000, but the unemployment rate remains high, around 20 percent. Colombia's external position has been strengthened, helped by higher oil prices, and the considerable real devaluation of the peso since the end of 1997 has helped nontraditional exports stage a strong recovery. The financial system has been strengthened, but some institutions, particularly in the mortgage sector, remain weak.

The main program objectives for 2001 are to achieve a further reduction in inflation to 8 percent (under an inflation targeting framework for monetary policy), continue the recovery of economic activity, and strengthen the public finances further to support the expansion of activity in the private sector. To achieve this, the combined public sector deficit is set to decline to 2.8 percent of GDP, from an estimated 3.6 percent of GDP last year (5.5 percent of GDP in 1999). The deficit reduction would be achieved with the help of a strong revenue package approved last year, and notwithstanding a court-ordered wage increase in the public sector and a projected further deterioration in the finances of the public pension systems.

The structural reform agenda for 2001 calls for considerable action to strengthen the control over expenditure at all levels of the public sector; an improvement in the finances of the social security institute's health service; and the presentation to congress of a second-generation pension reform. The latter is key to sustaining a strong fiscal position over the medium and long term. To further bolster the fiscal effort, the government will name a commission that will present recommendations early next year for reducing the inefficiencies created by tax distortions, revenue earmarking, and other restrictions on the use of public resources.

I. Introduction

1. The discussions for the 2001 Article IV consultation with Colombia and the second review under the extended arrangement were held in Bogotá and Washington during the period November 2000—January 2001.[1] The three-year arrangement, in an amount equivalent to SDR 1.957 billion (84 percent of quota on an annual basis), was approved on December 20, 1999 (EBS/99/218), and the first review was completed on September 7, 2000 (EBS/00/178). To date, the authorities have chosen not to make any of the purchases under the arrangement, and Colombia has no outstanding credit from the Fund.[2] In a letter to the Managing Director, dated February 23, 2001, the authorities describe developments under the program and the policies they intend to follow during 2001 and the rest of the period of the arrangement.

2. All quarterly performance criteria for 2000 through September were observed (Table 1), as were those for December related to the net international reserves and the net domestic assets of the central bank.[3] While most structural benchmarks have been achieved, some have been delayed (Table 2). Colombia has not accepted the obligations under Article VIII, Sections 2, 3, and 4 of the Articles of Agreement, and maintains multiple currency practices that are subject to Fund approval. Statistical data provided by the authorities to the Fund are generally adequate for surveillance. Colombia subscribes to the Special Data Dissemination Standard and is in observance of the standard.

3. At the conclusion of the last consultation with Colombia on December 20, 1999 (EBS/99/218 and Supplement 1), directors emphasized the importance of fiscal consolidation, a flexible exchange rate policy, and acceleration of key structural reforms. They underscored that the broadening of the value-added and income taxes would be important, and several directors expressed concern about the distortionary nature of the financial transactions tax. Most directors considered that inflation targeting could provide a transparent and credible framework for guiding monetary policy in Colombia, and directors commended the authorities for their prompt action to strengthen the financial system as it came under increasing stress. Directors also pointed to the risks facing the program, including the unsettled security

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[1] The staff participating in one or more rounds of the discussions were Messrs. Gronlie (Head), Gil-Diaz, Breuer, Fritz-Krockow, Espejo (all WHD), Bannister (PDR), Ms. Daban (FAD), Mr. Vesperoni (EP-WHD) and Ms. Wicker (Assistant-WHD). Mr. Junguito (Alternate Executive Director) participated in the policy discussions.

[2] The Fund's relations with Colombia are described in Appendix I.

[3] It is expected that the full set of data for measuring end-December compliance with the ceiling on the combined public sector deficit and the limits on the external public debt will be available before Executive Board consideration of the review.

situation, the possibility of lower than expected growth, the difficulties in mobilizing political support for the reforms, and the heavy reliance on privatization proceeds.

II. Background and Recent Developments

4. Colombia's economic performance deteriorated markedly in the last half of 1998 and during 1999 due to a combination of external shocks and a weakening of confidence. The external shocks included a deterioration in the terms of trade and the effects of the turbulence in international financial markets; the weakening of confidence was related to stepped-up guerrilla activity and uncertainty about the new government's policies in the face of a further deterioration in the public finances. These developments led to repeated episodes of pressure against the peso within its trading band despite a tightening of monetary policy that resulted in record high interest rates. Following significant intervention by the central bank to support the peso, the trading band was eliminated in September 1999 and the peso was allowed to float. The currency had already depreciated markedly in real effective terms during the preceding year, helped by two step-devaluations of the band and a fall in inflation, reversing the real appreciation that had taken place since the mid-1990s.

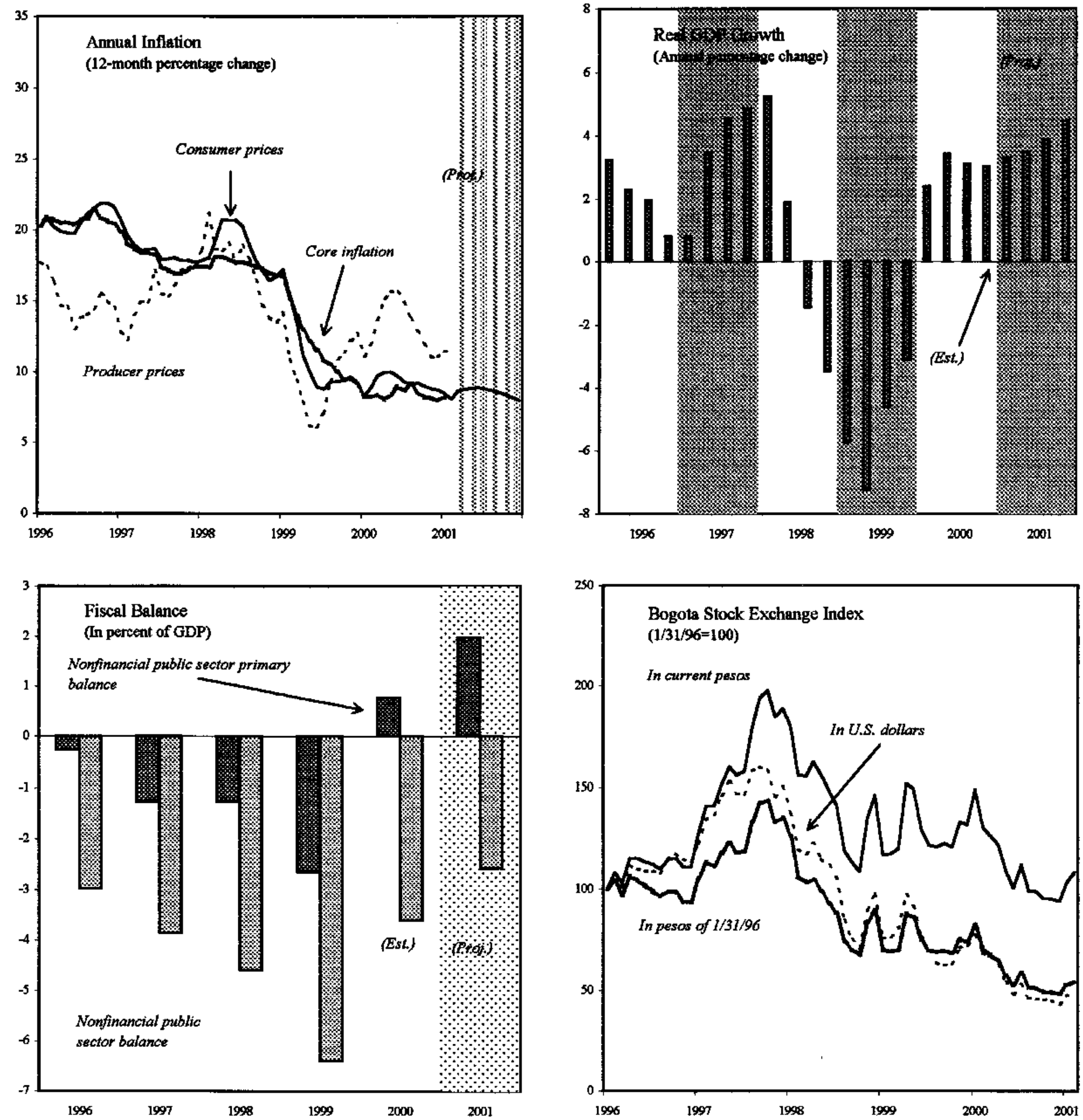
5. Following a notable increase in private sector debt (both external and domestic) over the course of several years, the sharp rise in real interest rates and the depreciation of the peso caused a marked increase in the debt service burden of the private sector in 1998, which, together with the weakening of confidence, contributed to a significant reduction in domestic demand. Thus, real GDP growth fell to 0.5 percent in 1998, and was negative by 4.3 percent in 1999 (Table 3, Figure 1). Economic activity began to recover in late 1999, and in 2000 real GDP grew by nearly 3.0 percent, based on a strong rebound in exports and some increase in domestic demand.[4] However, unemployment remained high at around 20 percent. Inflation fell to 8.8 percent during 2000, well below the 10 percent target set by the central bank, and declined further to 8.1 percent in February 2001.

6. The combined public sector deficit was reduced from 5.5 percent of GDP in 1999, to an estimated 3.6 percent of GDP in 2000, compared with a target of 3.7 percent of GDP in the program (Tables 4 and 5).[5] Fiscal performance in 2000 was helped by higher than projected oil revenues and lower investment spending, and the reduction in the deficit was

[4] In 2000, manufacturing output grew by 11.5 percent.

[5] The indicative target for the combined public sector deficit in 2000 had been set at 3.5 percent of GDP when the three-year program was first designed in 1999. However, at the time of the first program review in September 2000, an allowance was made in the program for the higher than envisaged fiscal carrying costs of the financial sector resolution strategy, equivalent to 0.2 percent of GDP for 2000 and beyond.

Figure 1. Colombia: Selected Economic Indicators



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

achieved despite a worse than projected financial position of the public pension and health systems and a court-ordered increase in public sector wages.[6]

7. Because of a considerable shortfall in the government's ambitious privatization program in 2000, the public sector's recourse to both domestic and external credit (including a drawdown of the government's portfolio abroad) exceeded the program projection (see Table 4).[7] A major part of the domestic financing was provided directly by the private sector through purchases of government securities, as discussed below.

8. The Colombian financial system was showing clear signs of distress by the second half of 1998. To head off a systemic crisis, the government introduced restructuring and recapitalization programs managed by FOGAFIN, the state agency for bank resolution and deposit guarantees. Subsequently, conditions in the banking sector improved, with the average capital adequacy ratio rising to 13.8 percent in November 2000 from 11.0 percent in December 1999. While the nonperforming loan ratio declined for the system as a whole, the portfolio of the mortgage institutions has deteriorated since the middle of last year, following an improvement in the preceding six months that resulted from debt relief provided to mortgage debtors (Figure 2). Moreover, a constitutional court ruling put a cap on mortgage rates last year, which increased the interest rate risk faced by these institutions. In response, the government recently introduced a partial insurance scheme that provides limited protection against deposit rate increases. Four public banks (Caja Agraria, Banco del Estado/Uconal, and BCH) were liquidated or merged in 2000 and two private banks which were intervened and taken over by the government in 1999 will be liquidated or sold in 2001, leaving the public sector with one bank (Banco Agrario), as envisaged in the program.[8]

9. While the private sector's portfolio of domestic financial assets grew by 10 percent in 2000, mainly reflecting a sharp increase in holdings of government securities, the broad

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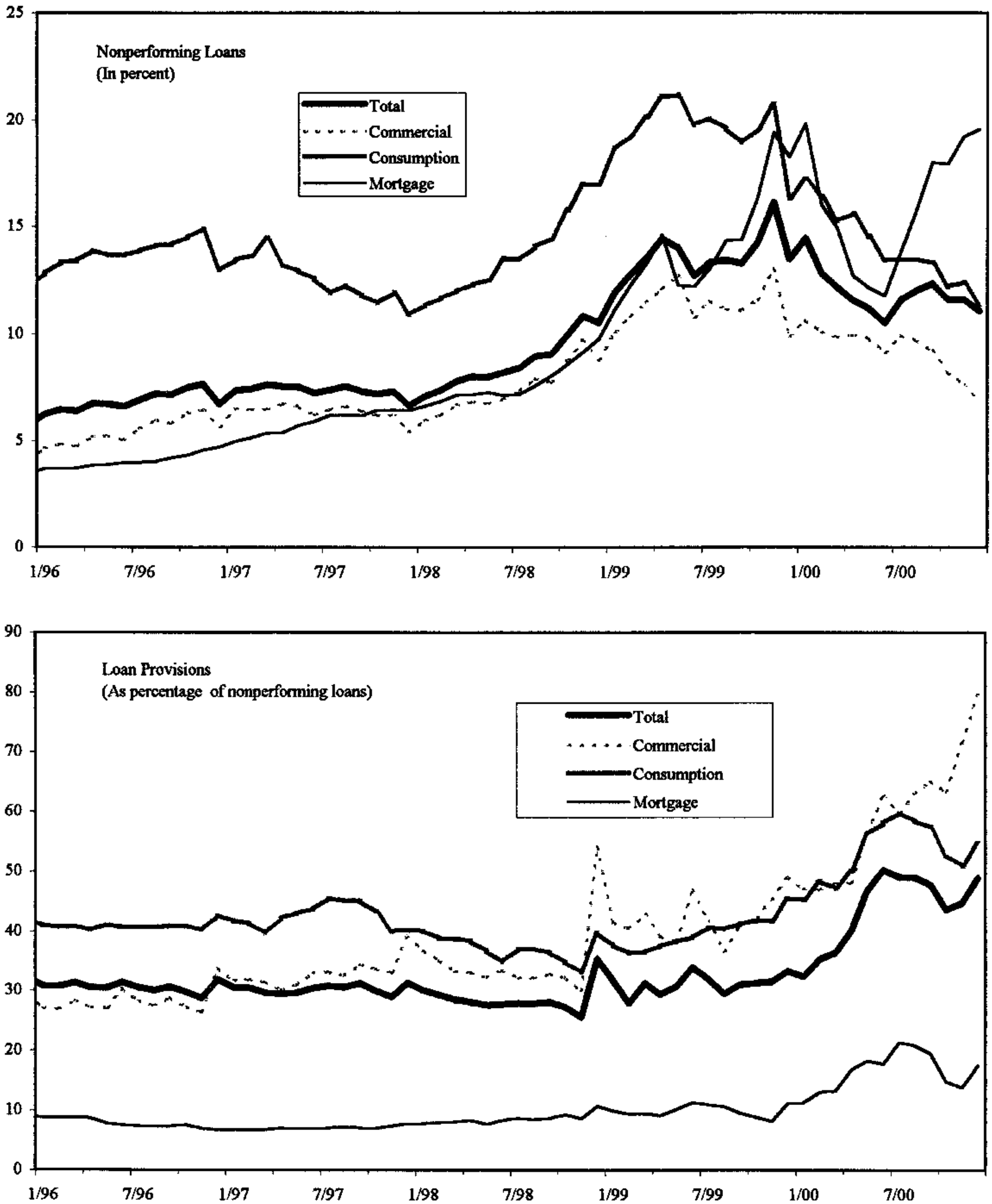
[6] In October 2000, the constitutional court revoked the wage freeze applied last year to some 70 percent of central government employees and to workers in many territorial governments, requiring that these employees instead be awarded wage increases corresponding to the previous year's inflation (9.2 percent, payable before the end of 2000), and that future wage increases must, at a minimum, compensate for inflation in the preceding year. A list of recent court decisions on economic and financial issues is presented in the companion paper "Selected Issues and Statistical Appendix."

[7] The possibility of a shortfall in privatization receipts had been foreseen in the program, and an adjustor was included for the external debt ceiling to allow the public sector to increase its external debt by half of any shortfall in privatization proceeds.

[8] See the companion paper "Selected Issues and Statistical Appendix" for a summary of the financial sector resolution strategy.

Figure 2. Colombia: Banking Indicators



Source: Superintendencia Bancaria de Colombia.

monetary aggregate rose by only 2.7 percent (Table 6). Narrow money (M_1), on the other hand, increased by 13.4 percent, mainly as a result of a sharp increase in the demand for currency in the wake of the problems faced by financial institutions and the effects of the financial transactions tax (0.2 percent on all withdrawals). Market interest rates rose somewhat in the last half of the year in response to increased public sector borrowing (see Table 6, Figure 3). Outstanding credit to the private sector was nearly unchanged in 2000 for the second consecutive year as the economic recovery was financed to a large extent by the productive sectors themselves and facilitated by increased utilization of installed capacity, particularly in the manufacturing sector.[9] However, a moderate increase in credit to the private sector was recorded in the last few months of the year.

10. Colombia's external current account balance improved somewhat in 2000, showing a surplus of 0.2 percent of GDP as both public and private savings improved. Nontraditional exports grew by 15 percent in U.S. dollar terms, helped by a real effective depreciation of the peso during the three years to the end of 2000 and strong demand in foreign markets, particularly the United States. Petroleum exports rose by 30 percent, somewhat less than anticipated due to lower than projected production, while coffee exports fell by more than 20 percent as world market prices fell and new producer countries gained market share (Table 7 and Figure 4). The capital account remained slightly negative in 2000 as the private sector continued to reduce its external debt while the public debt rose, in large measure to make up for the shortfall in proceeds from privatization, as discussed below. Colombia placed sovereign bonds in international markets for US$1.8 billion in 2000, at spreads of 600–700 basis points.[10]

11. The central bank's net international reserves rose by US$707 million in 2000, to US$8.8 billion, or US$250 million more than programmed (Figure 5). The central bank did not intervene in the foreign exchange market in 2000 for the purpose of smoothing out disorderly market conditions (which it may do according to an established set of rules), as the market remained orderly except during a short period in April/May when political events and increasing difficulties in executing the government's privatization program put pressure on the peso. In all, the peso depreciated by 19 percent against the U.S. dollar during 2000, for a real effective depreciation of 11.5 percent (Figure 6).

12. The government's structural reform agenda suffered a setback in 2000 as plans to privatize enterprises in the mining, electricity, telecommunications, and banking sectors for a

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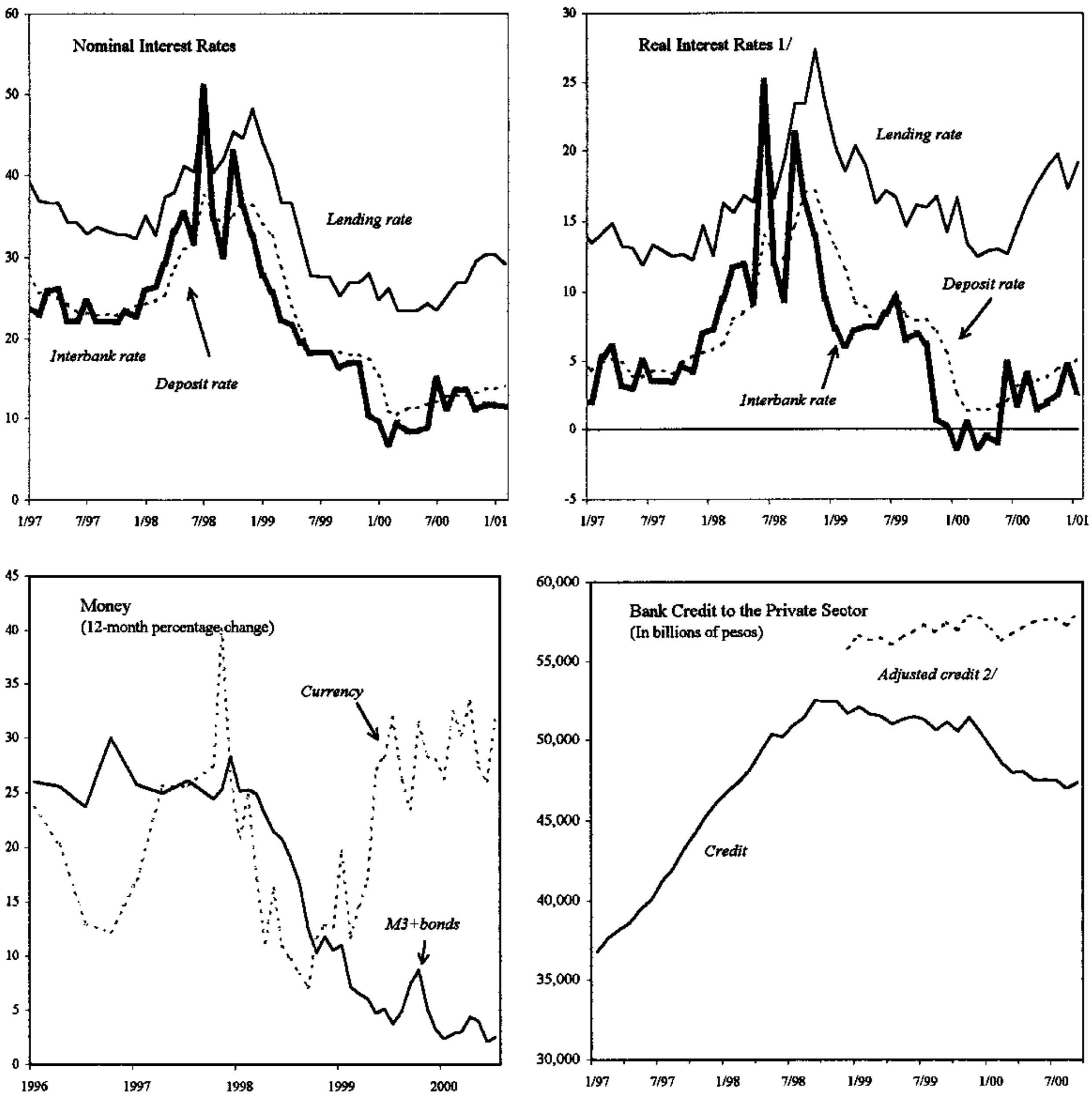
[9] Reported credit to the private sector fell by 7.5 percent in 2000, but it is estimated to have increased by 0.1 percent when the figures are adjusted for loan write-offs and mortgage debt relief.

[10] Of the total placement, about US$360 million were kept in the government's external portfolio to be used in 2001 for financing of the fiscal deficit.

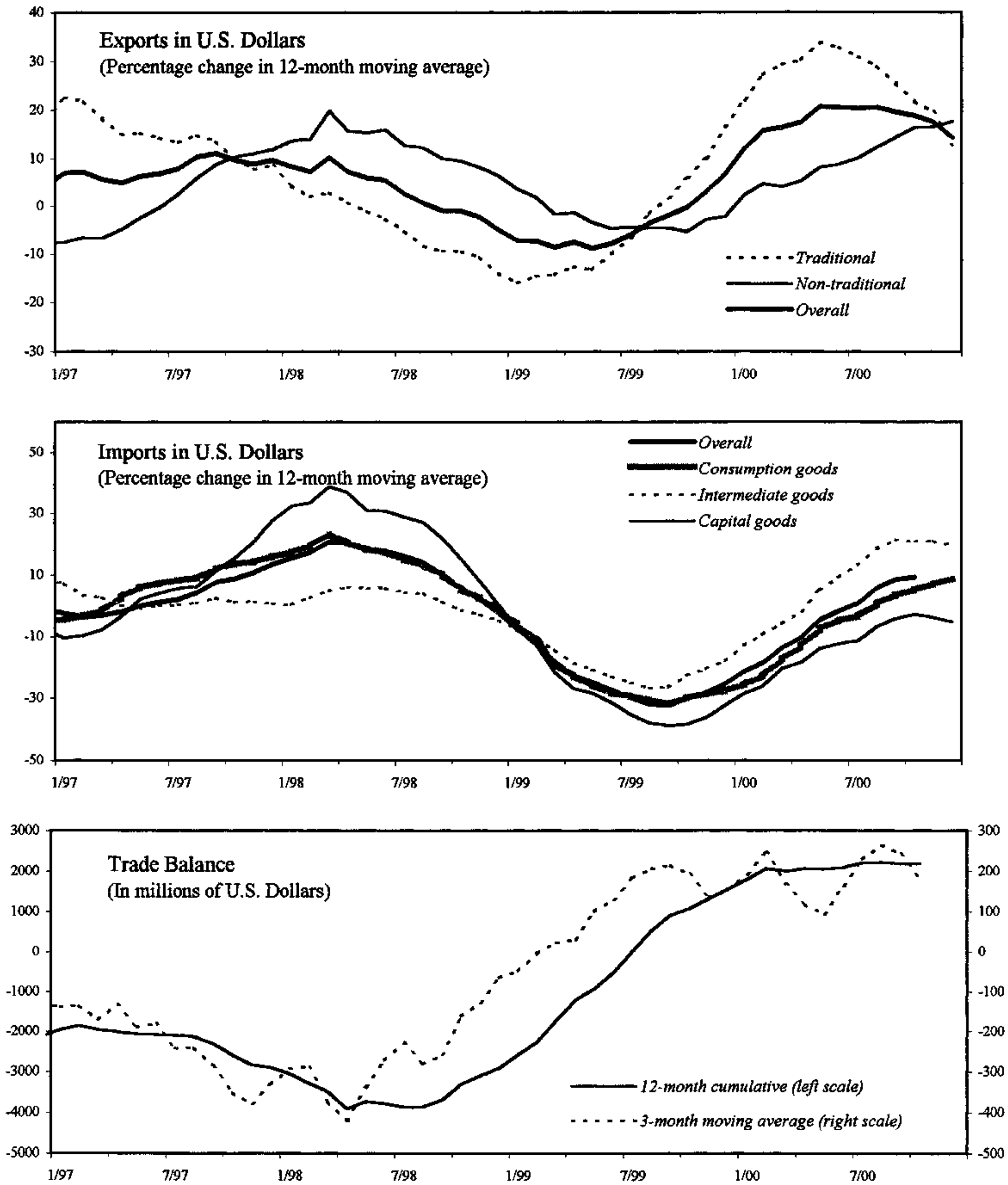
Figure 3. Colombia: Monetary Indicators



Source: Banco de la República.

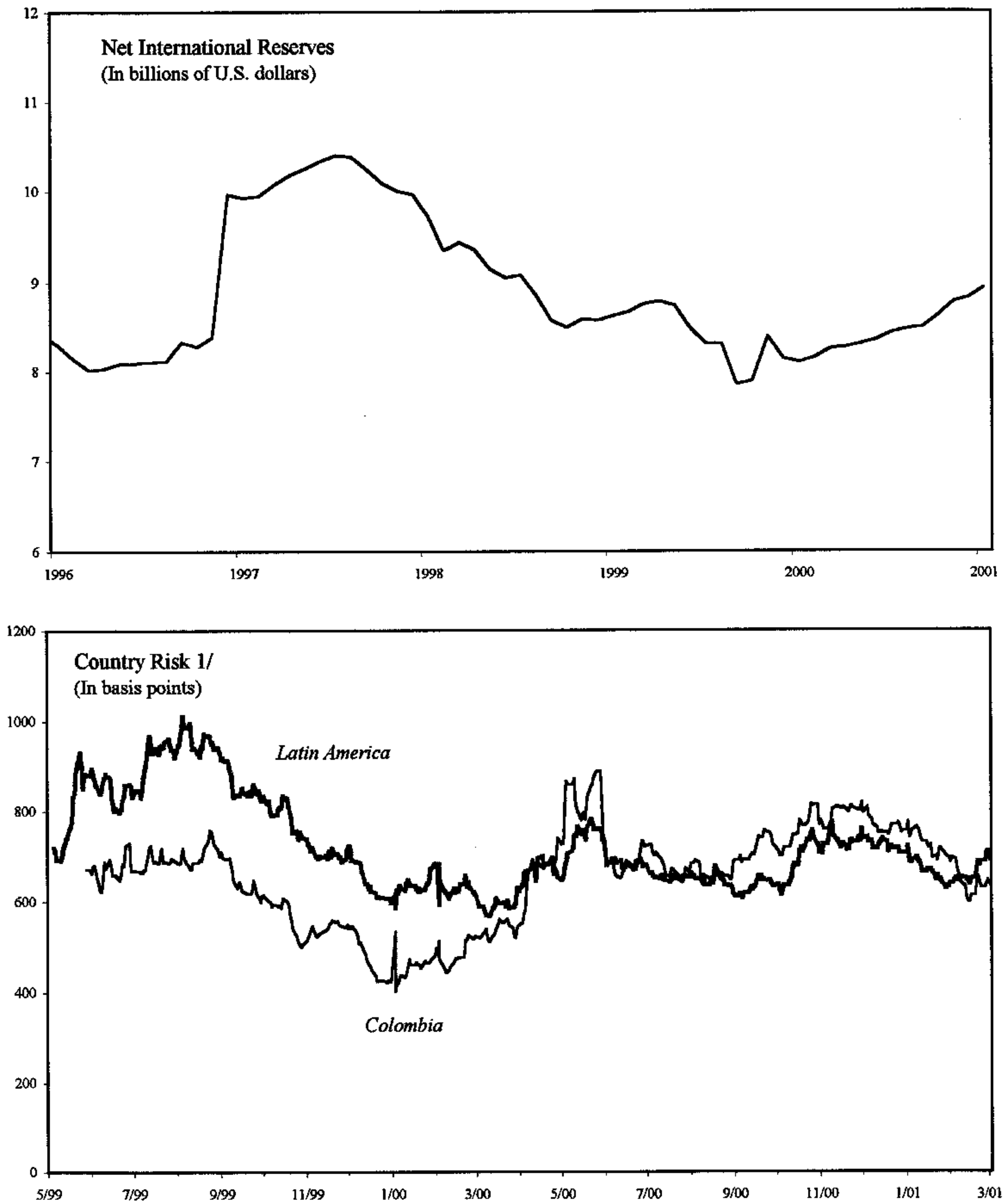
1/ Nominal interest rates reduced by inflation over preceding 12-month period.
2/ Adjusted credit includes loan write-offs and mortgage debt relief not included in reported credit data.

Figure 4. Colombia: Trade Indicators



Source: Banco de la República.

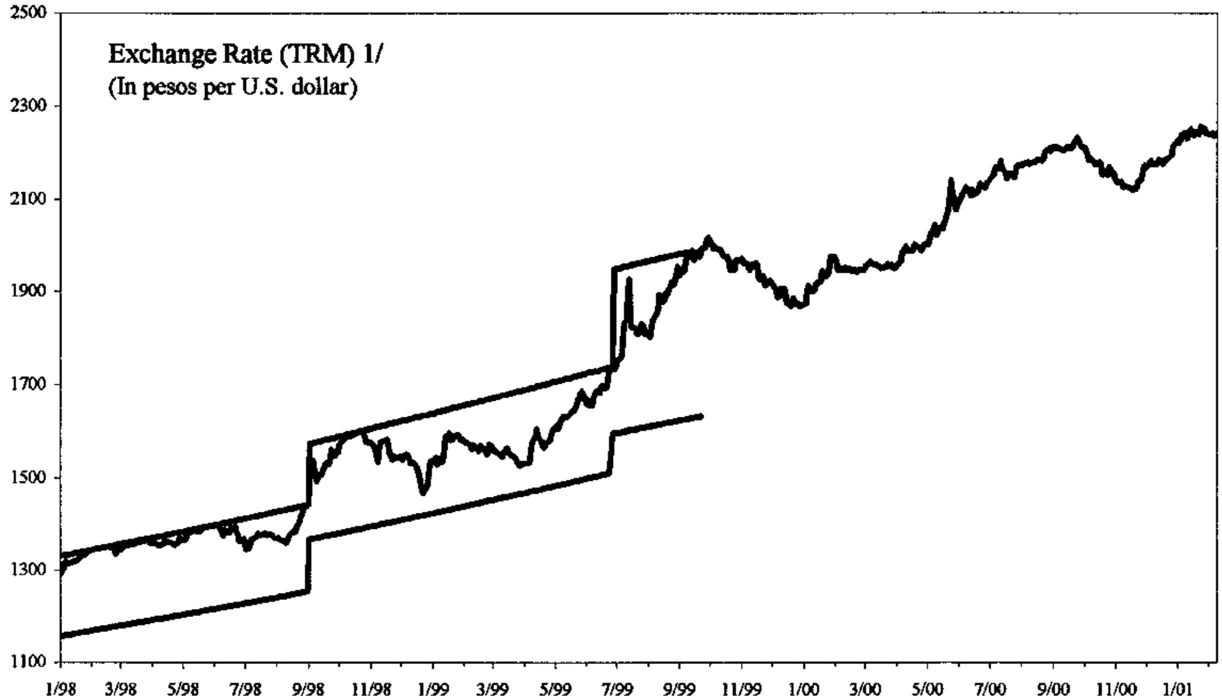
Figure 5. Colombia: External Indicators



Sources: Banco de la República; and J.P.Morgan.

1/ Country risk defined as EMBI+ sovereign spread. Data for Colombia not available prior to May 28, 1999.

Figure 6. Colombia: Exchange Rate Developments



Sources: Banco de la República; and Information Notice System.

1/ In September 1999 the authorities floated the peso.

total of 3.5 percent of GDP fell short by about 3.0 percent of GDP.[11] The shortfall was explained by the frequent episodes of violence against electricity installations in the first half of the year, the withdrawal by the city of Bogotá of the plan to sell its telephone company, and the time required to prepare public banks for divestment or liquidation.

13. On balance, the rest of the structural reform program evolved about as envisaged in 2000, although some reform projects were delayed. The proposed reform of the system of revenue transfers to territorial governments was approved by congress in December in the first of two readings (required for a constitutional change); it will be introduced for the second reading in the first half of 2001. This reform project was complemented by the approval last year of Law 617 designed to help control territorial government spending. Also, the draft law to reorganize lottery and gaming activities was passed in 2000 to help secure resources for the territorial governments' spending in the health sector. The issuance of the final regulation to implement the provisions of the 1999 financial reform law was delayed from June to December 2000.

III. Policy Discussions and the Program for 2001

14. The policy discussions took place against the background of political uncertainty, and nonetheless favorable developments with regard to economic growth, inflation, fiscal consolidation, and the external accounts. The political uncertainty reflected the security situation, which remained very difficult throughout 2000, and late in the year the largest insurgent group (FARC) broke off the peace negotiations with the government. They were resumed again in February of this year and the government has extended the time-frame for the exclusion zone until October 2001.[12] See Box 1 for a summary of the internal conflict.

15. The discussions—and the program design for 2001—focused on policies required to sustain the favorable economic trends both in the near and the medium term. The authorities reiterated their commitments to the three-year program and noted that the broad-based structural reform effort would continue to be strengthened, as had been envisaged when the program was drawn up in 1999. Reflecting this, the authorities and the staff agreed that the macroeconomic framework for 2001 should be based on the objectives established earlier: real GDP growth of nearly 4 percent, end-year inflation of 8 percent, an external current account deficit of about 2 percent of GDP, and a small accumulation of net international reserves (NIR) (see Table 3). These objectives would be supported by a further strengthening of public

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[11] The projected amount was reduced to 1.6 percent of GDP at the time of the first program review in September (EBS/00/178).

[12] The exclusion zone is a Switzerland-size area in the south of Colombia ceded temporarily to the FARC in 1999 in the framework of the peace negotiations.

savings that would help raise national savings and keep the external current account deficit within its long-term sustainable range while providing room for an increase in private investment.

Box 1. The Internal Conflict

The insurgency in Colombia spans nearly four decades, with increasing intensity in recent years. The origin of the *Fuerzas Armadas Revolucionarias de Colombia* (FARC), the largest guerrilla group, can be traced back to a period of serious political instability and violence in the 1950s. The second major group, *Ejercito de Liberación Nacional* (ELN), was created by students who came back from Cuba after Castro's revolution. In the early years, both groups grew slowly; it was not until the mid-1980s, after an aborted peace process, that their real strengthening began. From less than 2,000 armed insurgents at that time, their numbers grew to 12,000 active combatants by the end of the 1990s, with some estimates at 20,000 or more. The paramilitary ("self defense") groups emerged later in response to the guerrilla activity; these groups are thought to field around 5,000 combatants at present; some estimates go as high as twice this number. The number of municipalities with a guerrilla presence rose from a little more than 100 in the late 1980s to almost 600 (out of 1,075) in 1997.

Shortly after taking office in 1998 President Pastrana re-initiated peace negotiations with the largest guerrilla group. However, these were broken off by the FARC in late 2000, reportedly because the guerrillas viewed the government's efforts to control the paramilitary groups as insufficient. The negotiations were resumed again in February 2001, as noted in the text.

The guerrillas' control of territory is extensive, particularly in the outlying rural areas, and in 1999 the government ceded a Switzerland-size area temporarily to the FARC in the context of the renewed peace process. Their influence in many regions gives them indirect access to public funds; their direct funding has increasingly come from the illicit drug trade in the form of "taxes" and payment for "protection." The other main sources of funding are robbery and extortion, and kidnapping. In a study by Colombia's National Planning Department it is estimated that the total income of the guerrillas tripled in terms of GDP from 1990 to 1996, when it exceeded 1.5 percent of GDP.

There are no recent estimates available of the total cost inflicted by the insurgency on the Colombian economy; but it is estimated that the readily identifiable costs exceeded 2 percent of GDP in1996. The attacks on Colombia's four oil pipelines increased during the 1990s with substantial costs in terms of lost production, repair of installations, environmental clean-up, etc. There have been frequent attacks on the mining industry, highways, and other infrastructure, including the power grid, particularly in 2000 as the insurgents opposed the government's attempts to privatize enterprises in the electricity sector. These and other attacks and the spread of insecurity to many sectors of the economy have given rise to the establishment of an elaborate and costly security infrastructure by the private sector. The conflict also brings with it higher costs of health services and excessive outlays on the military and on police protection. In addition to these and other readily identifiable costs, there are costs arising from the internal displacement of an estimated 1.5 million people, the migration of human capital from Colombia, and the adverse impact on private investment.

A national planning department study projects that after a peace agreement, spending would need to be increased to strengthen the social infrastructure and finance the costs of integrating the former insurgents into civilian society. Such costs would amount to nearly 2 percent of GDP per year over a five-year period.

A. Fiscal Policy

16. The program for 2001 calls for the fiscal adjustment to continue along the path envisaged earlier. The combined fiscal deficit, which includes the NFPS deficit, the quasi-fiscal surplus of the central bank, the balance of FOGAFIN, and the fiscal carrying costs of the financial sector restructuring operations, would be reduced to 2.8 percent of GDP, about 0.2 percent of GDP higher than projected at the time of the first program review in September 2000 (see Table 4) due to higher costs of the resolution of the public banks. The NFPS deficit would be reduced to 2.6 percent of GDP, close to the 2.5 percent of GDP target established when the three-program was first drawn up, with the primary balance improving from a surplus of 0.8 percent of GDP in 2000 to 2.0 percent of GDP in 2001.[13]

17. As designed in 1999, the program called for a tax package to take effect in 2001 that would yield 0.6 percent of GDP. Meanwhile, as the financial problems of the public health and pension systems worsened and the constitutional court ordered an increase in the wage bill, the government strengthened its tax proposal to yield 1.4 percent of GDP, based on an increase in the rate of the presumptive income tax, an increase in the value-added tax from 15 to 16 percent, the introduction of a 1.2 percent customs service charge, and an increase in the rate of the financial transactions tax from 0.2 to 0.3 percent; the latter tax was made permanent.[14] On this basis, the revenue of the nonfinancial public sector is projected to be 0.6 percent of GDP higher than envisaged earlier, but marginally lower than last year relative to GDP, due to falling income from the oil sector as prices fall and production is set to decline more rapidly than envisaged, a further deterioration in the finances of the public pension system, and lower revenue of certain decentralized entities (see Table 4).

18. On the expenditure side, the court-ordered wage increase will raise the NFPS wage bill by 0.6 percent of GDP in 2001 relative to the earlier projection, but it will nevertheless fall somewhat in terms of GDP from 2000, and a small reduction in outlays is projected for the territorial governments following passage last year of the legislation to control their current

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[13] The authorities calculate a primary balance for the NFPS that excludes oil sector revenue and the financial position of the public pension sector and the social security system's health service. This balance would improve from a surplus of 1 percent of GDP in 2000 to 3.0 percent of GDP in 2001 (compared with 1999 the improvement would be 5.2 percentage points of GDP). The authorities consider that this improvement best describes the fiscal effort that is being made.

[14] In the attached letter, the authorities indicate that the tax package is expected to yield 1.9 percent of GDP, as they consider the 0.3 percent financial transactions tax to be a new tax that replaces the 0.2 percent tax that expired at the end of 2000. Under the program it had been expected that the financial transactions tax, at the 0.2 percent rate, would be renewed in 2001 to expire at the end of 2002, when the EFF-supported program ended.

spending. As a result, the current outlays of the nonfinancial public sector would decline by nearly 1 percent of GDP from last year. Capital outlays will be about unchanged from 2000, at 7.5 percent of GDP.

19. The government's financing plan for 2001 calls for most of the fiscal deficit to be financed from external sources. To implement its plan, the government has already placed bonds in the international financial markets for 1.0 percent of GDP, and a major bond placement (about 1.4 percent of GDP) with a partial World Bank guarantee is expected to be completed shortly.[15] With this, the planned external market financing for the year would be largely secured; most of the remaining (gross) external financing would be provided by multilateral institutions (1.5 percent of GDP), mainly in the form of policy-based loans in support of Colombia's structural reform program.

B. Monetary Policy

20. Last year, the central bank adopted a monetary policy framework based on inflation targeting (Box 2).[16] Reflecting this, a new procedure has been developed for monitoring monetary developments under the program, which calls for a review with the Fund on action to be taken—if any—in the event the rate of inflation deviates by 2 percentage points or more from the quarterly targets established for 2001. Moreover, Fund staff will be continuously appraised of the central bank's assessment of the inflationary outlook and of any action taken (when the deviation is less than 2 percent) to ensure that the inflation objectives are achieved. The central bank will share with the staff the information provided by its inflation forecasting

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[15] With the guarantee, the government would seek to ensure access to international capital markets for five to six times the final disbursements of US$235 million under the Financial Sector Adjustment Loan (FSAL). The operation would consist of an amortizing bond with a rolling reinstatable guarantee of principal and interest payments.

[16] Monetary policy had previously been guided by an intermediate target for the growth of base money and a trading band for the exchange rate. MAE is providing technical advice with regard to the change to inflation targeting.

Box. 2. The Implementation of Inflation Targeting

In October 2000 the Colombian monetary authorities announced the adoption of inflation targeting as the framework for monetary policy. During the 1990s the central bank set inflation objectives and used monetary aggregates, most recently base money, as an intermediate target. The floating of the exchange rate in 1999 established the preconditions for the implementation of inflation targeting.

Institutional framework

Legal framework—The legal framework for the central bank was put in place in 1991 and 1992. Under the constitution and subsequent laws the central bank has complete instrument independence and a mandate to pursue price stability. Central bank financing of the government deficit is tightly limited.

Design of the inflation target—The inflation target is defined as the annual rate of CPI inflation, which includes the volatile prices of energy and agricultural products. This index was chosen because it is widely understood by the public, and prices, wages, and financial contracts have often been linked to this "headline" index.

The target horizon—The central bank has announced targets for two years in advance. The target for 2001 is 8 percent and for 2002 it is 6 percent. These targets are consistent with the history of gradualism in Colombia that seeks to limit the costs of disinflation. The multiyear target also follows from the long lags between the use of monetary policy instruments and their effect on inflation (typically estimated at six to eight quarters).

Point target or target range—The inflation target is defined as a point rather than a range, because this is thought to provide a better guide to inflationary expectations and to communicate a higher degree of commitment by the monetary authorities to the inflation target.

Accountability and transparency—Each month the central bank makes the results of analyses of inflation forecasts and the observed outcomes of inflation known to the public through press releases, public pronouncements, and inflation reports. It also publishes an in-depth quarterly inflation report which contains information on policy; all the relevant information the central bank collects to measure inflation; forecast inflation outcomes; and measures inflationary expectations. In addition, twice a year the Board of Directors of the central bank presents a report to congress on economic developments and its policy position.

Operational issues: conduct of monetary policy

Policy implementation—The central bank intervenes in the market through open market operations to affect short-term interest rates. There may be limited intervention in the exchange market under well-defined circumstances. Changes in the monetary stance take place when shocks to the system put the inflation target in question.

Inflation forecasting—The Board of Directors and the staff of the central bank examine a broad range of indicators for inflation and inflationary expectations. To these are added projections of inflation from a variety of models including structural models, modified Phillips curve models, and vector-autoregression models. However, these models have had limited success in predicting inflation more than two or three quarters into the future.

Policy transmission channels—The policy transmission channels in Colombia from short-term interest rates to inflation are still somewhat uncertain, and the central bank has only recently begun to develop models that allow for a more detailed analysis of transmission mechanisms. In addition, the structural relationships between monetary policy instruments and economic variables in Colombia have been unstable during the recent economic downturn and under the new exchange rate regime, posing a challenge to the central bank as it gains experience with inflation targeting.

Conclusion—evaluation and assessment

While Colombia has many of the institutional features in place to practice inflation targeting, there are areas where it needs to gain experience in its operations. In particular, a better understanding of the transmission mechanisms and development of more reliable inflation forecasts will enhance the ability of the central bank to evaluate its policy and make the adjustments required to achieve the inflation targets. In addition, in the economy as a whole, the successful implementation of inflation targeting will require the continued absence of fiscal dominance and a continuation of the efforts to deal with the problems in the banking system.

models, its analysis of core inflation, its monthly inflation reports, and other indicators used to assess inflationary trends.[17]

21. The program for 2001 is based on a recovery in the growth of the broad monetary aggregates and a return to positive real growth in credit to the private sector after three years of continuous decline, to help sustain the economic recovery (see Table 6). The growth in bank liabilities would represent a reversal of the trend seen last year when an increasing proportion of private financial savings was channeled into government securities. Any upward pressure on bank interest rates required to achieve this is nevertheless expected to be modest since the program calls for only a small use of domestic credit by the public sector.

22. In the discussions, the staff noted that the continued economic recovery might lead to an increase in inflationary pressures; the demonstration-effect of the constitutional court's recent ruling to require backward indexation of public wages also may make the central bank's disinflation objectives more difficult to achieve. The authorities recognized these potential problems, but noted that there was still considerable slack in the economy, and that productivity gains have been significant. They also noted that because of the lower fiscal deficit and the availability of external financing for the public sector it was unlikely that a tightening of monetary conditions by the central bank would be required to help achieve the inflation target of the program.

C. Structural Issues and the Structural Reform Program

23. The objective of Colombia's structural reform program is to support a quick and sustainable recovery of economic activity while improving social services further, notably in health and education. To this end, the authorities have continued to develop and strengthen their structural agenda and secure legislative support for the reforms. They expect a number of key reforms to be put into effect in 2001 (see Table 2).

24. A main thrust of the government's structural reform strategy has been to strengthen the control over the public finances at all levels of the public sector. To this end, in addition to the law approved last year to help control territorial government spending, a reform of Colombia's system of revenue transfers to territorial governments is being sought, as noted above. Also, a bill will be introduced in congress in the first half of 2001 to set stricter standards for the use of the shared revenue, and a fiscal responsibility law—which will help

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[17] See the companion paper "Selected Issues and Statistical Appendix" for a review of the core inflation indexes used by the central bank, and summary of the procedures used by the central bank under its inflation targeting strategy.

pull these initiatives together—will be presented to congress in the early autumn of 2001.[18] These reforms are described in more detail in Box 3.

25. The efficiency in the collection and the use of public resources in Colombia is being hampered by distortions in the tax system and a pervasive system of revenue earmarking and other restrictions on the use of public resources.[19] The authorities recognize the existing distortions and inefficiencies, but considered a piecemeal approach to dealing with them to be impractical in the near term, particularly since any changes would require legislative approval and time would be needed to mobilize political support for the changes. Instead, to address these problems in a comprehensive manner, the government will name a commission—to be headed by a leading international expert—to study the issues and make recommendations for reforms. The commission will present its recommendations by May 2002, so as to help the next administration (which takes office in August 2002) propose initiatives to ensure that medium-term viability of the public finances can be achieved and sustained.[20]

26. In addition to seeking greater efficiency and better control in the use of public resources, the government also is embarked on a program to reduce the size of the public sector. Some progress to this end has been achieved in recent years through the liquidation of public banks and the privatization of public enterprises, and the government intends to continue its efforts to privatize the two large enterprises in the electricity sector (ISA and ISAGEN) that were not sold in 2000. Also, the government has recently announced a restructuring and downsizing plan for the public sector through executive action that is being initiated in the first half of this year to merge, close, or downsize public entities. This plan is in addition to the considerable action that has been taken over the recent past to streamline the operations and reduce the size of territorial governments as a condition for obtaining the central government guarantees needed to refinance their delinquent debts. To further strengthen the finances of the territorial governments, the authorities will introduce in congress in March of this year legislation that will give these governments additional autonomy and powers to raise revenue locally and strengthen their tax administrations.

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[18] Presentation to congress of the fiscal responsibility law was a structural benchmark under the program for December 2000.

[19] For example, the tax system gives rise to distortions by taxing financial transactions, levying a tax on the remittance of profits from foreign investment, taxing capital inflows through an unremunerated deposit requirement, and levying very high payroll taxes to finance worker training schemes and social programs. At the same time, a large part of the public sector's revenue is earmarked to specific uses; this is the case with the revenue sharing funds and the income from the oil sector.

[20] There is a precedent in Colombia, going back to 1970s, for using such commissions to propose changes in the public finances.

Box 3: Strengthening of Fiscal Rules in Colombia

To help achieve long-run sustainability of the public finances, the authorities are strengthening fiscal policy rules, both at the central and territorial levels of government, under a number of institutional arrangements.

Law 617, to strengthen the fiscal operations of territorial entities

In October 2000 congress approved Law 617 designed to strengthen the fiscal position of territorial governments and other territorial entities. This law sets limits on the operational expenditures of the territorial governments according to their size (based on population and current revenue levels). The law imposes the following sanctions for noncompliance: (i) territorial governments that do not observe the limits must present a fiscal adjustment program to the ministry of finance, (ii) failure to perform under the program would imply that the territorial government could be re-classified into a lower category, or merged with another; and (iii) the central government would be barred from providing guarantees and credits to delinquent territorial entities. Territorial public enterprises generating losses for three consecutive years would be closed,

The constitutional reform of revenue transfers to territorial governments ("*Acto Legislativo*")

Under the 1991 constitution, transfers to territorial governments must increase from 26 percent of the central government's current revenues in 1990 to 46.5 in 2002 (22 percent for the municipalities and 24.5 percent for the departments). Thus, nearly half the central government's revenue is being spent by lower levels of government, which constitutes a significant constraint on the central authorities' overall fiscal effort. Accordingly, in late 1999, the government introduced in congress a constitutional amendment that would change the transfer system from 2002.

Originally, the government considered freezing the transfers in real terms. When the proposal was presented to congress, it called for the transfers to increase in real terms (based on the previous year's inflation) in order to ensure that the provision of health and education services would keep pace with the population growth. After discussions in congress, the proposal established that: (i) transfers will grow by 1.75 percent in real terms in 2002–03, 2.0 percent during 2004–05, and 2.5 percent during 2006–08, and (ii) from 2008 they would increase at the average growth rate of the central administration's current revenues during the four preceding years. The draft law also sets limits on the growth, in real terms, of the central administration's operational expenditures: (i) for the years 2002–06 it will be limited to 1.5 percent and (ii) from 2007 it will be equal to the average growth of the central administration's current revenues during the four previous years. After the reform, the transfers will decline gradually from 4.8 percent of GDP in 2001 to 4.0 percent of GDP in 2010. The proposal was approved by congress in the fall sessions of 2000 but as a constitutional amendment it requires approval also in the next session which starts in March of this year. The reform of the transfer system will be complemented by a revision of Law 60 that delineates the distribution of the transfers and assigns the responsibilities of municipalities and departments with regard to spending on health and education, in order to strengthen the control over the use of these resources. The proposed revision of Law 60 will be introduced in congress in the March–June 2001 session.

The draft fiscal responsibility law

The government has advanced on the drafting of a fiscal responsibility law that would establish rules for a number of fiscal indicators including the nonfinancial public sector balance. These are to be accompanied by a multiyear budget framework, expenditure control procedures, and assorted reporting requirements. In drafting this law, which will be introduced in congress in the fall of 2001, the authorities are consulting with the Fund (FAD) on technical issues.

27. Looking toward the medium and long term, Colombia's public finances are unlikely to achieve viability unless a wide-ranging reform of the pension system is put in place. The earlier reform, in 1993, established a dual system where fully funded private capitalization funds offer an alternative to the guaranteed benefit pensions provided by the social security institute (ISS) and the numerous pension plans for public employees. In the recent past the public pension plans and the ISS pension system have seen a financial deterioration due to the rise in unemployment, a larger than anticipated transfer of existing affiliates and new entrants to the private capitalization funds, as well as the overly generous benefits and inadequate control procedures characteristic of some of the public plans. To deal with these issues, the government is preparing a second-generation pension reform (with technical advice from the World Bank) that will be presented to congress by mid-2001. The authorities explained that this reform has been delayed from what had been envisaged earlier because of the need to develop political support for a wide-ranging reform.[21] Ahead of the final design of the new system, the government has expressed its commitment to allow the private capitalization funds to continue to provide a viable pension alternative. Meanwhile, the authorities recognize that the financial weakening of the public pension system that is in prospect for a number of years during the transition period to the new system could give rise to a pension-induced fiscal deterioration. Against this background, in the forthcoming program review the staff will assess the consistency of the proposed reform with medium-term fiscal viability.[22]

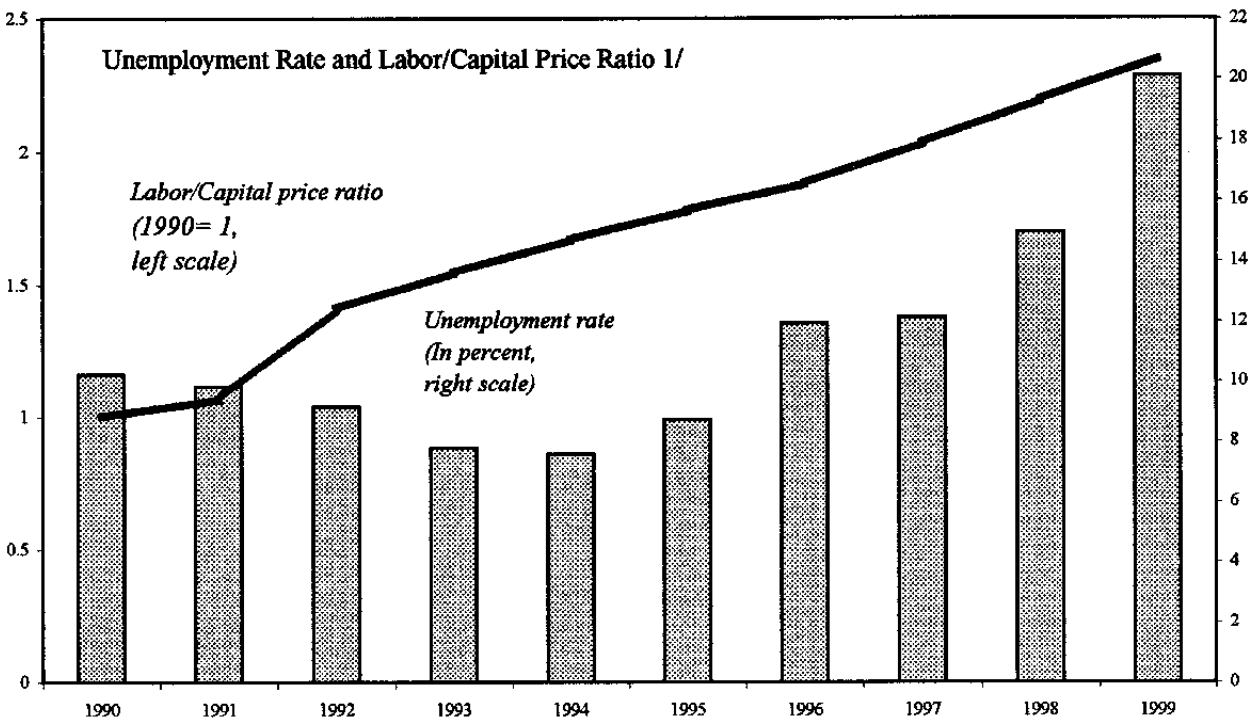
28. The finances of the health system under the ISS have seen a rapid deterioration in the recent past, mostly due to an increase in costs. To deal with these problems the authorities are evaluating options for organizational changes that they intend to put into effect by the middle of 2001. The ISS provides health services in competition with private suppliers; Colombia also has a publicly subsidized health scheme.

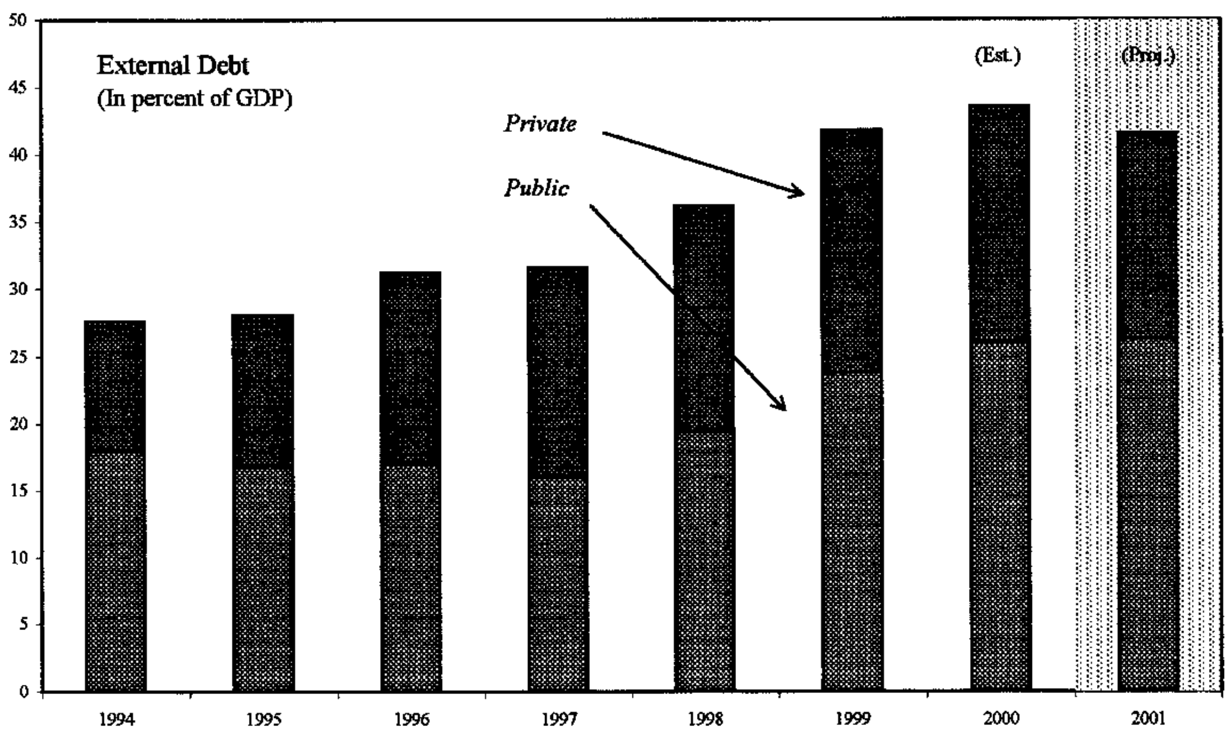
29. Unemployment has risen sharply in Colombia since the mid-1990s (Figure 7). At the same time, the price of labor relative to capital more than doubled during the 1990s, and reflecting this, the output resulting from the investment boom in the first half of the decade appears to have been rather capital intensive. The strong economic expansion during that period may have masked the resulting softening in the demand for labor, which became apparent only as the economic growth slowed in the last half of the decade. The authorities expect that the ongoing economic recovery will help reduce unemployment, and in an effort to speed up the process, they are seeking to lower unemployment through job creation programs for low income groups, training for the young unemployed, and financial incentives for

[21] This reform was a structural benchmark under the program for December 1999, subsequently changed to December 2000.

[22] Recent developments in the public pension system and the challenges faced by the authorities in designing the reform are discussed in the companion paper "Selected Issues and Statistical Appendix".

Figure 7. Colombia: Unemployment and External Debt





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

1/ The Labor Capital Price Ratio is the ratio between an index of labor costs and the price deflator of investment goods in the national accounts.

school-aged children to remain in school. In response to the staff's suggestions that the unemployment problem may need to be addressed also through reforms that would make the labor market more flexible, the authorities noted that collective bargaining agreements in Colombia allow more flexibility in labor contracts than is suggested by the present practice.[23]

IV. Financial Sector Restructuring

30. Colombia's financial system saw a notable strengthening in 2000, but the mortgage sector showed renewed weakness in the last half of the year, as noted above. To deal with this problem the government is introducing measures to strengthen the housing and construction sectors, and secure restructuring and recapitalization of the mortgage institutions involved (five private mortgage institutions together hold 20 percent of banking system deposits). It is expected that these institutions will be restructured, either through mergers with stronger financial groups or in the context of recapitalization by their owners. The remaining public institution in the mortgage sector—Granahorrar—will be sold or liquidated before the end of 2001; in case of liquidation, its deposits and performing assets would be passed to other institutions. The government's efforts to revive the housing industry will be focused on several programs: (i) the development of a market for mortgage-backed securities, which will also help develop a longer term securities market in Colombia and provide an investment outlet for the private pension funds; (ii) the recent establishment of an assets management company (CISA) that will seek to sell the foreclosed assets (mostly real estate) of the public banks; and (iii) the provision of targeted subsidies for the purchase of low income housing.

31. In addition to the sale or liquidation of Granahorrar, the authorities expect that before the end of 2001 they will sell Bancafé, the sole remaining of the publicly owned banks that had been slated for liquidation or privatization, thus meeting its objective of liquidating or divesting all public banks—except Banco Agrario—before the end of this year.

32. Commercial banks improved their capital and loan provisioning levels in 2000 by means of new capital injections and a decrease of loan delinquencies in the corporate and consumer sector. Since 1999 five small- and medium-size banks of a total of 26 private commercial banks have been recapitalized by the owners with credit from FOGAFIN backed by guarantees provided by the owners. During the same period only Granahorrar and Bancafé have been intervened with FOGAFIN taking ownership.

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[23] The companion paper "Selected Issues and Statistical Appendix" contains a chapter on some aspects of the current unemployment problem in Colombia.

V. External Policies

33. The projected increase in the external current account deficit to nearly 2 percent of GDP in 2001 reflects lower petroleum exports as the price of the Colombian mix of crudes is forecast to fall from US$28.8 per barrel in 2000 to US$25.3 per barrel in 2001 and production declines by around 10 percent to 630,000 barrels per day (see Table 7).[24] The growth of nontraditional exports is projected to continue despite a likely softening of import demand in foreign markets on the expectation that the real depreciation of the peso over the past few years will enable Colombia to continue to capture market share for its nontraditional exports (mostly manufactured products).

34. The capital account would strengthen in 2001, reflecting further borrowing by the public sector, as noted above. At the same time, the net private capital outflow (including errors and omissions), is expected to decline further in 2001, partly as interest rates fall abroad, particularly in the United States. It is estimated that the programmed increase in the central bank's net international reserves of US$326 million would be achieved through interest earnings on its reserves.

35. When the three-year program was designed in 1999, it was envisaged that Colombia's external debt would stabilize at about 44 percent of GDP over the medium term. At the end of 2000, the debt had reached 43.5 percent of GDP, less than anticipated earlier due to the higher than projected net repayments of private debt (see Figure 7). It is expected that the external debt will continue to fall in 2001, to about 41.5 percent of GDP (Table 8).

36. Colombia's external vulnerability indicators present a relatively favorable picture. In the current account, a low to moderate deficit is complemented by a comfortable level of reserves, covering over seven months of the following year's projected imports of goods and nonfactor services (Table 9). Also, reserves cover more than one hundred percent of short-term debt by remaining maturity and over 30 percent of broad money. The total external debt is relatively low and the spread of the benchmark Colombian bonds over U.S. treasury was 607 basis points at the beginning of March.

37. In the area of trade policy, Colombia continues to maintain an open regime, with a rank of 2 out of 10 on the Fund's overall index of aggregate trade restrictiveness. During 2000 the authorities eliminated performance requirements in the automotive sector, and implemented their WTO agreements on customs valuation and intellectual property rights,

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[24] Oil production in Colombia is projected to fall through the middle of the present decade as the output from existing fields decline, but it is projected to increase again to around 900 barrels per day at the end of the decade as new discoveries are brought on stream. Oil exploration in Colombia increased sharply in 2000 in response to new and more favorable contracting terms that were introduced in 1999.

but the price bands on agricultural imports remain to be harmonized in the context of the Andean community. In addition, the subsidy component of the tax rebate on the imported components of exports (CERTs) was removed, a move which indicates progress toward turning this program into a full-fledged duty drawback scheme. The subsidy components of the Plan Vallejo (a subsidy on imports of machinery used in export industries) and the free trade zones have been notified to the WTO and will be removed in agreement with WTO. Despite these achievements, the new customs service charge introduced in the recent tax law increases the overall level of the simple average tariff (including other duties and charges) to 12.8 percent. The staff pressed the authorities to establish a fixed deadline for the removal of this charge and the implicit value added tax on some imports, but they preferred to deal with them in the context of the commission that has been established to review the public finances.[25]

VI. MEDIUM-TERM OUTLOOK

38. The baseline medium-term scenario elaborated by the staff for the period until 2010, assumes a gradual increase in the rate of real GDP growth to 4.5 percent and a decline of consumer price inflation to around 4 percent. It also assumes that the structural reforms designed to enhance control over public sector expenditure are fully implemented and that the cash deficit of the ISS health system is eliminated. It also is based on a strong and front-loaded effort to deal with the cash imbalances in the public pension system during the transition period. Against this background the medium-term scenario is based on a decline over the period in the sovereign risk spread paid by Colombia on its external debt. Under these assumptions, the combined public sector deficit would be around 1.5 percent of GDP in 2003 and remain at about that level until after the middle of the decade, as the effect of the fiscal reforms, the downsizing efforts, and the measures to deal with the pension system deficits in the transition period out-weigh a further deterioration in oil revenue. The deficit would decline somewhat toward the end of the present decade as new oil discoveries come on stream. Under this scenario, the total public debt would decrease from 42 percent of GDP in 2002 to 34 percent of GDP in 2010 (Table 10, Figure 8). Colombia's external debt (private and public) would stabilize at around 40 percent of GDP, and at the same time permit a widening of the private sector's savings-investment gap to help underpin the projected levels of economic growth. International reserves would be accumulated at a pace consistent with adequate levels of the external vulnerability indicators.

39. The medium-term scenario presented above is sensitive to the fiscal effect of the pension reform. If the annual primary deficit of the ISS pension system remains at around 1 percent of GDP on average during the transition period, the public debt would remain at

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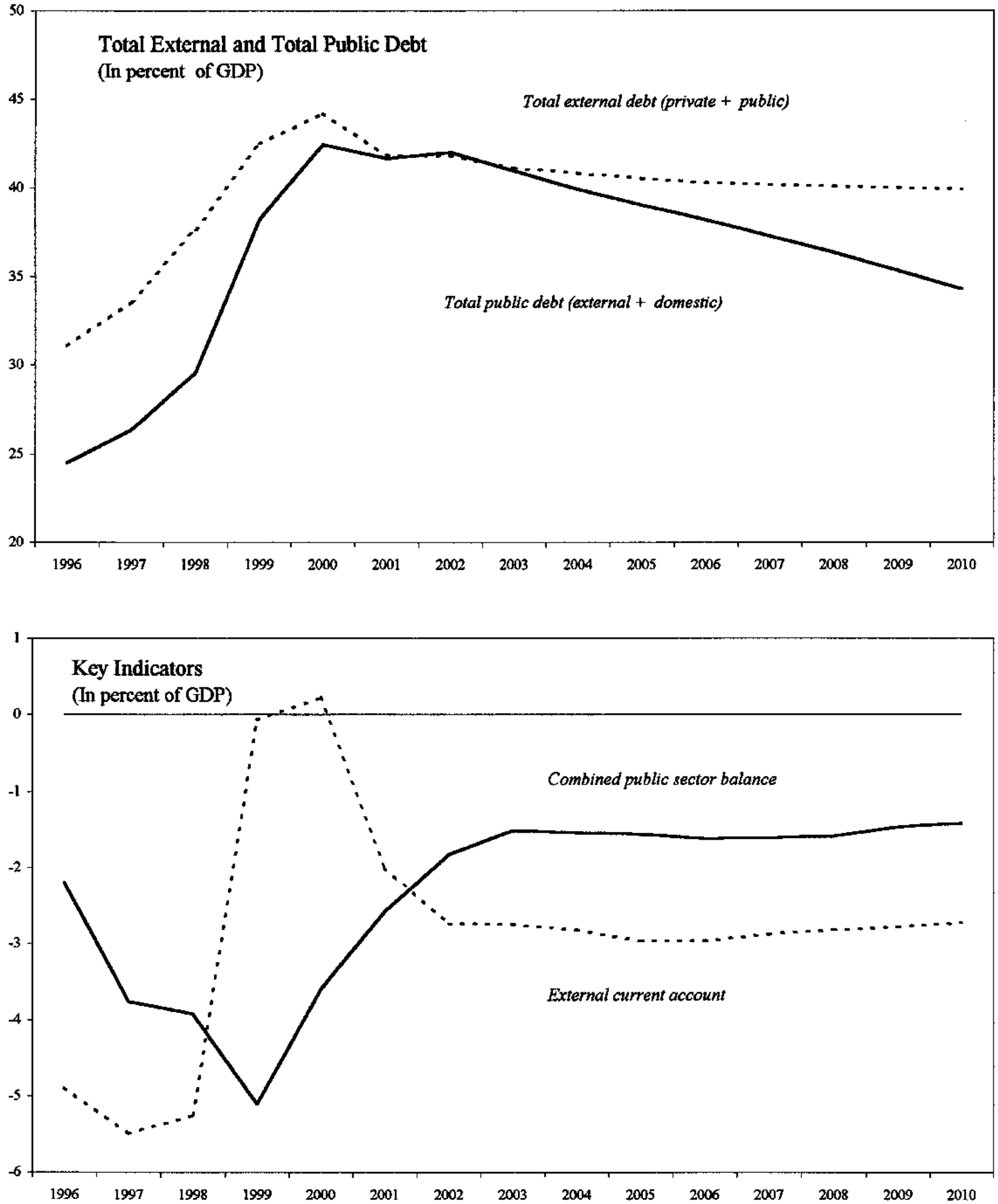
[25] Since domestic producers of VAT-exempt items pay VAT on their inputs, while importers of such items pay no VAT, the "implicit" VAT is levied to offset the cost difference (with elaborate calculations of the equivalent tax rates, item by item).

Figure 8. Colombia: Medium Term Outlook
1996-2010



Sources: Colombian authorities; and Fund staff estimates.

around 42 percent of GDP through 2010, while the total external debt (public and private) would increase by about 6 percent of GDP. Stabilizing Colombia's external debt under this scenario would require the gap between private savings and investment to be maintained at around 0.5 percent of GDP, which could make the targets for real GDP growth difficult to achieve. If, under an alternative scenario, the international interest rates paid by Colombia, including the risk spread, were to remain at the 2001 level, the public debt would stabilize at around 39 percent of GDP by 2010, while the total external debt (public and private) would increase by about 3 percent of GDP.

VII. Performance Criteria, Purchases, and Reviews

40. As specified in the technical memorandum attached to the letter from the Colombian authorities (see Appendix I), the program will be monitored through quarterly performance criteria on the overall deficit of the combined public sector; the inflation targets; the net international reserves (NIR); the increase in medium- and long-term debt; the outstanding amount of short-term external debt of the public sector; and the issuance of guarantees by the public sector for private external debt. The performance criteria for the overall deficit of the combined public sector deficit will be adjusted in case of disbursement of concessional external loans and a loan from a multilateral institution in support of the "Plan Colombia," as well as for a part of any excess petroleum revenue over the baseline projection. The NIR target may be adjusted to facilitate intervention by the central bank to maintain orderly conditions in the exchange market. The program also contains structural benchmarks that will be subject to semi-annual reviews with the Fund, the first at end-June 2001 and the second at the end of the year. Reviews with the Fund also will be triggered if the 12-month inflation rate deviates from its target in the last month of any calendar quarter. There would be four equal purchases under the second year of the arrangement, each for SDR 150.5 million, the first upon completion of the present (second) review of the program, and the subsequent ones will be based on the observance of the quantitative performance criteria for end-March 2001, end-June 2001 (and completion of the third program review), end-September 2001, and end-December 2001 (and completion of the fourth program review). The quantitative performance criteria for end-September and end-December 2001 will be set at the time of the program review scheduled for end-June 2001. The authorities have indicated that their letter of February 23, 2001 to the Managing Director and the attached technical memorandum will be published.

VIII. Staff Appraisal

41. The Colombian economy is on a path to recovery from the 1998/99 recession, helped by the satisfactory implementation of the initial phase of the government's three-year program. This is remarkable given that the domestic security situation has remained very difficult. The peace negotiations were resumed in early 2001, which holds out encouraging prospects, also for the economy.

42. Fiscal consolidation is critical to achieving the objectives for the three-year program and the medium term, and structural reforms will ensure that the public finances remain strong. In the near term a strong fiscal position is necessary to prevent rising interest rates from threatening the recovery and aggravating the situation of the financial institutions; beyond that, it would keep the debt at prudent levels and provide for flexibility in economic policy making.

43. The authorities are making strong efforts to control spending and strengthen the fiscal rules at all levels of the public sector. The proposed reform of revenue transfers has won the first of two legislative approvals, and this reform will be strengthened by legislation that will provide for a more efficient use of the transferred funds. The staff supports the government's intention to consolidate the reforms in this area through a fiscal responsibility law that will be presented to congress later this year.

44. The tax package that was approved late last year was strong in terms of revenue mobilization; however, while it will help strengthen the fiscal consolidation effort, it also introduced or deepened tax distortions. The increase in the rate of the financial transactions tax is likely to aggravate further the disintermediation of financial savings and its yield is likely to fall as taxpayers continue to develop ways to avoid it. This tax should be phased out, as should the customs service charge.

45. Because they consider a piecemeal resolution to the problems arising from revenue earmarking to be impractical in the short term in view of the time required to mobilize political support for reforms in this area, the authorities have decided to deal with these fiscal inefficiencies and the tax distortions in a comprehensive manner through a commission that will present its recommendations to the government that takes office next year. The staff believes that the elimination of these fiscal inefficiencies is of the utmost importance and would have preferred that action be taken more expeditiously.

46. The reform of the official pension system will be key to the longer term sustainability of the public finances, and the staff looks forward to its presentation to congress. It would encourage the authorities to ensure that the reform covers all public pension plans and that it adequately addresses the need to sustain a strong overall fiscal position during the transition period.

47. The staff welcomes the decision of the central bank to adopt a monetary policy framework based on inflation targeting. Having gained credibility for its disinflation policy over the past several years, this change sends a strong signal about the bank's commitment to its inflation objectives. The demonstration effect of last year's re-indexation of public salaries and the ongoing economic recovery may pose a challenge for the central bank's disinflation policy. The staff will encourage the central bank to continue develop its understanding of the transmission mechanism between monetary measures and inflation, and recommend that the bank be guided by the inflation target in its policy decisions.

48. The staff is encouraged by the strengthening of the banking system that has taken place in 2000, and the resolute way in which the authorities are dealing with the loss-making public banks. The plans for the mortgage sector both in terms of restructuring the institutions and launching programs to revive the housing and construction industries are appropriate, and should be pursued vigorously and without delay. To date, the strategy adopted for the few private banks that have required recapitalization with the help of FOGAFIN has been generally successful in improving their solvency, but it continues to rely heavily on macroeconomic stability and a steady recovery in economic activity to avoid additional fiscal costs. This makes it all the more important that implementation of the government's program remains strong and credible.

49. The staff welcomes the programs that are being put in place to deal with the high level of unemployment in Colombia, particularly those emphasizing training. At the same time, there is still a need to deal with the structural problems related to high payroll taxes, the wage indexation mechanisms, and the lack of flexibility in employment terms.

50. Colombia maintains multiple currency practices arising from taxes on profit remittances from direct investment in Colombia and on foreign exchange earnings from personal services and transfers. The authorities should eliminate the remaining multiple currency practices to allow Colombia to accept the obligations under Article VIII of the Fund's Articles of Agreement by September 2002, as agreed under the program. Since these practices were not introduced for balance of payments reasons, the staff does not recommend their approval.

51. Despite the adverse security situation, Colombia's three-year program is being implemented about as envisaged, with an appropriate focus on fiscal adjustment and structural reform. The economy is growing, inflation is on a downward path, and the external accounts are strong. The challenge faced by the authorities to achieve fiscal sustainability has been highlighted over the past year by the financial deterioration of the public pension system. The staff expects that the forthcoming proposal for pension reform will be strong enough to allow the private sector to expand its activity while ensuring that Colombia's external debt remains at prudent levels. To further ensure the success of the program and sustain the improvements over the medium term, the staff will encourage the authorities to move swiftly to reduce the tax distortions and the revenue earmarking and take action to deal with obstacles to job creation.

52. On the basis of the performance to date and the strong program presented by the authorities for 2001, the staff recommends completion of the second review under the extended arrangement.

53. It is recommended that the next Article IV consultation be held on the standard 12-month cycle.

Table 1. Colombia: Performance Criteria 1/

	2000			
	Mar. 31	Jun. 30	Sep. 31	Dec. 31
Cumulative flows from January 1, 1999 (In billions of Colombian pesos)				
Overall balance of the combined public sector				
Floor	-11,550	-13,300	-13,700	-14,500
Outcome	-5,903	-7,570	-9,400	...
Margin or deviation (-)	5,647	5,730	4,300	...
Outstanding stock (In billions of Colombian pesos)				
Net domestic assets of the Banco de la Republica				
Ceiling	-8,950	-9,050	-8,500	-7,100
Adjusted ceiling	-8,655	-7,205	-6,655	-5,255
Outcome	-9,789	-8,718	-9,543	-7,374
Margin or deviation (-) 2/	1,135	1,513	2,888	2,119
(In millions of U.S. dollars)				
Net international reserves of the Banco de la Republica				
Target	8,150	8,350	8,250	8,570
Adjusted target	8,006	7,450	7,350	7,670
Outcome	8,254	8,335	8,496	8,822
Margin or deviation (-)	248	885	1,146	1,152
Cumulative net disbursement from January 1, 1999 (In millions of U.S. dollars)				
Net disbursement of medium- and long-term external debt by the public sector				
Ceiling	2,600	2,750	3,200	3,500
Adjusted ceiling	2,793	3,383	4,318	4,722
Outcome	2,291	2,248	2,592	...
Margin or deviation (-)	502	1,135	1,726	...
Change in the outstanding stock of short-term external debt of the public sector				
Ceiling	70	70	70	70
Outcome	56	56	2	...
Margin or deviation (-)	14	14	68	...

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

1/ Definitions of concepts and adjustments to the performance criteria are explained in the Technical Memorandum of Understanding attached to the Letter of Intent.

2/ The end-1999 deviation (excess) in net domestic assets reflected excess liquidity demand at the end of the year related to the Y2K problem.

Table 2. Colombia: Structural Benchmarks Under the Program

	Benchmark	Status
By December 31, 1999	Present to congress a proposal for a second generation social security reform. (Modifying Law 100 of 1993.)	Postponed to December 2000.
	Present to congress a proposal for the creation of the territorial government pension funds.	Done. Approved by congress in December 1999.
	Present to congress for first reading a constitutional reform which delinks transfers to territorial governments from current income of the central government.	Done in March 2000. Reform proposal somewhat different from envisaged in program. Approved in December 2000.
	Present to congress a proposal for the fiscal strengthening of territorial governments by means of limiting their current expenditures.	Done. Approved by congress in October 2000.
	Present to congress a proposal to organize lottery activities to help boost public revenue.	Done. Approved by congress in December 2000.
By March 31, 2000	Present to congress a proposal for widening the base of the income tax, tackling "loopholes" in the VAT (national tax reform). The reform of the income tax/VAT will be designed to yield a total of 0.6 percent of GDP per year on an annual basis starting in 2001 with additional 0.2 percent of GDP in 2002.	Done, but proposal different from that envisaged in program. Approved by congress in December 2000.
By June 30, 2000	Regulations issued to implement the provisions of the financial reform law enacted in July 1999.	Done. Executive decree on early warning indicators was issued in December 2000.
By September 30, 2000	Present to congress the 2001 budget consistent with a nonfinancial public sector deficit of at most 2.5 percent of GDP	Done. Approved by congress in October 2000.
By December 31, 2000	Present to congress a draft fiscal responsibility law.	Postponed to September 2001.
	Present to congress a proposal for a second generation social security reform (modifying Law 100 of 1993).	Postponed to June 2001.
By March 31, 2001	Present to congress a proposal on territorial tax policy, granting more fiscal autonomy to territorial governments (territorial tax reform).	
	Present to congress for last reading a constitutional reform which delinks transfers to territorial governments from current income of the central government.	
	Government ministries to present to cabinet their plans for restructuring/downsizing of the ministries and their dependent entities.	

	Benchmark	Status
	Design a legal framework for CISA (asset management company) to facilitate sale of foreclosed assets.	
By June 30, 2001	Put into effect a reform of the health system under the social security institute.	
	Present to congress a proposal for a second generation pension reform (modifying Law 100 of 1993).	
	Revise investment norms applicable to private pension funds to help stimulate the development of longer term capital markets.	
	Introduce legislation (revision of Law 60 regarding public education and health) to strengthen control over the public finances and resource allocation.	
	Approve regulatory framework for mortgage-backed securities.	
	Develop framework to facilitate the purchase and assumption of assets and liabilities of financial institutions.	
By September 30, 2001	Present to congress a draft fiscal responsibility law.	
By December 31, 2001	Full disinvestment of all remaining public banks, excluding Banco Agrario.	
By June 30, 2002	Final report of the commission on public finances.	
By September 30, 2002	Complete process of bringing provisioning standards of the financial institutions to international levels.	
	Latest date for accepting the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement.	

Table 3. Colombia: Selected Economic and Financial Indicators

	1996	1997	1998	1999 Prog.	1999 Prel.	2000 Prog.	2000 Est.	Proj. 2001	Proj. 2002
(Percentage changes, unless otherwise indicated)									
National income and prices									
Real GDP	2.1	3.4	0.5	-3.5	-4.3	3.0	2.8	3.8	4.5
GDP deflator	16.9	16.8	15.6	11.6	12.4	11.5	10.2	9.0	6.9
Consumer prices (average)	20.8	18.5	18.7	11.3	10.9	11.2	9.2	8.8	6.9
Consumer prices (end of period)	21.6	17.7	16.7	11.0	9.2	10.0	8.8	8.0	6.0
External sector (on the basis of U.S. dollars)									
Exports (f.o.b.)	3.5	10.0	-4.8	8.9	4.8	9.2	12.7	-2.0	1.9
Imports (f.o.b.)	-0.6	12.6	-5.3	-29.8	-26.4	20.2	8.8	7.7	10.3
Export volume	-0.9	6.4	6.6	5.1	1.0	6.0	0.2	3.5	3.4
Import volume	1.0	20.5	-0.5	-28.9	-26.7	18.4	11.6	6.1	8.4
Terms of trade (deterioration -)	6.1	10.7	-6.2	5.0	3.4	1.5	17.1	-6.7	-3.2
Nominal exchange rate to U.S. dollar 1/ (depreciation -)	-12.9	-11.2	-24.2	...	-23.7	...	-16.1	...	...
Real effective exchange rate 1/2/ (depreciation -)	7.0	11.3	-4.6	...	-9.6	...	-7.3	...	...
Central administration									
Revenue	23.0	27.9	9.8	9.2	8.1	20.7	25.3	26.6	9.0
Expenditure 3/	32.2	16.9	25.4	23.5	15.7	2.5	12.6	11.2	7.2
Money and credit 4/									
Broad money	30.0	24.5	10.3	12.8	8.7	18.2	2.7	19.2	11.8
Private sector credit 5/	25.7	25.6	11.9	5.9	3.5	16.7	0.1	10.8	15.3
Income velocity of money	2.8	2.7	2.8	2.7	2.8	2.6	3.1	2.9	2.9
Interest rate (90-day time deposits) 5/									
Nominal	27.9	24.3	34.1	...	15.4	...	12.7	...	...
Real	5.0	5.6	14.9	...	5.6	...	3.3	...	...
Broad money (as ratio to net international reserves)	3.4	3.6	3.8	3.5	3.5	3.3	2.7	3.1	3.2
(In percent of GDP)									
Central administration balance 3/	-5.0	-3.7	-5.4	-7.1	-7.4	-6.1	-6.0	-4.1	-3.7
NFPS savings 3/	6.3	5.6	4.0	2.6	2.9	4.7	4.0	4.9	4.6
Nonfinancial public sector balance 3/	-3.0	-3.9	-4.6	-6.3	-6.4	-3.5	-3.6	-2.6	-1.9
Combined public sector balance 3/	-3.1	-3.9	-3.8	-5.9	-5.5	-3.7	-3.6	-2.8	-1.9
Foreign financing	0.9	0.6	2.6	1.6	1.3	1.4	1.8	2.3	2.2
Domestic financing 7/8/	1.4	2.0	1.1	3.6	3.5	0.7	1.5	0.5	-0.2
Privatization	0.8	1.3	0.1	0.7	0.7	1.6	0.3	-0.1	-0.2
Public debt 9/	24.5	26.7	29.9	34.5	38.2	34.4	42.4	41.7	42.0
Gross domestic investment	22.2	20.9	18.2	15.3	12.3	18.4	14.5	17.0	18.0
Gross national savings	17.3	15.4	13.0	14.0	12.3	16.0	14.7	15.2	15.3
Current account (deficit -)	-4.9	-5.5	-5.3	-1.3	-0.1	-2.4	0.2	-1.8	-2.7
External debt 10/	31.2	31.6	36.2	41.1	41.8	43.1	43.5	41.6	39.6
Of which: Public sector 10/	17.0	16.1	19.4	23.3	23.8	24.8	25.9	26.2	26.0
Total short-term external debt to reserves 11/	40.4	41.5	42.3	72.0	97.8	57.2	88.9	96.2	84.3
(In percent of exports of goods, services and income)									
External debt service 10/	39.2	47.1	48.8	50.0	51.1	49.0	47.4	52.8	49.4
Of which: Public sector	21.7	24.0	23.2	22.6	23.3	21.1	21.8	28.0	28.2
Interest payments 10/	14.9	16.9	17.9	16.9	17.4	16.4	17.2	19.1	18.3
Of which: Public sector	8.0	8.4	8.6	8.9	8.9	9.3	9.3	11.0	11.1
(In millions of U.S. dollars)									
Overall balance of payments	1,727	277	-1,390	-750	-319	478	706	326	324
Gross official reserves 12/	9,938	9,908	8,740	8,215	8,103	9,458	9,006	10,138	10,645
Gross official reserves (in months of imports of goods and services)	6.5	6.9	7.9	5.8	6.8	5.9	7.1	6.8	6.6

Sources: Colombian authorities; and Fund staff estimates and projections.

1/ Annual average.
2/ Based on the Information Notice System.
3/ According to the new definition of floating debt (=unpaid bills plus outstanding commitments).
4/ All annual changes in foreign currency stocks valued at constant exchange rate.
5/ The figures for 1999-2002 have been adjusted for loan write-offs resulting from the mortgage debt reduction and bank restructuring programs.
6/ End of period.
7/ Includes the balance of the quasi-fiscal operations of Banco de la Republica.
8/ Includes residual differences between items above and below the line, as well as sales of assets and extension of phone licenses.
9/ Includes bonds issued to recapitalize financial institutions.
10/ Includes short-term debt.
11/ Short-term debt is defined by its remaining maturity from 1999 onward.
12/ Assuming no purchases under the current EFF arrangement.

Table 4. Colombia: Operations of the Combined Public Sector

(In percent of GDP)

	1996	1997	1998	1999 Prog.	1999 Actual	2000 Prog.	2000 Est.	2001 Prog.	2001 Proj.	2002 Prog.	2002 Proj.
Total revenue	**27.0**	**27.4**	**26.7**	**27.3**	**27.3**	**29.0**	**28.8**	**28.1**	**28.7**	**27.4**	**28.1**
Current revenue	**27.0**	**27.4**	**26.7**	**27.3**	**27.3**	**29.0**	**28.8**	**28.1**	**28.7**	**27.4**	**28.1**
Tax revenue 1/	16.8	17.7	17.5	16.5	16.8	17.9	17.5	18.7	19.5	19.3	19.5
Nontax revenue	10.2	9.7	9.2	10.8	10.4	11.2	11.3	9.5	9.2	8.1	8.6
Property income	0.8	0.9	0.9	0.9	1.0	1.0	1.2	1.0	1.0	1.0	1.0
Operating surplus of public enterprises	4.7	3.5	3.3	4.0	4.0	4.9	4.5	4.1	4.0	3.4	3.8
Of which: Ecopetrol	2.0	1.5	1.6	2.3	2.4	3.5	3.2	3.0	2.7	2.2	2.5
Other 2/	4.7	5.4	5.1	5.9	5.4	5.4	5.7	4.4	4.3	3.7	3.9
Of which: oil stabilization fund	0.1	0.1	0.1	0.5	0.8	0.5	0.8	0.1	0.3	0.0	-0.1
Total expenditure and net lending 1/	**29.8**	**31.4**	**30.7**	**33.6**	**33.2**	**32.4**	**32.3**	**30.7**	**31.3**	**28.9**	**29.9**
Current expenditure	**20.6**	**21.8**	**22.7**	**24.7**	**24.4**	**24.4**	**24.8**	**23.2**	**23.9**	**22.9**	**23.3**
Wages and salaries	6.6	6.7	7.0	7.5	7.7	7.2	7.6	6.7	7.3	6.5	7.0
Goods and services 3/	3.5	3.7	3.5	3.4	3.6	3.3	3.5	3.0	3.2	2.9	3.0
Interest	2.7	2.6	3.3	4.0	3.8	4.2	4.4	4.2	4.6	4.1	4.5
External	1.0	1.0	1.1	1.5	1.4	1.6	1.7	1.7	2.0	1.6	1.8
Domestic	1.7	1.6	2.2	2.5	2.3	2.6	2.7	2.5	2.6	2.5	2.8
Transfers to private sector	7.7	7.9	8.5	9.6	9.1	9.6	9.3	9.3	9.3	9.3	9.3
Of which: from social security	4.2	4.6	5.0	5.8	5.5	5.8	5.8	5.9	6.0	6.0	6.1
Other 4/	0.2	1.0	0.4	0.1	0.2	0.0	0.1	0.0	-0.4	0.0	-0.5
NFPS saving	*6.3*	*5.6*	*4.0*	*2.6*	*2.9*	*4.7*	*4.0*	*4.9*	*4.9*	*4.5*	*4.8*
Capital expenditure 4/	**9.1**	**9.6**	**7.9**	**8.6**	**8.7**	**8.1**	**7.5**	**7.5**	**7.5**	**6.0**	**6.6**
Fixed capital formation	8.9	9.1	7.8	8.4	8.6	8.0	7.4	7.4	7.4	5.9	6.5
Transfers	0.2	0.4	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Net lending	0.0	0.0	0.0	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy 5/	-0.2	0.1	-0.6	0.0	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector balance	**-3.0**	**-3.9**	**-4.6**	**-6.3**	**-6.4**	**-3.5**	**-3.6**	**-2.5**	**-2.6**	**-1.5**	**-1.8**
Quasi-fiscal balance (BR cash profits)	0.0	-0.1	0.8	0.4	0.4	0.5	0.4	0.5	0.5	0.5	0.5
Fogafin balance	...	...	...	0.3	0.5	-0.1	0.0	0.2	0.1	0.2	0.1
Net cost of financial restructuring 6/	...	...	...	-0.2	0.0	-0.6	-0.4	-0.7	-0.9	-0.6	-0.6
Overall balance	**-3.1**	**-3.9**	**-3.8**	**-5.9**	**-5.5**	**-3.7**	**-3.6**	**-2.6**	**-2.8**	**-1.5**	**-1.7**
Overall financing	**3.1**	**3.9**	**3.8**	**5.9**	**5.5**	**3.7**	**3.6**	**2.6**	**2.8**	**1.5**	**1.7**
Foreign, net	0.9	0.6	2.6	1.6	1.3	1.4	1.8	0.6	2.3	1.0	2.2
Of which											
Changes in assets held abroad (-increase)	-0.4	-0.6	0.1	-0.6	-0.9	-1.3	-0.4	0.4	0.4	0.1	0.2
Domestic, net	1.4	2.0	1.1	3.6	3.5	0.7	1.5	0.5	0.6	0.7	-0.4
Financial system and bonds	0.3	2.0	0.7	3.1	2.9	0.9	1.9	0.8	1.2	0.7	0.5
Change in floating debt, net 7/	1.0	0.0	0.4	0.5	0.6	-0.2	-0.4	-0.3	-0.7	0.0	-0.9
Privatization (including concessions) 8/	0.8	1.3	0.1	0.7	0.7	1.6	0.3	1.5	-0.1	-0.2	-0.2
Memorandum items:											
NFPS primary balance	-0.3	-1.3	-1.3	-2.3	-2.6	0.7	0.8	1.7	2.0	2.6	2.8
Primary NFPS non-oil nonsocial security balance	-0.6	-0.8	-0.8	-1.3	-2.1	0.8	1.0	2.4	3.0	4.1	4.5

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

1/ Excludes proceeds of financial transaction tax in 1999 from revenue and expenditure.
2/ Includes local fees, penalties and oil stabilization fund.
3/ From year 2000 includes the unpaid bills of *Instituto del Seguro Social*.
4/ Includes change in the budget carry-over of the central administration and in the unpaid bills of selected nonfinancial public enterprises.
5/ Includes residual differences between items above and below the line.
6/ Transfer to Caja Agraria in 1999, interest payments on public banks restructuring bonds and mortgage debt relief related costs.
7/ From 2000 includes the unpaid bills of selected nonfinancial public enterprises and of the *Instituto del Seguro Social*.
8/ Includes nonrecurrent fees from telecommunications licensing.

Table 5. Colombia: Operations of the Central Administration

(In percent of GDP)

	1996	1997	1998	1999 Prog.	1999 Actual	2000 Prog.	2000 Est.	2001 Prog.	2001 Proj.	2002 Prog.	2002 Proj.
Total revenue	**11.8**	**12.6**	**11.9**	**11.9**	**11.9**	**12.8**	**13.2**	**13.8**	**14.7**	**13.9**	**14.4**
Current revenue	**11.8**	**12.6**	**11.9**	**11.9**	**11.9**	**12.8**	**13.2**	**13.8**	**14.7**	**13.9**	**14.4**
Tax revenue 1/	10.1	10.8	10.5	10.1	10.0	11.0	11.3	12.2	13.1	12.4	12.9
Net income tax and profits	3.8	4.4	4.3	4.2	4.2	4.3	4.6	4.7	5.3	4.6	5.0
Goods and services	5.3	5.3	5.0	4.9	4.9	5.1	5.0	5.8	5.7	6.1	5.8
Value-added tax	4.7	4.8	4.5	4.4	4.4	4.6	4.6	5.1	5.2	5.3	5.3
Gasoline tax	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.8	0.5	0.9	0.5
International trade	0.9	1.0	1.2	0.9	0.9	1.0	1.0	1.0	1.2	1.0	1.2
Financial transaction tax	0.0	0.0	0.0	0.0	0.0	0.6	0.6	0.6	0.8	0.6	0.8
Stamp and other taxes	0.0	0.1	0.0	0.0	0.0	0.1	0.1	0.1	0.0	0.0	0.0
Nontax revenue and transfers	1.7	1.8	1.4	1.9	1.9	1.8	1.9	1.6	1.7	1.5	1.4
Property income	0.3	0.3	0.3	0.2	0.3	0.3	0.6	0.4	0.4	0.3	0.4
Other	1.4	1.5	1.1	1.7	1.6	1.5	1.3	1.2	1.2	1.2	1.0
Total expenditure and net lending	**16.8**	**16.3**	**17.2**	**19.0**	**19.4**	**19.0**	**19.2**	**18.0**	**18.9**	**17.9**	**18.1**
Current expenditure	**11.8**	**12.4**	**13.9**	**15.1**	**15.0**	**15.3**	**16.1**	**14.4**	**15.5**	**14.2**	**15.1**
Wages and salaries	2.5	2.5	2.7	2.9	2.9	2.8	3.1	2.5	3.0	2.4	2.9
Goods and services	1.3	1.6	1.4	1.3	1.3	1.2	1.4	1.0	1.3	1.2	1.3
Interest	1.1	1.2	1.9	2.3	2.1	2.7	2.7	2.9	3.2	2.8	3.2
External	0.5	0.6	0.7	1.0	1.0	1.1	1.2	1.2	1.6	1.2	1.5
Domestic	0.6	0.6	1.2	1.3	1.1	1.6	1.5	1.7	1.6	1.6	1.7
Other expenditure 2/	0.2	0.4	0.4	0.1	0.2	0.0	0.1	0.0	-0.4	0.0	-0.5
Current transfers 3/	6.7	6.8	7.4	8.5	8.5	8.6	8.8	8.0	8.4	7.8	8.3
Capital expenditure 2/	**4.6**	**3.6**	**3.2**	**3.4**	**3.8**	**3.1**	**2.5**	**3.3**	**3.0**	**3.7**	**2.7**
Fixed capital formation	2.5	1.5	1.1	1.1	1.6	1.1	0.4	1.3	1.0	1.3	0.9
Capital transfers	2.1	2.2	2.0	2.3	2.2	2.0	2.1	2.0	2.0	2.4	1.8
Net lending	0.4	0.2	0.2	0.5	0.6	0.6	0.5	0.3	0.4	0.0	0.3
Overall balance	**-5.0**	**-3.7**	**-5.4**	**-7.1**	**-7.4**	**-6.1**	**-6.0**	**-4.2**	**-4.1**	**-4.0**	**-3.7**
Memorandum items:											
Transfers to local governments	4.0	4.0	4.3	4.6	5.0	4.2	4.8	4.5	4.8	4.1	4.6

Sources: National Department of Planning; CONFIS; and Fund staff estimates.

1/ Excludes proceeds of financial transaction tax in 1999 from revenue and expenditure.

2/ Includes the change in the budget carry-over.

3/ Includes interest payment to the rest of the nonfinancial public sector.

Table 6. Colombia: Summary Accounts of the Financial System

	1996	1997	1998	1999 Prog.	1999 Actual	2000 Prog.	2000 Est.	Prog. 2001	Proj. 2002
	(Annual percentage changes) 1/								
	I. Financial System 2/								
Net foreign assets	**7.0**	**-0.7**	**-2.5**	**-2.0**	**2.8**	**2.1**	**3.8**	**0.1**	**-0.1**
Net domestic assets	**24.8**	**22.9**	**12.7**	**14.6**	**5.8**	**16.1**	**-1.1**	**19.1**	**11.8**
Credit to public sector (net)	1.1	-0.3	7.3	8.2	3.7	4.6	1.0	9.3	-2.0
Quasi-fiscal deficit (surplus -)	0.0	0.2	-2.4	-1.2	-1.2	-1.7	-1.3	-1.8	-1.6
Credit to private sector	28.4	20.9	8.9	2.4	-5.3	13.6	-7.6	9.8	14.6
Other (net)	-4.6	2.1	-1.1	5.2	8.6	-0.4	6.7	1.9	0.7
Liabilities to private sector	**31.8**	**22.2**	**10.2**	**12.6**	**8.6**	**18.2**	**2.7**	**19.2**	**11.7**
	II. Banco de la Republica (BR) 3/								
Net international reserves	**51.4**	**0.1**	**-33.2**	**-21.5**	**-13.1**	**18.1**	**14.9**	**6.2**	**6.0**
Net domestic assets	**-45.7**	**24.9**	**16.6**	**43.2**	**54.1**	**-3.8**	**-4.9**	**-2.0**	**5.7**
Credit to public sector (net)	0.7	-3.2	6.3	15.2	20.6	0.4	-3.3	-6.9	-8.0
Credit to financial system	-14.1	10.4	6.7	13.0	24.3	-0.7	-4.8	3.9	13.6
Credit to private sector (net)	-7.1	14.4	7.2	2.7	2.5	-0.3	0.3	0.0	0.0
Other (net)	-25.3	3.3	-3.6	12.4	6.7	-3.3	2.9	1.0	0.0
Monetary base	**5.7**	**25.0**	**-16.6**	**21.7**	**41.0**	**14.3**	**10.0**	**4.3**	**11.6**
Memorandum items:									
	(Flows in millions of U.S. dollars)								
Net official international reserves 4/	1,572	4	-1,341	-725	-443	744	706	326	324
	(Annual percentage change)								
Broad money 5/	30.0	24.5	10.3	12.8	8.7	18.2	2.7	19.2	11.8
Money (M1)	15.8	20.6	1.8	1.3	27.8	16.3	13.4	12.0	11.7
Quasi-money and other	34.1	25.4	12.3	15.4	4.6	18.6	-0.2	21.4	11.8
Private sector credit 6/	25.7	25.6	11.9	5.9	3.5	16.7	0.1	10.8	15.3
	(Annual percentage changes in real terms)								
Broad money 5/	6.9	5.7	-5.5	1.7	-0.5	7.5	-5.6	10.4	5.4
Money (M1)	-4.7	2.5	-12.8	-8.7	17.0	5.7	4.2	3.7	5.4
Quasi-money and other	10.3	6.6	-3.7	3.9	-4.3	7.8	-8.2	12.4	5.4
Private sector credit 6/	3.4	6.7	-4.1	-4.6	-5.3	3.7	-7.9	2.6	8.7
Base money	-13.0	6.2	-28.5	9.7	29.0	3.9	1.1	-3.5	5.3
	(Nominal GDP/broad money)								
Velocity of broad money	2.8	2.7	2.8	2.7	2.8	2.6	3.1	2.9	2.9
	(Annual percentage changes)								
Private sector portfolio	...	...	...	...	14.4	16.7	10.0	13.1	11.7
In financial sector	...	...	...	...	8.6	18.2	2.7	19.2	11.8
In government bonds	...	...	...	...	68.0	-23.0	42.9	-18.2	4.1

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

1/ All annual changes in foreign currency stocks valued at a constant exchange rate.

2/ Changes in relation to private sector liabilities at the beginning of the period.

3/ Changes in relation to monetary base at the beginning of period.

4/ The NIR are equal to the BOP concept of NIR excluding accrued, but unpaid, interest on assets *(causaciones)*.

5/ M3 plus bonds issued by financial institutions.

6/ The figures for 1999-2002 have been adjusted for loan write-offs resulting from the mortgage debt reduction and bank restructuring programs.

Table 7. Colombia: Summary Balance of Payments, 1996-2002

	1996	1997	1998	1999	2000 Prog.	2000 Est.	Proj. 2001	Proj. 2002
	(In millions of U.S. dollars)							
Current account balance	**-4,752**	**-5,867**	**-5,205**	**-61**	**-948**	**178**	**-1,604**	**-2,525**
Trade balance	-2,092	-2,638	-2,450	1,775	2,761	2,606	1,463	473
Exports, f.o.b.	10,966	12,065	11,480	12,030	14,002	13,786	13,507	13,761
Coffee	1,577	2,259	1,893	1,324	1,240	1,029	1,119	1,197
Petroleum products	2,895	2,707	2,329	3,757	5,128	4,916	3,797	3,257
Non-traditional	4,671	5,197	5,420	5,279	5,881	6,071	6,796	7,456
Other	1,824	1,901	1,838	1,670	1,753	1,771	1,795	1,852
Imports, f.o.b.	13,058	14,703	13,930	10,255	11,241	11,180	12,043	13,288
Services (net)	-1,192	-1,518	-1,464	-1,261	1,499	-1,194	-1,149	-1,129
Income (net)	-2,066	-2,325	-1,717	-1,422	-2,769	-2,073	-2,779	-2,747
Interest (net)	-1,408	-1,728	-1,720	-1,842	-2,055	-2,026	-2,127	-2,078
Of which: public sector	-582	-597	-604	-803	-1,001	-965	-1,204	-1,261
Other Income (net)	-657	-597	3	421	-715	-47	-652	-668
Current transfers (net)	597	614	426	846	559	839	861	878
Capital and financial account balance	**6,372**	**7,017**	**4,259**	**-93**	**897**	**-148**	**1,929**	**2,849**
Financial account balance	6,372	7,017	4,259	-93	897	-148	1,929	2,849
Public sector (net)	810	500	1,493	939	901	897	1,963	1,996
Nonfinancial public sector	886	808	1,827	2,368	1,199	1,612	2,056	2,022
Medium- and long-term (net)	1,330	1,268	1,989	2,071	2,078	2,052	1,640	1,726
Disbursements	2,742	2,955	3,589	3,817	3,700	3,652	4,017	4,442
Amortization	1,412	1,687	1,601	1,746	1,622	1,600	2,377	2,716
Other long-term flows	0	-23	-15	0	0	0	0	0
Short term 1/	-444	-436	-147	296	-879	-440	416	296
Financial public sector	-76	-308	-334	-1,429	-298	-715	-93	-26
Private sector (net)	5,562	6,517	2,766	-1,032	-4	-1,045	-33	853
Nonfinancial private sector (net)	5,347	5,843	3,475	75	-34	-870	-127	629
Direct investment	2,784	4,830	2,432	1,115	1,453	1,181	1,002	1,277
Of which: privatization	584	2,989	511	0	1,443	342	80	0
Leasing finance	86	257	266	77	124	-174	-27	104
Long-term loans	2,767	1,524	285	-270	-277	-788	-1,051	-744
Short term 2/	-290	-768	491	-846	-1,334	-1,089	-51	-8
Financial private sector (net)	215	673	-709	-1,107	30	-175	94	224
Net errors and omissions	**107**	**-873**	**-443**	**-164**	**529**	**676**	**0**	**0**
Changes in NIR	**1,727**	**277**	**-1,390**	**-319**	**478**	**706**	**326**	**324**
	(In percent of GDP)							
Current account balance	-4.9	-5.5	-5.3	-0.1	-1.1	0.2	-1.8	-2.7
	(In months of imports of goods and services)							
Gross international reserves 3/	6.5	6.9	7.9	6.8	5.9	7.1	6.8	6.6

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

1/ Includes movements of short-term assets owned by the public sector abroad.
2/ Includes net portfolio investment.
3/ Not including Fund purchases under the current EFF arrangement.

Table 8. Colombia: External Debt and Debt-Service Projections

	1996	1997	1998	1999	Est. 2000	Proj. 2001	Proj. 2002
	(In millions of U.S. dollars)						
Total debt outstanding	30,275	33,700	35,861	36,137	35,968	36,409	37,615
Medium- and long-term 1/	26,267	29,586	32,164	33,150	33,145	33,404	34,348
Short term	4,008	4,114	3,697	2,987	2,824	3,005	3,267
Public sector debt outstanding	16,505	17,143	19,198	20,586	21,438	22,985	24,685
Medium- and long-term 1/	15,336	16,207	18,222	19,916	21,253	22,800	24,500
Short term	1,169	936	976	670	185	185	185
Private sector debt outstanding	13,770	16,556	16,663	15,550	14,530	13,424	12,930
Medium- and long-term 1/	10,931	13,379	13,942	13,233	11,891	10,604	9,848
Short term	2,840	3,177	2,721	2,317	2,638	2,820	3,082
Leasing	1,327	1,727	2,075	2,160	2,040	2,015	2,216
Public sector	254	398	479	483	537	539	636
Private sector	1,073	1,329	1,595	1,677	1,503	1,476	1,580
Total debt service	5,430	7,101	6,985	7,494	7,888	8,776	8,358
Public sector	3,012	3,620	3,323	3,418	3,624	4,646	4,774
Amortization	1,910	2,359	2,098	2,114	2,081	2,822	2,899
Interest	1,103	1,261	1,225	1,304	1,543	1,824	1,875
Private sector	2,418	3,482	3,663	4,076	4,263	4,130	3,584
Amortization	1,450	2,188	2,331	2,827	2,940	2,788	2,360
Interest	968	1,293	1,332	1,249	1,323	1,342	1,224
	(In percent of GDP)						
Total debt 2/	31.2	31.6	36.2	41.8	43.5	41.6	39.6
Public sector	17.0	16.1	19.4	23.8	25.9	26.2	26.0
Private sector	14.2	15.5	16.8	18.0	17.6	15.3	13.6
	(In percent of exports of goods, services, and income)						
Total debt stock	218.4	223.3	250.5	246.5	216.2	219.1	222.1
Total debt service	39.2	47.1	48.8	51.1	47.4	52.8	49.4
Public sector	21.7	24.0	23.2	23.3	21.8	28.0	28.2
Private sector	17.4	23.1	25.6	27.8	25.6	24.9	21.2
Interest	14.9	16.9	17.9	17.4	17.2	19.1	18.3
Public sector	8.0	8.4	8.6	8.9	9.3	11.0	11.1
Private sector	7.0	8.6	9.3	8.5	8.0	8.1	7.2
Amortization	24.2	30.1	30.9	33.7	30.2	33.8	31.0
Reserves to short-term external debt 3/	1.3	1.1	1.1	1.0	1.1	1.1	1.1

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

1/ Includes leasing.
2/ Calculated at the annual average exchange rate.
3/ Short-term debt by remaining maturity.

Table 9. Colombia: Indicators of External Vulnerability

(In percent of GDP, unless otherwise indicated)

	1996	1997	1998	1999	2000 Prog.	2000 Est.	Latest Obs.	Date of Obs.	Proj. 2001	Proj. 2002
Financial indicators										
Public sector debt (domestic and external)	24.5	26.7	29.9	38.2	34.4	42.4	...	...	41.7	42.0
Broad money (percent change, 12-month basis)	29.9	24.5	10.3	8.7	18.2	2.7	2.6	Q3/00	19.2	11.8
Private sector credit (percent change, 12-month basis)	24.9	25.6	11.9	6.1	16.7	-7.5	-7.4	Q3/00	11.7	18.7
90-day time deposit rate	27.9	24.3	34.1	15.4	...	...	13.3	Q4/00	...	...
90-day time deposit rate (real)	5.2	5.6	14.9	5.7	...	...	4.5	Q4/00	...	...
External indicators										
Exports (percent change, 12-month basis in U.S. dollars)	3.5	10.0	-4.8	4.8	9.2	12.7	12.7	Q4/00	-2.0	1.9
Imports (percent change, 12-month basis in U.S. dollars)	-0.6	12.6	-5.3	-26.4	20.2	8.8	8.8	Q4/00	7.7	10.3
Terms of trade (percent change, 12-month basis)	6.1	10.7	-6.2	3.4	1.5	17.1	15.2	Q3/00	-6.7	-3.2
Non-Oil terms of trade (percent change, 12-month basis)	0.8	16.2	1.6	-8.0	...	0.4	0.4	Q4/00	-2.5	0.1
Current account balance	-4.9	-5.5	-5.3	-0.1	-2.4	0.2	0.2	Q3/00	-1.8	-2.7
Capital and financial account balance	6.4	6.6	4.3	-0.1	3.3	-0.2	0.0	Q3/00	2.2	3.0
Of which										
Inward short-term portfolio investment (debt securities, etc.)	-0.3	-0.2	0.5	-1.7	-1.9	-1.4	-0.3	Q3/00	0.8	0.6
Other investment (loans, trade credits, etc.)	-0.6	-0.6	-0.4	-0.9	0.1	-0.6	-0.6	Q3/00	0.0	0.3
Inward foreign direct investment and long-term flows	7.3	7.3	4.2	2.4	5.1	2.0	0.6	Q3/00	1.5	2.1
Gross official reserves (in billions of U.S. dollars) 1/	9.9	9.9	8.7	8.1	9.5	9.0	9.0	Q4/00	10.1	10.6
Central bank short-term foreign liabilities (in millions of U.S. dollars)	5.8	-2.4	0.7	0.2	8.3	8.7	.	Q4/00	8.7	8.7
Short-term net foreign assets of the financial sector (in billions of U.S. dollars)	6.2	6.1	5.5	6.2	5.6	7.2	7.1	Q3/00	7.2	7.2
Official reserves in months of imports of goods and services 1/6/	6.5	6.9	7.9	6.8	5.9	7.1	7.0	Q3/00	6.8	6.6
Broad money to reserves 1/	3.4	3.6	3.8	3.5	3.3	2.7	2.5	Q3/00	3.1	3.2
Total short-term external debt to reserves 1/2/	40.4	41.5	42.3	97.8	...	88.9	...	Q3/00	96.2	84.3
Total external debt	31.2	31.6	36.2	41.8	43.1	43.5	43.3	Q3/00	41.6	39.6
Of which										
Public sector debt	17.0	16.1	19.4	23.8	24.8	25.9	25.9	Q3/00	26.2	26.0
Total external debt to exports of goods, services, and income	218.4	223.3	250.5	246.5	223.0	216.2	245.2	Q3/00	219.1	222.1
External interest payments to exports of goods, services, and income	17.4	16.9	17.9	17.4	16.4	17.2	17.2	Q3/00	19.1	18.3
External amortization payments to exports of goods, services, and income	14.9	30.1	30.9	33.7	29.7	30.2	30.2	Q3/00	33.8	31.0
Exchange rate (per U.S. dollar, period average)	1,037	1,141	1,426	1,756	...	2,088	2,229	12/28/00	...	...
Real effective exchange rate appreciation (+) (end of period) 3/	19.9	-5.1	-4.5	-9.4	...	...	-11.5	12/28/00	...	...
Financial market indicators										
Stock market index	847	1,417	1,086	998	...	713	827	2/22/01	...	...
Foreign currency debt rating 4/	...	BBB-	BBB-	BB+	...	BB	BB	5/23/00	...	...
Spread of benchmark bonds (basis points, end of period) 5/	...	...	728	445	...	728	607	3/01/01	...	...

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

1/ Not including purchases under the current EFF arrangement.

2/ Short-term debt is defined by its remaining maturity from 1999 onward.

3/ Source: INS.

4/ Standard & Poors.

5/ Consists of the spread on a US$750 million global ten-year note issued in 1997.

Table 10. Colombia: Medium-Term Outlook 1/

	2002	2004	2006	2008	2010
I. Output and Prices					
(Annual percentage changes)					
Real GDP	4.5	4.5	4.5	4.5	4.5
Consumer prices, end of period	6.0	4.0	4.0	4.0	4.0
(In percent of GDP, unless indicated otherwise)					
II. Saving and Investment					
Gross national saving	15.3	16.1	17.0	17.9	18.3
Private sector	10.5	10.8	11.4	12.1	12.2
Nonfinancial public sector	4.8	5.3	5.7	5.8	6.1
Gross domestic investment	18.0	18.9	20.0	20.7	21.0
Private sector	11.4	12.1	12.7	13.3	13.5
Public sector capital expenditure	6.6	6.8	7.3	7.4	7.5
External current account balance	-2.7	-2.8	-3.0	-2.8	-2.7
Private sector 2/	-0.9	-1.3	-1.3	-1.2	-1.3
Nonfinancial public sector 2/	-1.8	-1.5	-1.6	-1.6	-1.4
III. Nonfinancial and Combined Public Sector					
Nonfinancial public sector					
Revenue	28.1	27.7	27.7	27.8	27.9
Expenditure	29.9	29.3	29.4	29.4	29.4
Current expenditure	23.4	22.5	22.1	22.0	21.9
Capital expenditure	6.6	6.8	7.3	7.4	7.5
Primary balance	2.7	1.8	1.3	1.3	1.4
Overall balance	-1.8	-1.5	-1.6	-1.6	-1.4
Combined public sector balance	-1.8	-1.5	-1.5	-1.4	-1.2
IV. Financial System					
Velocity (GDP / broad money)	2.9	2.9	2.9	2.8	2.7
Real growth in private sector credit	11.0	5.6	7.2	5.9	6.3
V. Balance of Payments 3/					
External current account	-2.7	-2.8	-3.0	-2.8	-2.7
Of which: Trade balance	0.5	1.0	1.7	2.0	2.2
Exports	14.9	15.5	16.1	16.9	17.0
Imports	14.4	14.5	14.4	14.8	14.8
Capital and financial account balance	3.1	3.4	3.5	3.7	3.5
Public sector	2.2	1.6	1.4	1.3	1.0
Private sector	0.9	1.8	2.1	2.4	2.5
Overall balance	0.4	0.6	0.6	0.9	0.8
VI. Debt					
Total external debt 3/	41.8	40.8	40.3	40.1	39.9
Public debt	28.4	28.3	27.7	27.0	25.9
Private debt	13.3	12.5	12.6	13.1	14.0
Total public debt	42.0	39.9	38.2	36.3	34.3
Domestic debt 4/	13.5	11.6	10.5	9.4	8.3
External debt 3/	28.4	28.3	27.7	27.0	25.9

Sources: Colombian authorities; and Fund staff estimates.

1/ Prepared by Fund staff.
2/ Savings-investment gaps.
3/ Calculated at the end-of-period exchange rate.
4/ Includes bonds issued to recapitalize financial institutions.

COLOMBIA: FUND RELATIONS
(As of January 31, 2001)

I. Membership Status:
Joined: 12/27/45
Status: Article XIV

II	General Resources Account	SDR Million	Percent of Quota
	Quota	774.00	100.0
	Fund holdings of currency	488.20	63.1
	Reserve position in Fund	285.80	36.9

III.	SDR Department:	SDR Million	Percent Allocation
	Net cumulative allocation	114.27	100.0
	Holdings	103.32	90.4

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	12/20/1999	12/19/2002	1,957.00	0.00

VI. Projected Obligations to Fund: None

VII. Exchange Rate Arrangement:

In January 1994, the Banco de la Republica (BR) adopted a managed float of the exchange rate vis-à-vis the U.S. dollar within a 14 percentage point band. The midpoint of the band was devalued by 9 percent in September 1998. In June 1999, the midpoint of band was again devalued by 9 percent, the width increased to 20 percent points, and the slope reduced from 13 percent to 10 percent. Finally, in September 1999 the BR eliminated the band, floating the peso. Multiple currency practices that result from taxes on profit remittances from direct investment in Colombia and on foreign exchange earnings from personal services and transfers, and export tax credit certificates (CERTs) have not been approved under Article VIII. In April 2000, the BR reduced to zero the deposit requirement on external loans. At end-January 2001, the exchange rate was Col$2,240.8 per U.S. dollar.

VIII. Last Article IV consultation and recent contacts:

The 1999 Article IV consultation was concluded by the Executive Board on December 20, 1999. At that time, Directors also approved Colombia's request for an extended arrangement. The first review under the Extended Arrangement was completed by the Executive Board on September 7, 2000.

IX. Recent Technical Assistance:

Dept.	Purpose	Time of Delivery
FAD	Advise on tax administration	February 1998
STA	Advise on national accounts statistics	March 1998
STA	Advise on government finance statistics	May 1998
FAD	Follow-up on customs administration	June 1998
STA	Follow-up on national accounts statistics	June 1998
MAE	Financial sector stability assessment (FSSA)	May 1999
STA	Advice on government finance statistics	August 1999
STA	Advise on banking statistics	October 1999
FAD	Advise on tax policy	November 1999
FAD	Advise on tax administration	December 1999
MAE	Advise on the deposit insurance system	March 2000
STA	Advise on national accounts statistics	March 2000
FAD	Follow-up on customs administration	February 2000
FAD	Advise on the measurement of the deficit of the nonfinancial public sector	May 2000
FAD	Follow up on customs administration	June 2000
STA	Advise on money and banking statistics	September 2000
MAE	Advise on banking restructuring issues	September 2000
MAE	Advise on banking supervision and regulation	December 2000

X. Resident Representative: None.

XI. Colombia has not yet accepted the Fourth Amendment to the Articles of Agreement.

Colombia: Schedule of Purchases Under the Extended Fund Facility 1999-2002

Date	Amount (In millions of SDRs)	Conditions
December 15, 1999	150.5	Board approval.
February 15, 2000	150.5	Observance of end-December 1999 performance criteria.
May 15, 2000	150.5	Observance of end-March 2000 performance criteria.
August 15, 2000	150.5	Observance of end-June 2000 performance criteria and completion of first review.
November 15, 2000	150.5	Observance of end-September 2000 performance criteria.
February 15, 2001	150.5	Observance of end-December 2000 performance criteria and completion of second review.
May 15, 2001	150.5	Observance of end-March 2001 performance criteria.
August 15, 2001	150.5	Observance of end-June 2001 performance criteria and completion of third review.
November 15, 2001	150.5	Observance of end-September 2001 performance criteria.
February 15, 2002	150.5	Observance of end-December 2001 performance criteria and completion of fourth review.
May 15, 2002	150.5	Observance of end-March 2002 performance criteria.
August 15, 2002	150.5	Observance of end-June 2002 performance criteria and completion of fifth review.
November 15, 2002	150.5	Observance of end-September 2002 performance criteria.

Colombia: Projected Payments to the Fund as at February 28, 2001
(Purchases under Obligation Scheduled)

(In millions of SDRs)

	Overdue	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Beyond	Total
Obligations from existing drawings													
1. Principal													
a. Repurchases	0	0	0	0	0	0	0	0	0	0	0	0	0
b. PRGF/SAF repayments	0	0	0	0	0	0	0	0	0	0	0	0	0
2. Charges and interest 1/													
a. on Fund credit	0	0	0	0	0	0	0	0	0	0	0	0	0
b. on use of SDRs	0	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	4
Total obligations 2/	0	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	4
(percent of quota)	0	0	0	0	0	0	0	0	0	0	0	0	0.5
Obligations from prospective drawings													
1. Principal													
a. Repurchases	0	0	0	0	0	87.8	250.8	326.1	326.1	326.1	326.1	313.5	1956.5
b. PRGF/SAF repayments	0	0	0	0	0	0	0	0	0	0	0	0	0
2. Charges and interest 1/													
a. on Fund credit	0	39.9	83.9	104.3	104.7	104.1	94.4	77.8	60.8	44	27.3	13.2	754.3
b. on use of SDRs	0	0	0	0	0	0	0	0	0	0	0	0	0
Total obligations 2/	0	39.9	83.9	104.3	104.7	191.9	345.3	403.8	386.9	370.1	353.3	326.7	2710.8
(percent of quota)	0	5.2	10.8	13.5	13.5	24.8	44.6	52.2	50	47.8	45.7	42.2	350.2
Cumulative (existing and prospective)													
1. Principal													
a. Repurchases	0	0	0	0	0	87.8	250.8	326.1	326.1	326.1	326.1	313.5	1956.5
b. PRGF/SAF repayments	0	0	0	0	0	0	0	0	0	0	0	0	0
2. Charges and interest 1/													
a. on Fund credit	0	39.9	83.9	104.3	104.7	104.1	94.4	77.8	60.8	44.0	27.3	13.2	754.3
b. on use of SDRs	0	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	4
Total obligations 2/	0	40.1	84.3	104.7	105.1	192.3	345.6	404.2	387.3	370.4	353.7	327.1	2714.8
(percent of quota)	0	5.2	10.9	13.5	13.6	24.8	44.7	52.2	50	47.9	45.7	42.3	350.8

1/ Projections are based on current rates of charge, including burden-sharing charges where applicable, for purchases in the GRA, and on current interest rates for SAF, PRGF, and Trust Fund. The current SDR interest rate is assumed for net use of SDRs.

2/ Overdue obligations (if applicable) will be settled in full at close of business March 01, 2001.

COLOMBIA: RELATIONS WITH THE WORLD BANK GROUP

I. BACKGROUND

1. Since 1995 Colombia has made average net repayments to the World Bank of US$104 million a year. The range of programs has encompassed various sectors: agriculture, health, education, transportation, water supply and sewerage, public sector management, finance and urban development. The World Bank continues to support programs in these sectors.

II. OBJECTIVES

2. The overriding objective of the World Bank's assistance program for Colombia continues to be the support of the government's efforts in pursuing poverty reduction, social development, and sustainable growth. These objectives are to be achieved by interventions in six strategic areas: (i) peace and development; (ii) rural development; (iii) human capital; (iv) public sector responsiveness and efficiency; (v) infrastructure services; and, (vi) sustainable development.

III. LENDING

3. The Colombia Country Assistance Strategy (CAS) progress report that was considered by the Bank's Executive Board on November 18, 1999, proposes a "high case" lending program of an average of US$433 million for fiscal years 1998–2001. Lending in FY 2000 amounted to US$941 million, including the Cartagena Water and Sewerage (US$85 million), Rural Education (US$20 million), Financial Sector Adjustment Loan (US$506 million), Earthquake Reconstruction (US$225 million), Sierra Nevada Sustainable Development (US$5 million), and the Community Works and Employment Generation (US$100 million) loan. The latter loan, together with the Human Capital Protection loan (US$150 million) currently under preparation for FY 2001, supports the strengthening and expansion of the social safety net in Colombia. A fiscal structural adjustment loan, as well as a social sector adjustment loan are under preparation for FY 2002.

IV. NONLENDING SERVICES (NLS)

4. The Bank is now preparing, jointly with the government, AAAs (Analytical and Advisory Activities) on a number of topics to strengthen its policy dialogue and as the analytical underpinning of forthcoming operations. Also, the Bank is undertaking analytical work to assist the government in identifying the groups that are suffering the most from the economic recession, as well as those who are bearing the brunt of fiscal austerity measures.

Additional studies deal with regional trade integration, corruption, and emissions of greenhouse gases.

5. As part of the Bank's analytical work on peace and development, three studies were commissioned: (i) on the international experience of post conflict reconstruction that could be relevant to Colombia; (ii) on the various forms of violence and their impact on social capital; and (iii) on the structural determinants of conflict in Colombia.

V. WORLD BANK TECHNICAL ASSISTANCE (TA)

6. The World Bank is active in securing grants from various sources, including bilateral donors to support project preparation, economic and sector work, supervision and implementation issues.

VI. IFC

7. IFC investment in Colombia increased markedly in FY00 to US$85 million. IFC's strategy is to extend its assistance to the Colombian private sector with a continued focus on: (i) financial markets; (ii) infrastructure; and (iii) selective direct investments in manufacturing and services.

VII. MIGA

8. Colombia became a full member of MIGA on November 30, 1995. As of June 30, 2000, MIGA's gross exposure in Colombia amounts to US$105 million, for a total of four Contracts of Guarantee.

Colombia: Financial Relations with the World Bank Group

(In millions of U.S. dollars)

	Commitments (Net of Cancellations)	Disbursements	Undisbursed Amounts
I. IBRD operations (as of January 31, 2001)			
Current operations	**2014.0**	**1,154.0**	**860.0**
Agricultural and rural development	56.0	36.6	19.4
Public sector management	42.5	33.4	9.2
Education	162.2	101.8	60.4
Population, health, and nutrition	150.0	49.9	100.1
Transportation	202.1	97.9	104.2
Urban development	155.0	92.4	62.6
Water supply and sewerage	230.0	89.4	140.6
Natural resource management	28.6	23.6	5.0
Power	260.3	240.8	19.5
Financial sector	497.3	262.1	235.2
Multi-sector	230.0	126.1	103.9

II. IFC Operations (as of January 31, 2001)

	Loans	Equity (+Quasi)	Partici-pation	Total
Total commitments 1/	83.9	30.9	41.7	156.5
Total undisbursed	67.6	2.6	25.0	95.2

III. IBRD Loan Transactions (as of January 31, 2001)

	1995	1996	1997	1998	1999	2000
Disbursements	323.9	192.8	152.0	172.2	237.5	471.0
Repayments	536.9	344.5	379.8	394.3	238.8	278.1
Net disbursements	-212.3	-151.7	-227.8	-221.6	-1.4	192.8

Source: World Bank.

1/ After cancellations, terminations, exchange adjustments, repayments, writeoffs, and sales.

COLOMBIA: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

I. BACKGROUND AND OBJECTIVES

1. In August 1999, the IDB Board of Directors approved the bank's strategy for Colombia for the period 1999–2001. The Board established the following targets: (i) support the peace process by facilitating a national dialogue; (ii) help reduce poverty and inequality by increasing investment in human capital and easing access to basic social services and productive resources; (iii) deepen the decentralization process by strengthening the power of the civil society at local and regional levels; (iv) modernize the public sector by reforming public institutions and improving public finances; and (v) promote sustainable growth.

II. LENDING

2. As of January 31, 2001, the IDB is implementing 37 loans for an amount equivalent to US$2,730.25 million. These loans include projects to support the private sector, technical assistance, and investments projects in the agricultural sector, transportation, water supply and sewerage, management of natural resource, and development of human capital.

COLOMBIA: FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of January 31, 2001)

I. IDB OPERATIONS

(In millions of U.S. dollars)

Current operations	Commitments	Disbursed	Undisbursed
Agricultural and rural development	121.50	30.11	91.39
Public sector management	74.84	18.14	56.70
Education	1360.00	87.10	48.90
Population, health, and nutrition	78.00	59.10	18.90
Transportation	312.25	297.81	14.44
Urban development	60.00	10.49	49.51
Water supply and sewerage	162.15	48.92	113.23
Natural resource management	76.00	45.73	30.27
Power	688.00	467.56	220.44
Financial sector	300.00	153.00	147.00
Multi-sector	721.50	288.92	432.58
Total	**2,730.25**	**1,506.88**	**1,223.37**

II. IDB LOAN TRANSACTIONS

	1996	1997	1998	1999	2000	2001
Gross disbursements	262.7	271.6	412.9	952.4	241.2	380.0
Amortization	458.6	575.0	366.9	441.8	447.7	465.7
Net disbursements	**-195.9**	**-303.4**	**46.0**	**510.6**	**-206.5**	**-85.7**

COLOMBIA: STATISTICAL ISSUES

1. The data provided by the authorities to the Fund are generally adequate for surveillance; recent coordination among compiling agencies have served to reduce or eliminate significant gaps in some source data that compromised the usefulness of the public finance data. Colombia has subscribed to and is in observance of the Special Data Dissemination Standard (SDDS), and its metadata are posted on the Fund's Dissemination Standards Bulletin Board (DSBB).

Real sector

2. The National Department of Statistics (DANE) is responsible for the compilation of the national accounts, though the Banco de la Republica (BR) compiles the financial accounts for this system of macroeconomic data. In 1999, the DANE revised the national accounts data by introducing a new 1994 benchmark and base year (the previous base year was 1970); improved the trade data by incorporating transactions in the free trade zones; and included part of the illegal activities in the national accounts. The March 2000 technical assistance mission in national accounts assisted the authorities in improving the new estimates of national accounts and provided recommendations for the backward extrapolation of the series to 1990 as well as for the improvement of estimates at constant prices. A follow up mission in February 2001 is assessing the process of compiling supply and use tables in the current period.

Government finance statistics

3. In an effort to reconcile above-the-line data on revenue and expenditure with financing data, and as a by-product of this process produce more complete, reliable, and timely data on the financing of the nonfinancial sector, the government has prepared a new and more comprehensive methodology to monitor and report public finance data. It is expected that the new methodology will become the standard basis for the ongoing monitoring of fiscal developments under the Fund-supported program.

4. Additional improvements are needed to:

- develop timely and reliable data on local government finances, (revenue and expenditure), reconciling data compiled by the budget office with the national accounting office fiscal data reports; and

- improve monitoring of floating debts by gradually extending the coverage from the central government to include main public enterprises.

Financial sector statistics

5. An October 2000 money and banking mission carried out the following tasks: (i) conducted a thorough review of the procedures for collecting, compiling, and disseminating Colombia's monetary statistics, with particular attention to the subsector of

other depository corporations; (ii) compiled a revised set of analytical accounts for these corporations and redesigned the compilation system for internal use and for reporting these data to the Fund's Statistics and Western Hemisphere Departments; and (iii) assessed the degree of implementation of the recommendations made over the past three years, the reasons for which some fundamental changes were not fully executed, and agreed with the authorities on a consolidated action plan to fix some problems. Special emphasis was placed on issues that were affecting the quality of the data; in particular, promote inter-agency cooperation, implement procedures for ensuring consistency of the data, and define revision policies.

Balance of payments and external debt

6. Since late 1994, the BR has been developing quarterly balance of payments data and, more recently, it adopted BPM5 as recommended by the 1997 STA mission. The new balance of payment statistics extended the coverage of the trade account by including transactions in the free trade zones, improved the current surveys, particularly of the service sector, to enhance coverage and consistency in the methodology; and improved the capital account data based on actual disbursement rather than registers. However, several issues still remain:

- the process of data compilation should be improved by enhancing coordination between the BR and DANE; and
- external debt data should be improved by obtaining monthly figures on public sector short-term external debt, and by refining the calculation of interest payments for the private sector debt.

Colombia: Core Statistical Indicators
as of January 31, 2001

	Exchange Rates	International Reserves	Reserve/ Base Money	Central Bank Balance Sheet	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Government Balance 1/	GDP GNP	External Debt
Date of latest observation	1/31/01	1/31/01	1/31/01	11/30/00	9/30/00	12/00	Dec. 2000	Nov. 2000	2000 Q3	Sep. 2000	2000 Q2	2000 Q3
Date received	1/31/01	1/29/01	1/31/01	1/20/01	1/20/01	1/16/01	1/16/01	Jan. 2001	Dec. 2000	Nov. 2000	Dec. 2000	Dec. 2000
Frequency of data	Daily	Daily	Daily	Monthly	Weekly	Daily	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Quarterly
Frequency of reporting	Monthly	Weekly	Weekly	Monthly	Monthly	Monthly	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Quarterly
Source of data 2/	BR	BR	BR	BR	BR	BR	BR	BR/DANE	BR	CONFIS	DANE/DNP	BR
Mode of reporting	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	Fax/E-mail	E-mail
Confidentiality	No	No	No	No	No	No	No	No	No	No	No	No
Frequency of Publication	Daily	Daily	Daily	Monthly	Weekly	Daily	Monthly	Monthly	Quarterly	--	Quarterly	Quarterly

1/ Central administration.
2/ BR = Banco de la Republica; DANE = National Department of Statistics; DNP = National Department of Planning; CONFIS = Consejo Superior de Politica Fiscal.

INTERNATIONAL MONETARY FUND

COLOMBIA

Staff Report for the 2001 Article IV Consultation and Second Review Under the Extended Arrangement

Supplementary Information

Prepared by the Western Hemisphere Department
(In consultation with the Policy Development and Review Department)

Approved by Claudio M. Loser and Liam Ebrill

March 26, 2001

1. Since the distribution of the staff report (EBS/01/34) final data have become available for the fiscal deficit in 2000 and the external public debt at the end of last year. The combined public sector deficit was 3.4 percent of GDP, compared with the estimate of 3.6 percent of GDP that was presented in the staff report. The performance criteria for end-December 2000 on the external debt and the combined public sector deficit were observed, as shown in the attached update of staff report Table 1.

2. The combined public sector deficit was lower than the earlier estimate due to lower current expenditures (by 0.5 percent of GDP), while investment spending was somewhat higher. (See the attached update of staff report Table 4).

3. On March 16 Colombia re-opened its 2008 Euro-denominated bond issue for € 200 million, bringing the total secured financing from bonds for 2001 to € 1.2 billion (about US$1.1 billion). On March 8 the World Bank approved a guarantee operation under which the equivalent of € 240 million will be used to provide a partial guarantee for a bond issue by the Republic of Colombia of between US$1.0 and US$1.3 billion dollars, as referred to in paragraph 19 of the staff report. The guaranteed bond issue is expected to take place in April. The Euro-denominated bond issue and the World Bank guaranteed bonds make up two-thirds of the projected disbursements of public external debt in 2001 (totaling 4 percent of GDP); the remaining amount would come from multilateral institutions, mainly in the form of policy-based loans in support of Colombia's structural reform program.

Table 1. Colombia: Performance Criteria 1/

	2000			
	Mar. 31	Jun. 30	Sep. 31	Dec. 31
Cumulative flows from January 1, 1999 (In billions of Colombian pesos)				
Overall balance of the combined public sector				
Floor	-11,550	-13,300	-13,700	-14,500
Outcome	-5,903	-7,570	-9,400	-12,733
Margin or deviation (-)	5,647	5,730	4,300	1,767
Outstanding stock (In billions of Colombian pesos)				
Net domestic assets of the Banco de la Republica				
Ceiling	-8,950	-9,050	-8,500	-7,100
Adjusted ceiling	-8,655	-7,205	-6,655	-5,255
Outcome	-9,789	-8,718	-9,543	-7,374
Margin or deviation (-) 2/	1,135	1,513	2,888	2,119
(In millions of U.S. dollars)				
Net international reserves of the Banco de la Republica				
Target	8,150	8,350	8,250	8,570
Adjusted target	8,006	7,450	7,350	7,670
Outcome	8,254	8,335	8,496	8,822
Margin or deviation (-)	248	885	1,146	1,152
Cumulative net disbursement from January 1, 1999 (In millions of U.S. dollars)				
Net disbursement of medium- and long-term external debt by the public sector				
Ceiling	2,600	2,750	3,200	3,500
Adjusted ceiling	2,793	3,383	4,318	4,722
Outcome	2,291	2,248	2,592	2,958
Margin or deviation (-)	502	1,135	1,726	1,764
Change in the outstanding stock of short-term external debt of the public sector				
Ceiling	70	70	70	70
Outcome	56	56	2	0
Margin or deviation (-)	14	14	68	70

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

1/ Definitions of concepts and adjustments to the performance criteria are explained in the Technical Memorandum of Understanding attached to the Letter of Intent.

2/ The end-1999 deviation (excess) in net domestic assets reflected excess liquidity demand at the end of the year related to the Y2K problem.

Table 4. Colombia: Operations of the Combined Public Sector

(In percent of GDP)

	1996	1997	1998	1999		2000		2001		2002	
				Prog.	Actual	Prog.	Est.	Prog.	Proj.	Prog.	Proj.
Total revenue	**27.0**	**27.4**	**26.7**	**27.3**	**27.3**	**29.0**	**28.8**	**28.1**	**28.7**	**27.4**	**28.1**
Current revenue	**27.0**	**27.4**	**26.7**	**27.3**	**27.3**	**29.0**	**28.8**	**28.1**	**28.7**	**27.4**	**28.1**
Tax revenue 1/	16.8	17.7	17.5	16.5	16.8	17.9	17.5	18.7	19.5	19.3	19.5
Nontax revenue	10.2	9.7	9.2	10.8	10.4	11.2	11.3	9.5	9.2	8.1	8.6
Property income	0.8	0.9	0.9	0.9	1.0	1.0	1.2	1.0	1.0	1.0	1.0
Operating surplus of public enterprises	4.7	3.5	3.3	4.0	4.0	4.9	4.5	4.1	4.0	3.4	3.8
Of which : Ecopetrol	2.0	1.5	1.6	2.3	2.4	3.5	3.2	3.0	2.7	2.2	2.5
Other 2/	4.7	5.4	5.1	5.9	5.4	5.4	5.7	4.4	4.3	3.7	3.9
Of which: oil stabilization fund	0.1	0.1	0.1	0.5	0.8	0.5	0.8	0.1	0.3	0.0	-0.1
Total expenditure and net lending 1/	**29.8**	**31.4**	**30.7**	**33.6**	**33.2**	**32.4**	**32.3**	**30.7**	**31.3**	**28.9**	**29.9**
Current expenditure	**20.6**	**21.8**	**22.7**	**24.7**	**24.4**	**24.4**	**24.8**	**23.2**	**23.9**	**22.9**	**23.3**
Wages and salaries	6.6	6.7	7.0	7.5	7.7	7.2	7.6	6.7	7.3	6.5	7.0
Goods and services 3/	3.5	3.7	3.5	3.4	3.6	3.3	3.5	3.0	3.2	2.9	3.0
Interest	2.7	2.6	3.3	4.0	3.8	4.2	4.4	4.2	4.6	4.1	4.5
External	1.0	1.0	1.1	1.5	1.4	1.6	1.7	1.7	2.0	1.6	1.8
Domestic	1.7	1.6	2.2	2.5	2.3	2.6	2.7	2.5	2.6	2.5	2.8
Transfers to private sector	7.7	7.9	8.5	9.6	9.1	9.6	9.3	9.3	9.3	9.3	9.3
Of which: from social security	4.2	4.6	5.0	5.8	5.5	5.8	5.8	5.9	6.0	6.0	6.1
Other 4/	0.2	1.0	0.4	0.1	0.2	0.0	0.1	0.0	-0.4	0.0	-0.5
NFPS saving	*6.3*	*5.6*	*4.0*	*2.6*	*2.9*	*4.7*	*4.0*	*4.9*	*4.9*	*4.5*	*4.8*
Capital expenditure 4/	**9.1**	**9.6**	**7.9**	**8.6**	**8.7**	**8.1**	**7.5**	**7.5**	**7.5**	**6.0**	**6.6**
Fixed capital formation	8.9	9.1	7.8	8.4	8.6	8.0	7.4	7.4	7.4	5.9	6.5
Transfers	0.2	0.4	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.0
Net lending	0.0	0.0	0.0	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy 5/	-0.2	0.1	-0.6	0.0	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector balance	**-3.0**	**-3.9**	**-4.6**	**-6.3**	**-6.4**	**-3.5**	**-3.5**	**-2.5**	**-2.6**	**-1.5**	**-1.8**
Quasi-fiscal balance (BR cash profits)	0.0	-0.1	0.8	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5
Fogafin balance	...	...	...	0.3	0.5	-0.1	0.0	0.2	0.1	0.2	0.1
Net cost of financial restructuring 6/	...	...	...	-0.2	0.0	-0.6	-0.4	-0.7	-0.9	-0.6	-0.6
Overall balance	**-3.1**	**-3.9**	**-3.8**	**-5.9**	**-5.5**	**-3.7**	**-3.4**	**-2.6**	**-2.8**	**-1.5**	**-1.7**
Overall financing	**3.1**	**3.9**	**3.8**	**5.9**	**5.5**	**3.7**	**3.4**	**2.6**	**2.8**	**1.5**	**1.7**
Foreign, net	0.9	0.6	2.6	1.6	1.3	1.4	1.8	0.6	2.3	1.0	2.2
Of which											
Changes in assets held abroad (-increase)	-0.4	-0.6	0.1	-0.6	-0.9	-1.3	-0.4	0.4	0.4	0.1	0.2
Domestic, net	1.4	2.0	1.1	3.6	3.5	0.7	1.2	0.5	0.6	0.7	-0.4
Financial system and bonds	0.3	2.0	0.7	3.1	2.9	0.9	1.7	0.8	1.2	0.7	0.5
Change in floating debt, net 7/	1.0	0.0	0.4	0.5	0.6	-0.2	-0.5	-0.3	-0.7	0.0	-0.9
Privatization (including concessions) 8/	0.8	1.3	0.1	0.7	0.7	1.6	0.4	1.5	-0.1	-0.2	-0.2
Memorandum items:											
NFPS primary balance	-0.3	-1.3	-1.3	-2.3	-2.6	0.7	0.8	1.7	2.0	2.6	2.8
Primary NFPS non-oil nonsocial security balance	-0.6	-0.8	-0.8	-1.3	-2.1	0.8	1.3	2.4	3.0	4.1	4.5

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

1/ Excludes proceeds of financial transaction tax in 1999 from revenue and expenditure.
2/ Includes local fees, penalties and oil stabilization fund.
3/ From year 2000 includes the unpaid bills of *Instituto del Seguro Social*.
4/ Includes change in the budget carry-over of the central administration and in the unpaid bills of selected nonfinancial public enterprises.
5/ Includes residual differences between items above and below the line.
6/ Transfer to Caja Agraria in 1999, interest payments on public banks restructuring bonds and mortgage debt relief related costs.
7/ From 2000 includes the unpaid bills of selected nonfinancial public enterprises and of the *Instituto del Seguro Social*.
8/ Includes nonrecurrent fees from telecommunications licensing.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 01/36
FOR IMMEDIATE RELEASE
April 12, 2001

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes Article IV Consultation with Colombia

On March 28, 2001, the Executive Board concluded the Article IV consultation with Colombia.[1]

Background

Colombia's economic performance deteriorated markedly in the last half of 1998 and during 1999 due to a combination of external shocks and a weakening of confidence. The external shocks included deterioration in the terms of trade and the effects of the turbulence in international financial markets in the aftermath of the Asian and Russian crisis. The weakening of confidence was related to the worsening of the internal security situation, and uncertainty in the face of continued deterioration of public finances and clear signs of stress in the financial sector. Real GDP growth fell to 0.5 percent in 1998 and was negative by 4.3 percent in 1999, and the combined public sector deficit widened to 5.5 percent in 1999 from 3.8 percent of GDP in 1998. Unemployment rose to 20 percent.

To deal with these problems, the authorities designed a three-year stabilization program based on fiscal consolidation, exchange rate flexibility (the peso was floated in September 1999), and structural reforms. The structural program included measures to strengthen expenditure control in the public sector, privatization, and financial sector restructuring. In December 1999, the Fund approved a three-year extended arrangement in support of the Colombian government's program.

Economic conditions have since seen a notable improvement. Inflation ended 2000 below 9 percent, and real GDP grew at nearly 3 percent based on a strong recovery of exports and

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the March 28, 2001 Executive Board discussion based on the staff report.

some rebound in domestic demand. The external current account improved to a surplus of 0.2 percent of GDP due to higher export receipts and a moderate recovery in imports. The combined public sector deficit was reduced to 3.4 percent of GDP in 2000 because of higher oil revenues and lower expenditure, and despite a court-ordered increase in public sector wages and a deteriorating financial position of the public pension systems. The conditions in the financial sector improved in 2000 with the help of a restructuring and recapitalization program implemented by the authorities. The government's privatization plans fell short of its objectives, but the rest of the structural reform program progressed about as envisaged.

The government's program for 2001 aims to sustain the recovery. Growth is projected to increase to near 4 percent and inflation to fall further to 8 percent. The external position is projected to remain strong with debt falling slightly in relation to GDP. The fiscal program for 2001, which is critical to achieving these objectives, calls for the nonfinancial public sector deficit to fall to 2.6 percent from 3.5 percent of GDP in 2000. This is to be achieved through expenditure reduction and a strong tax effort—drawing on the tax package that was recently approved by congress—to compensate for a projected decline in income from the petroleum sector. Most of the financing of the fiscal deficit is being secured from external sources. Monetary policy in 2001 will be implemented under an inflation-targeting framework and the exchange rate will continue to float.

Executive Board Assessment

Directors commended the authorities' efforts to achieve fiscal consolidation, financial sector restructuring, and structural reforms, as well as the central bank's adoption of an inflation-targeting framework for monetary policy. These policies have provided an essential underpinning to the economy's recovery from the 1998–99 recession. Directors supported the authorities' determination to persevere with and, where necessary, reinforce these policies to address the challenges that Colombia continues to face. They considered that the main economic challenges are to place the fiscal accounts on a sustainable footing, reduce the high level of unemployment, and further strengthen the financial system.

Directors commended the authorities' fiscal efforts to date and noted that the outcome would have been more favorable had it not been for the need to absorb the costs of court-ordered wage increases. At the same time, they considered that further measures are needed to attain a sustainable fiscal position. Directors noted that the recent fiscal adjustment has been aided by factors that may not be sustainable--such as higher than projected oil revenues and lower public investment--and by revenues from some taxes that are distortionary. Moreover, fiscal pressures could emerge from a number of sources, including costs related to the pension system and achievement of a lasting peace, as well as uncertainties relating to oil revenues and other developments in the world economy. Overall, Directors considered that the preservation of a sound fiscal situation should be central to the authorities' economic efforts. Without the necessary action on the fiscal front, there will be undesirable upward pressure on interest rates, external financing will be more difficult to arrange than otherwise, and policymakers' options in responding to shocks will be excessively constrained.

Against this background, Directors looked forward to the creation of a commission that would propose a comprehensive plan to improve the efficiency of the tax system and make it less distortionary. They considered it important to phase out the financial transactions tax and the new customs service charge. While understanding the complexity of the issues involved, Directors regretted the delay in submitting the fiscal responsibility law and the second-generation pension reform to congress, and urged the authorities to act expeditiously in these areas. They attached particular importance to the pension reform. Reform of the health care system is also needed. More generally, Directors encouraged the authorities to continue reducing the size of the public sector, including through privatization of public enterprises. Directors were concerned about the rapid increase in unemployment, which at present levels could contribute to social tensions. They considered that the authorities' various initiatives, including the creation of short-term jobs, training programs, and incentives for education, could help in addressing this critical problem. More fundamentally, however, Directors noted that a successful attack on unemployment will require the correction of distortions in the labor market, such as high payroll taxes, and greater flexibility in the terms of employment.

Directors welcomed the central bank's commitment to continue lowering inflation. They noted that this commitment will be harder to meet the greater the reliance on backward indexation of wages and prices, which they considered should be avoided. Directors encouraged the central bank to continue studying the various transmission mechanisms of monetary policy with a view to refining the inflation-targeting framework.

Directors commended the authorities' resolute actions in dealing with loss-making public banks and strengthening the banking system. Capital adequacy levels have risen and problems with nonperforming loans have diminished. They welcomed the authorities' efforts to strengthen the mortgage institutions, and generally supported the measures to help spur activity in the housing and construction industries. Directors noted that maintaining a healthy banking system could have benefits for the fiscal situation in that it would avoid possible restructuring costs. It would also increase the authorities' room for maneuver in the conduct of monetary policy by increasing resilience to exchange and interest rate changes. Directors appreciated Colombia's efforts to combat money laundering.

Directors noted that the external current account deficit has been reduced substantially in the past two years, partly as a result of higher oil prices, but also reflecting the authorities' prudent policies and the depreciation of the peso under the floating exchange rate regime. They welcomed the progress already made by the authorities in securing external financing for 2001, which is especially important given recent uncertainties about near-term developments in external markets. At the same time, Directors urged the authorities to stand ready to deal with the effects on the program of a weakening of external demand and possible adverse developments in the terms of trade.

Directors commended the authorities' determination in pursuing their adjustment and reform policies despite the difficult domestic security situation. They noted that confidence will strengthen if the security situation improves, welcomed the resumption of the peace process earlier this year, and wished the authorities much success in their efforts.

Directors noted Colombia's participation in the Special Data Dissemination Standard and encouraged the authorities to improve the quality of data, especially on public domestic debt.

Directors also encouraged the authorities to take the necessary steps to accept the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Colombia: Selected Economic Indicators

	1997	1998	1999	Prel. 2000	Proj. 2001
(Annual percentage change, unless otherwise indicated)					
National income and prices					
Real GDP	3.4	0.5	-4.3	2.8	3.8
Consumer prices (end of period)	17.7	16.7	9.2	8.8	8.0
Nominal exchange rate 1/ (depreciation -)	-9.1	-20.1	-18.9	-15.8	...
Real effective exchange rate 1/2/ (depreciation -)	11.3	-4.6	-9.6	-7.3	...
Money and credit 3/					
Broad money	24.5	10.3	8.7	2.7	19.2
Private sector credit	25.6	11.9	3.5	0.1	10.8
Broad money (as ratio to net international reserves)	3.6	3.8	3.5	2.7	3.1
Income velocity of money	2.7	2.8	2.8	3.1	2.9
(In percent of GDP, unless otherwise indicated)					
External sector					
Current account	-5.5	-5.3	-0.1	0.2	-1.8
Capital and financial account balance	6.6	4.3	-0.1	-0.2	2.2
External debt	31.6	36.2	41.8	43.5	41.6
Gross official reserves (in months of imports of goods and services)	6.9	7.9	6.8	7.1	6.8
Savings and Investment					
Gross domestic investment	20.9	18.2	12.3	14.5	17.0
Gross national savings	15.4	13.0	12.3	14.7	15.2
Public finances					
Combined public sector balance 4/	-3.9	-3.8	-5.5	-3.4	-2.8
Nonfinancial public sector balance 4/	-3.9	-4.6	-6.4	-3.5	-2.6
Nonfinancial public sector primary balance	-1.3	-1.3	-2.6	0.8	2.0
Public sector debt	26.3	29.5	38.2	42.4	41.6

Sources: Colombian authorities; and Fund staff estimates and projections.

1/ End of period.

2/ Based on Information Notice System.

3/ All annual changes in foreign currency stocks valued at constant exchange rate.

4/ Excluding privatization proceeds.

INTERNATIONAL MONETARY FUND

NEWS BRIEF

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Washington, D. C. 20431 USA

IMF Completes Second Review Under the Extended Arrangement for Colombia

The Executive Board of the International Monetary Fund (IMF) completed the second review of Colombia's performance under the Extended Fund Facility (EFF)[1] arrangement approved on December 20, 1999 (see Press Release No. 99/63), allowing Colombia to draw, if needed, up to SDR 1.96 billion (US$ 2.7 billion) from the IMF. To date, the country has not made any purchases under the arrangement.

In commenting on the Executive Board's discussion of the review, Stanley Fischer, First Deputy Managing Director, made the following statement:

"Economic activity in Colombia strengthened in 2000, following the 1998/99 recession, helped by satisfactory implementation of the initial phase of the government's three-year program. The government's program for 2001 aims to sustain the recovery. Growth is projected to increase to near 4 percent and inflation to fall further to 8 percent. The external position is projected to remain strong with debt falling slightly in relation to GDP.

[1] The EFF is an IMF financing facility that supports medium-term programs that seek to overcome balance of payments difficulties stemming from macroeconomic imbalances and structural problems. The repayment terms are 10 years with a 4 ½-year grace period, and the interest rate, adjusted weekly, is currently about 3.8% a year.

"The fiscal program for 2001, which is critical to achieving these objectives, calls for the nonfinancial public sector deficit to fall to 2.6 percent from 3.5 percent of GDP in 2000. This is to be achieved through expenditure reduction and a strong tax effort—drawing on the tax package that was recently approved by congress—to compensate for a projected decline in income from the petroleum sector. Most of the financing of the fiscal deficit is being secured from external sources. Monetary policy in 2001 will be implemented under an inflation-targeting framework and the exchange rate will continue to float.

"The government will carry forward its ambitious agenda for reforming and downsizing the public sector, including through strengthening control over finances at all levels of government, streamlining the tax and revenue sharing systems, and reforming the public health and pension systems.

"The restructuring program for the financial sector in 2001 focuses on strengthening the mortgage institutions. The remaining public banks, except one, will be divested or liquidated before the end of the year, as envisaged earlier.

"Unemployment has reached a high level. The government is introducing measures to reduce it, including through the creation of short-term jobs, training programs, and incentives for education, but complementary measures to improve labor market flexibility are also needed.

"Directors commended the authorities' policy efforts, which have achieved considerable success despite the difficult domestic security situation," Mr. Fischer said.

Statement by Murilo Portugal, Executive Director and
Roberto Junguito, Alternate Executive Director
for Colombia
March 28, 2001

Our authorities would like to commend staff for a substantive report and for the well-focused Selected Issues paper on Colombia's key areas of economic policy-making.

The performance under the program has been highly satisfactory, a result that is especially noteworthy given the delicate security situation that the country has been facing. Economic growth, estimated at 2.8 percent of GDP in 2000, recovered significantly after the more than 4 percent GDP slump in 1999; inflation has been declining to the projected levels; there has been a strong fiscal adjustment; the current account registered a small surplus; international reserves have increased continuously and remain at comfortable levels; and there has been improvement in the financial sector. Unemployment, however, remains very high, despite the economic upturn.

Our authorities would like to underline that all quarterly performance criteria through December 2000 were met, including the fiscal and external debt ceilings, whose results were not available when the staff paper was issued. Furthermore, as may be gathered from Table 2, most structural benchmarks were also met. Though the fiscal responsibility law was not submitted to Congress as programmed, the delay was motivated by the submission to Congress of two major pieces of legislation, later approved, that already advanced crucial fiscal responsibility clauses for both the central government and the territories. This means that the only benchmark that was not met was the presentation to Congress of a pension reform plan.

Regarding fiscal policy, the combined public sector deficit declined from 5.5 percent of GDP in 1999 to 3.4 percent in 2000. The adjustment would have been larger had the constitutional court ruling, decreeing retroactive public wage increases indexed to past inflation, not taken place at year-end. In terms of the primary balance of the NFPS, the adjustment appears even more pronounced, since it changed from a deficit of 2.6 percent of GDP in 1999 to a surplus of 0.9 percent in 2000. The primary balance for the NFPS excluding oil sector revenue and the financial position of the public pension sector between 1999-2000, which describes well the fiscal effort that is being made, shows an adjustment of more than 2.5 percent of GDP.

The fiscal program's goal for 2001 is to reduce the combined fiscal deficit to 2.8 percent of GDP. This will be feasible as a result of the economic recovery and, mainly, of a set of already approved tax and expenditure measures. On the tax side, the package passed through Congress last year is expected to yield 1.4 percent of GDP, which is significantly more than envisaged in the program. On the expenditures side, outlays will decline in terms of GDP, despite the new rules for public sector wage setting dictated by the Constitutional Court, as a result of the projected reduction of expenditures in territorial governments, following the passage last year of legislation to control current public expenditures, and of the approval of a tight central government budget.

Regarding the tax reform, the authorities would like to note the important effort made by the government, from a political-economic perspective, in passing through Congress such a substantial revenue-raising package, during a period of economic hardship, growing insecurity, and lack of a government majority in Congress. The tax package increased the presumptive income tax rate, and the value added tax rate, introduced a small customs service charge, and increased the financial transactions tax rate from 0.2 to 0.3 percent and made it permanent.

Although some of the reforms, in particular the financial transactions tax, do have distortionary elements (see both the Selected Issues papers on the Bank Debit Tax and on Tax Issues and Customs Reforms), the government believes that the result was the best possible under the circumstances, and that the measures will significantly help overcome the fiscal gap during the remaining period of the Administration. In view of the positive experience with the Musgrave, Taylor and Bird fiscal missions of the past decades, the government has considered timely the establishment of a Commission on Public Finances, led by an international expert and with the advice of a widely representative group of Colombians, to assess the structure of the fiscal system and propose changes. The results of the Commission are expected to be received in May 2002 and to be handed to the incoming administration.

Three other important pieces of legislation on fiscal issues will be submitted to Congress in 2001: the Acto Legislativo (constitutional amendment) on territorial transfers (for last reading); a proposal on territorial tax reform, granting more fiscal autonomy to local governments; and a draft fiscal responsibility law, which complements measures already being adopted in that area. Furthermore, the authorities are interested in obtaining IMF technical assistance to review the institutional organization of the Ministry of Finance on fiscal issues. The government is undertaking a self-assessment on fiscal transparency with the view of measuring compliance with international standards.

A key feature of the 2001 program is the government's financing strategy. While in 2000 there was a frustrated over-reliance on privatization proceeds, and there was need to access both international and domestic markets beyond projected levels, for 2001 there is a more realistic and sound approach. As staff indicates, the authorities opted for financing government needs mainly from external sources, while leaving the domestic market growth to satisfy private sector demand, thus preventing crowding-out and upward pressures on interest rates. Although the government has an interest in privatizing the electrical companies, given the security risks on distribution lines and the eventual lack of interest by investors, no formal commitment on revenues is established in the program. Proceeds, if they were to come forth, would be a bonus and would be used either to reduce borrowing requirements or for liability management.

As to the public external financing requirements, the government has already placed bonds in the euro market for about $700 million dollars, and the remaining needs will be raised through ordinary World Bank and IDB loans and through a bond placement supported by a World Bank guarantee already approved. Such projected financing is consistent with ceilings on external financing and, if the opportunities arise, the government will also prefinance 2002 requirements keeping the resources outside the country. We would also like to add that the Direction of Public Credit of Colombia follows closely the guidelines for public debt management discussed by the IMF Board.

The Colombian Central Bank has advanced in the adoption of a monetary policy framework based on inflation targeting. The program introduces the substitution of the NDA criterion, for a review by the IMF Board of actions taken by the Central Bank whenever the rate of inflation deviates by two percentage points or more from the quarterly targets. The Banco de la República provides the staff with the projections of its inflation forecasting models (a new model is being developed with the technical support of the Bank of England), its analysis of core inflation (some useful suggestions for new measures have been suggested by the IMF in the Selected Issues paper), its monthly inflation reports, and other relevant indicators and decisions taken by the monetary authorities. The authorities are confident that the operation of the monitoring procedures will be successful as they are convinced that the Colombian Central Bank has the constitutional authority, the technical capacity, and the track record to adopt the necessary corrective actions, if needed, to achieve the inflation targets. The end-year CPI inflation targets for 2001 and 2002 are 8.0 percent and 6.0 percent, respectively.

Staff has issued a useful Selected Issues paper on inflation targeting in Colombia. The authorities share the staff's views regarding the advantages of the inflation targeting framework and the overall description of the institutional features developed by the Colombian Central Bank since 1991 to facilitate the adoption of inflation targeting.[1] However, they do not think that the paper presents an adequate perspective of the inflation control achievements made under the previous monetary-based stabilization scheme. Figure 1 of the issues paper shows that Colombia was able to *gradually and consistently* reduce CPI inflation from more than thirty percent to single digit levels. Moreover, Colombia was, thus, able to overcome its near to three-decade moderate inflation levels.

Another successful component of the Colombian economic program has been the flexible exchange rate regime adopted in September 1999. It has allowed a gradual depreciation of the real exchange rate, which, together with the growing demand from trading partners, led non-traditional exports to grow significantly in 2000. As a result, and with the aid of growing oil revenues, the current account had a small surplus. The current

[1] An independent central bank with the mandate to control inflation, the announcement of a multi-annual inflation target, the unanimity Board rule to lend to the government, the development of forecasting models, publishing inflation reports and accountability to Congress, among others.

account result, and increasing access to international capital markets, permitted international reserves to rise above the floor established in the program. Perhaps the most important end result in the external sector has been the improvement in the country's vulnerability indicators.

The Colombian financial system strengthened significantly in 2000. The average capital-adequacy ratio rose to 13.8 percent by November from 11 percent in December 1999 and the non-performing loan ratio declined for the system as a whole. Advances were also made in the public banks, where four public banks were liquidated or merged and preparations have advanced to put another at the point of sale this year. Notwithstanding, the mortgage institutions showed increased weakness in the last half of the year, and the government is introducing measures for their restructuring and recapitalization and for the general strengthening of the housing and construction sector. The special issue paper on Banking Stress in the late 1990's presents a thorough description of the causes behind the recent financial sector crisis and the policy response. The authorities consider that the advice on financial sector issues provided by the IMF and the World Bank has been timely and useful.

Structural reforms are a major component of the program. As noted, the 2001 agenda involves the second round and final approval by Congress of the constitutional amendment regarding revenue transfers to territorial governments; the introduction, in early autumn, of a fiscal responsibility law, which complements measures already being adopted, and legislation to strengthen the fiscal autonomy and tax collection capacity of territorial governments. The adoption and operation of the inflation targeting framework is also part of the package. In addition, the authorities continue to advance measures, through executive action, to restructure and downsize the public sector, and are continuing their efforts to privatize two large enterprises in the electricity sector, as well as to merge, liquidate, and sell all remaining public banks (excepting Banco Agrario).

A major challenge is the pressing need to put in place a wide-ranging reform of the pension system. As pointed out by staff, in the medium- and long-term the public finances are unlikely to achieve viability unless such reform is approved. To deal with this issue, the government, with technical support from the World Bank, is preparing a second-generation pension reform to be presented to Congress by mid-2001. Intensive discussions within the government are taking place to agree on a common proposal, and the authorities are also building consensus for reform among political parties and interested groups. In the view of the Colombian authorities, this is the most challenging and difficult economic area to obtain wide agreement and support. The Selected Issues paper presents a good overview of developments of the pensions regime and of the topics, being discussed in Colombia, that should be addressed in a new reform.

Another key structural issue of Colombia is unemployment. As noted in the substantive issues paper on unemployment in the 1990's, the open unemployment rate rose from 7.5 percent in 1994 (lowest on record) to more than 20 percent in September 2000 (highest ever registered). The paper argues, with empirical and analytical support, that the decline of economic activity in recent years cannot alone explain such surge in unemployment, and notes other factors such as the increase in the relative cost of labor to capital, the mismatch of skills demanded and supplied and the increase in the unemployment rate of the highest income earners in the family. The structural nature of the problem has prompted he authorities to undertake employment programs designed to create employment among lower income groups, training for the young unemployed, and support for families with school-aged children. Also, the Colombian Central Bank will hold a seminar at end-March with international and local experts to review and propose further policies to reduce unemployment.

Undoubtedly, the major structural problem in Colombia regards the internal conflict and the need to achieve a peace agreement with the insurgent groups. Box 1 of the staff report summarizes the background of the important issues surrounding the problem, as well as an indicative assessment of its economic implications. The last paragraph of the Box points out that, after a peace agreement, spending would need to be increased to strengthen the social infrastructure and cover the financing of integrating the former insurgents into civilian society. As explained in the Letter of Intent, the peace discussions with insurgent groups may contemplate the implementation of partial agreements that require a temporary increase in the NFPS deficit in order to ensure their adequate implementation. As it is widely known, the government is also advancing on "Plan Colombia," which integrates strategies for combating drug trafficking and addressing the difficult security situation, and is obtaining contributions to the Plan, mainly in the form of grants.

We would like to finish by referring briefly to transparency, standards, performance criteria and purchases. Colombia has accepted to publish the staff report; it participates in the SDDS; it undertook the FSAP; and is in the process of advancing on self-assessments on fiscal transparency. On the other hand, authorities are generally meeting all the criteria of the FATF norms on money laundering, as well as the guidelines on debt management.

The authorities expect to continue meeting all performance criteria and structural benchmarks, though for strictly technical reasons (the absence of the Minister of Finance from the country since mid-March) there may be a delay for a couple of weeks in the adoption of two end-March benchmarks, the plans for downsizing of the public sector, and the presentation to Congress of the territorial tax reform.

The authorities continue to treat the EFF as if it were a formal precautionary arrangement, and, as a result, no disbursements have been made.