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Colombia: Third Review Under the Extended Arrangement—Staff Report; Staff Statement; News Brief on the Executive Board Discussion; and Statement by the Executive Director for Colombia

In the context of the Third Review Under the Extended Arrangement, the following documents have been released and are included in this package:

- the staff report for the Third Review Under the Extended Arrangement, prepared by a staff team of the IMF, following discussions that ended on **November 20, 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 Janaury 14, 2002**. 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 statement of **January 25, 2002** updating information on recent developments.

- a News Brief summarizing the **views of the Executive Board as expressed during its January 25, 2002 discussion** of the staff report that completed the review.

- a statement by the Executive Director for Colombia.

The documents listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Colombia*

*May also be included in Staff Report

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

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to Publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

COLOMBIA

Third Review Under the Extended Arrangement

Prepared by the Western Hemisphere and Policy Development
and Review Departments

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

Approved by Claudio M. Loser and Liam P. Ebrill

January 14, 2002

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Executive Summary

Colombia's economic performance deteriorated markedly in 1998–99 as a result of external shocks, the negative effect on confidence of intensified guerilla activity and a further fiscal deterioration. To address the economic difficulties, the authorities designed a three-year stabilization program for the period through 2002 aimed at restoring economic growth, reducing inflation, and strengthening the country's external position. To achieve these objectives, the program called for fiscal consolidation; exchange rate flexibility (the peso was floated in September 1999); and an ambitious structural reform program focused on privatization, financial sector restructuring, pension reform, and a strengthening of 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.

Considerable macroeconomic stabilization has been achieved under the program. Inflation has been reduced, fiscal consolidation has advanced, the exchange market has remained orderly, and significant structural reforms have been implemented, albeit with some slippages. Unemployment remains high and there are concerns that the public debt to GDP ratio will not stabilize or decline unless the adjustment effort is continued.

The momentum of Colombia's economic recovery slowed in 2001 in the context of a drop in oil exports related to guerilla sabotage, a weakening in external demand as world growth slowed, and a fall in coffee prices to historically low levels. Nonetheless, the external position remained strong and Colombia maintained access to international financial markets, notwithstanding the problems faced by some other emerging market economies. Conditions in the financial system continued to improve, although problems remain, particularly in the mortgage sector.

The 2002 program calls for a reduction in inflation to 6 percent, the maintenance of a strong external position, and a further strengthening of the public finances to gain better control over the public debt dynamics and help lay the ground for a robust recovery of activity in the private sector. Consistent with this, the combined public sector deficit would decline to 2.6 percent of GDP, from an estimated 3.3 percent of GDP in 2001 (5.6 percent of GDP in 1999).

The structural agenda for 2002 calls for reform of the special (privileged) pension regimes, which would complement the reform of the general regime that was presented to congress in December 2001. The pension reform is a critical element in achieving and maintaining a strong fiscal position over the medium and longer term. In recognition of the need to continue the fiscal consolidation effort beyond the period of the program, the government has appointed a high level Public Revenue Commission, which will present its recommendations to the new administration that takes office in August.

I. Introduction

1. The discussions for the third review of the extended arrangement were held in Bogotá during August 29–September 15, 2001 and during two subsequent visits by the authorities to headquarters.[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 second review was completed on March 28, 2001 (EBS/01/34). To date, no purchases have been made under the arrangement, and Colombia has no outstanding credit from the Fund.[2] In a letter to the Managing Director, dated December 20, 2001 (Appendix VII), the authorities describe developments under the program and the policies they intend to follow in 2002.

2. All quarterly performance criteria for June 2001 were observed, except for the ceiling on the combined public sector deficit, which was exceeded by a very small amount (Table 1). Performance criteria for September and December were to have been set at the time of the third review, but because of the delay in completing the discussions for the review, no such criteria were set. The review, which had been scheduled for mid-August, was delayed because of the additional time needed by the authorities to develop policies for 2002 and implement some overdue structural reforms, including pension reform, as discussed below. Colombia has not accepted the obligations under Article VIII, Sections 2, 3, and 4 of the Articles of Agreement, and maintains multiple currency practices subject to Fund approval. Statistical information provided to the Fund is generally adequate, but the fiscal data need to be improved. Colombia subscribes to the Special Data Dissemination Standard.

3. At the conclusion of the last Article IV consultation with Colombia, on March 28, 2001, Directors commended the authorities' efforts to promote fiscal consolidation, financial sector restructuring, and structural reforms, and welcomed the adoption of an inflation-targeting framework for monetary policy. They considered that the main challenges were to put the public finances on a sustainable footing, reduce the high level of unemployment, and continue to strengthen the financial system.

II. Background and Developments in 2001

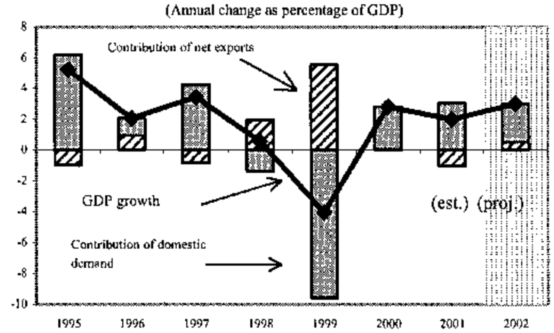
4. Congressional and presidential elections are scheduled for March and May 2002, respectively. In the past year the peace negotiations with the largest guerrilla group (FARC)

[1] The staff participating in the discussions were Messrs. Gronlie (Head), Gil-Díaz, Breuer, Fritz-Krockow, Espejo, Klyuev (all WHD) and Hilaire (PDR). Mr. Junguito (Alternate ED) participated in the policy discussions.

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

have focused on an exchange of prisoners, an agreement to stop kidnappings, the government's efforts to control the paramilitary groups, and the conditions for a cease-fire. The agreement on the demilitarized zone (sanctuary for the FARC) expires in January 2002. While a limited exchange of prisoners took place in June 2001, the guerrillas have continued their actions against civilian targets, including stepped-up sabotage against the economic infrastructure that resulted in a serious disruption of oil exports. The paramilitary groups also intensified their campaigns last year. In response to the continued violence, the government has taken steps to strengthen its military capability while exploring conciliation options and garnering international support for the peace process.

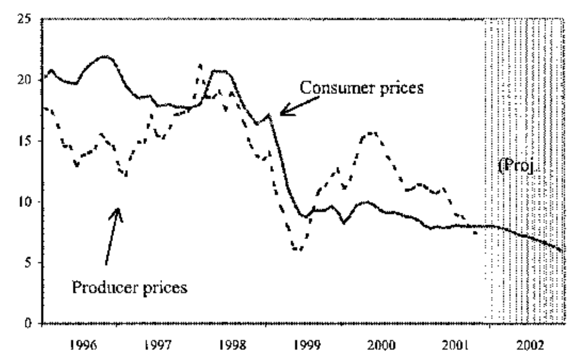
Figure 1. Real GDP Growth and Its Components
(Annual change as percentage of GDP)



Sources: DANE; and Fund staff estimates and projections.

5. Real GDP growth is estimated to have fallen to around 1.8–2.0 percent in 2001 from nearly 3 percent the year before, as domestic demand stagnated and the trade balance weakened (Table 2 and Figure 1). Domestic demand continued to be affected by relatively high private debt levels; the persistence of high unemployment; a lack of progress in resolving the internal conflict; and historically low coffee prices, which affect the income of a large number of Colombians. Output also suffered from the increased sabotage and a slowdown in the growth of nontraditional exports, as external demand weakened.

Figure 2. Colombia: Annual Inflation
(12-month percentage change)

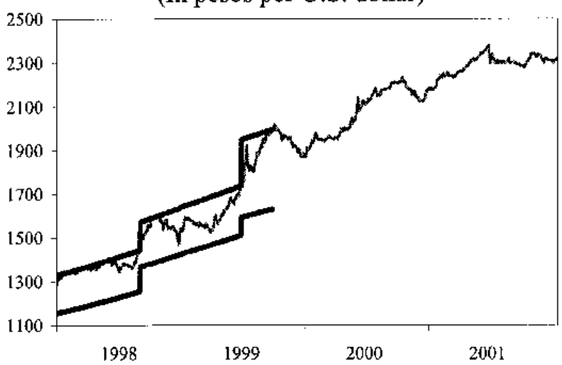


Source: Banco de la República.

6. Inflation has eased further, with the 12-month rate moderating from near 9 percent at the end of 2000 to 7.8 percent in November 2001 (Figure 2). The price performance was helped by the economic slowdown and, to some extent, by the relative stability of the currency. In real effective terms, the peso appreciated somewhat in 2001 (through October), but it has depreciated by about 20 percent since its most appreciated level in 1997 (Figures 3 and 4).

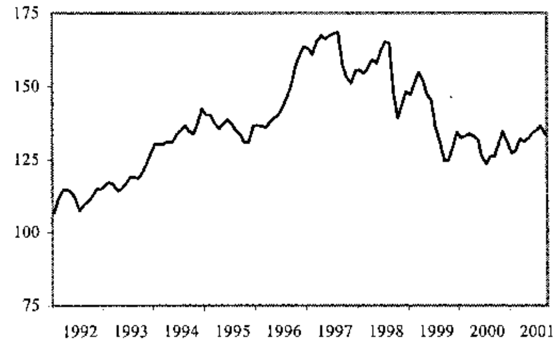
7. Although the rate of unemployment has declined from its peak in early 2001, it remains high at near 17 percent (Figure 5). A major increase in unemployment in the second half of the 1990s reflected a combination of factors. The participation rate increased sharply, while the demand for labor weakened as its price with respect to capital more than doubled during the 1990s. Also, labor absorption has been hampered by a relatively high minimum wage, rigid work arrangements, and high payroll taxes.

Figure 3. Exchange Rate 1/
(In pesos per U.S. dollar)



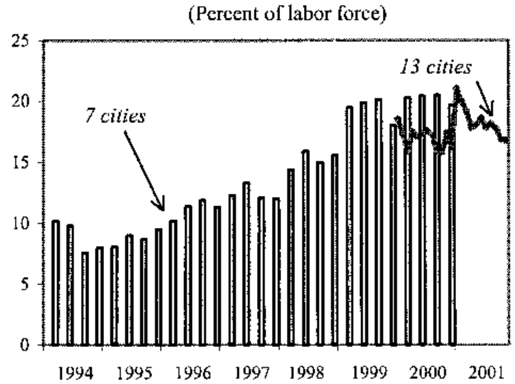
Source: Banco de la República.
1/ In September 1999, the peso was floated.

Figure 4. Real Effective Exchange Rate 1/
(1990 = 100)



Source: Information Notice System.
1/ An increase (decrease) indicates appreciation (depreciation).

Figure 5. Unemployment Rate 1/
(Percent of labor force)



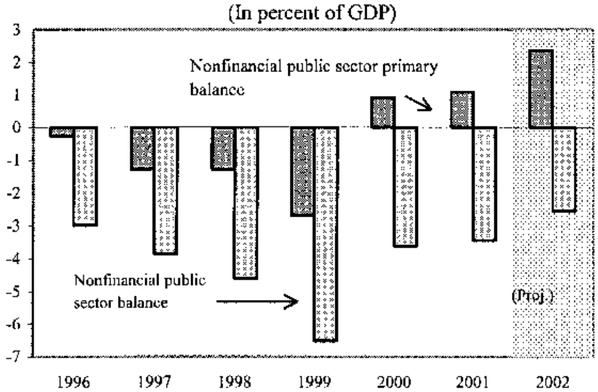
Source: DANE.
1/ Because of changes in methodology, the two series are not directly comparable.

A. Fiscal Developments

8. The combined public sector deficit fell sharply to 3.5 percent of GDP in 2000, and is estimated at 3.3 percent of GDP for 2001. This deficit is in line with the indicative target presented at the time of the second program review in March 2001, after adjusting for the effects on revenue collections of the weaker-than-projected economic growth and the temporary loss of revenue resulting from sabotage against oil installations (Tables 3 and 4, Figures 6 and 7).

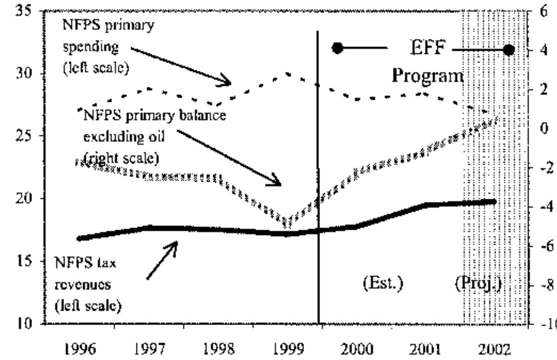
9. The overall revenue position of the nonfinancial public sector (NFPS) is estimated to have fallen short of the indicative target for 2001 by 0.3 percent of GDP, with tax collections falling 0.9 percent of GDP below target due to the cyclical downturn, the introduction of

Figure 6. Fiscal Balance
(In percent of GDP)



Sources: Ministry of Finance; and Fund staff estimates and projections.

Figure 7. Fiscal Strenghtening under the EFF Program
(In percent of GDP)



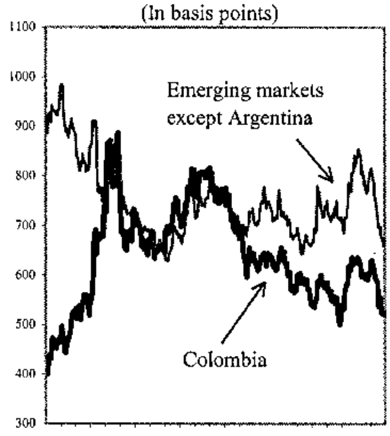
Sources: Ministry of Finance; and Fund staff estimates and projections.

exemptions from the financial transactions tax, and some initial problems in implementing the tax package that took effect at the beginning of the year. Much of the shortfall in tax collection was compensated by better-than-projected operating results of the public enterprises, particularly those in the electricity sector as tariffs rose sharply in the wake of sabotage against the distribution network.

10. It is estimated that NFPS spending exceeded the program by 0.5 percent of GDP in 2001, because of increased purchases of security equipment, rising costs of the public health system, and higher pension and separation payments as retirements increased in response to concerns about the funding of some public pension plans and the forthcoming pension reform, and as territorial governments reduced their staffing in an effort to implement the fiscal rules enacted in 2000. At the same time, wage costs and interest payments were lower than envisaged as domestic interest rates declined more than anticipated and the constitutional court reversed, in part, an earlier decision that required backward indexation of public wages. Higher profits of the central bank and lower costs of bank restructuring helped strengthen the fiscal balance of the combined public sector (see Table 3).

11. By May 2001, the NFPS had completed its foreign market-borrowing program for the year through bond placements of US$2.7 billion (of which US$1 billion carried a partial World Bank guarantee). Together with the disbursement of multilateral loans, this brought the net external financing to 3.2 percent of GDP, leaving 0.1 percent of GDP to be financed domestically, down from 1.3 percent of GDP in 2000 (see Table 3). Between May and December, the government prefinanced more than half of its market-borrowing requirement for 2002, which totals US$2.8 billion. The spread on Colombian sovereign bonds declined throughout 2001, except during a period after the September 11 events in the United States (Figure 8). Also, in June the government swapped domestic debt corresponding to

Figure 8. Country Risk 1/
(In basis points)



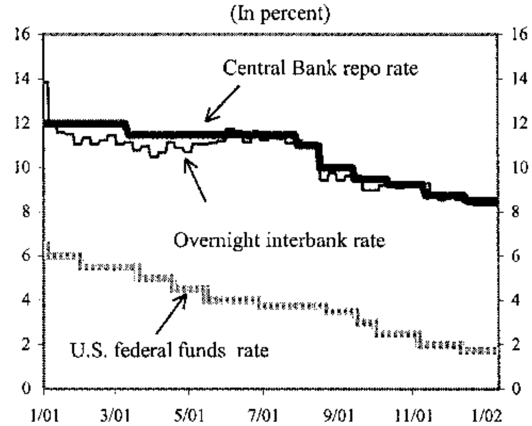
Source: JP Morgan.
1/ As measured by the EMBI + index.

nearly US$2.5 billion falling due in 2001–05 with instruments of longer maturity, thereby reducing domestic amortization payments by one-third in 2002.

B. Monetary Developments and Financial System Issues

12. The quarterly inflation targets established by the central bank were achieved through September 2001 (most recent quarterly data).[3] In view of the favorable outlook for inflation and the declining interest rates in the United States, the central bank lowered its rates by a total of 350 basis points (bps) between March and December (Figure 9). Lending rates declined by 274 bps in the period through November (Figure 10). Government bond rates fell for all maturities and the yield curve flattened somewhat (Figure 11).

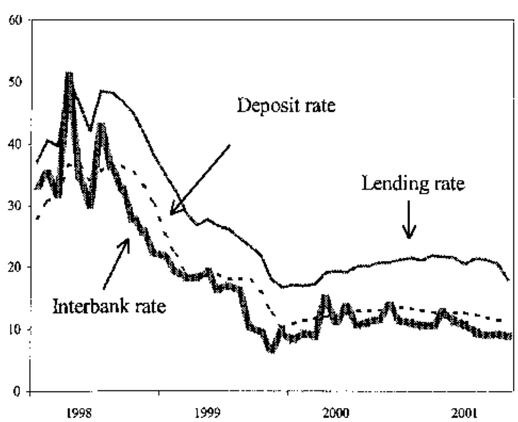
Figure 9. Short-Term Interest Rates
(In percent)



Source: Banco de la República.

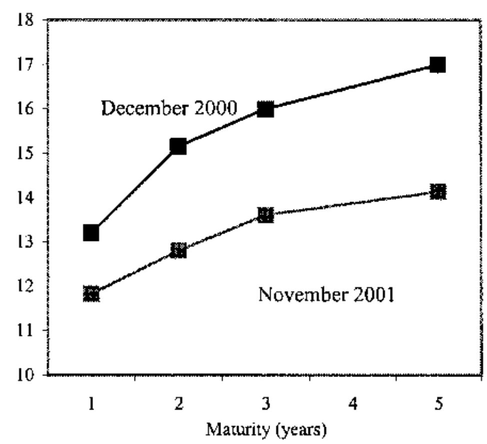
13. It is estimated that the private sector's portfolio of domestic financial assets grew by 8 percent in 2001 (Table 5), with the growth of the broad monetary aggregate increasing to 6.5 percent from 1.3 percent in 2000. The rapid growth in currency since 1999 subsided in 2001 in response to the recovery of the financial sector and the exemption from the financial

Figure 10. Nominal Interest Rates
(In percent)



Source: Banco de la República.

Figure 11. Yield Curve for Colombia Treasury Bonds
(In percent)



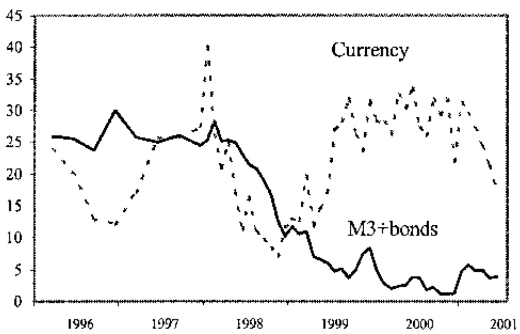
Source: Banco de la República.

[3] The technical underpinnings of the central bank's inflation targeting framework for monetary policy are described in "Colombia—Staff Report for the Second Review Under the (continued…)

transactions tax (0.3 percent on withdrawals) granted on deposits in mortgage banks from April 2001 (Figure 12). Outstanding credit to the private sector is estimated to have risen by 5.5 percent in 2001 when adjusted for loan write-offs and mortgage debt relief, after rising by 2 percent on average in the two preceding years (Figure 13).

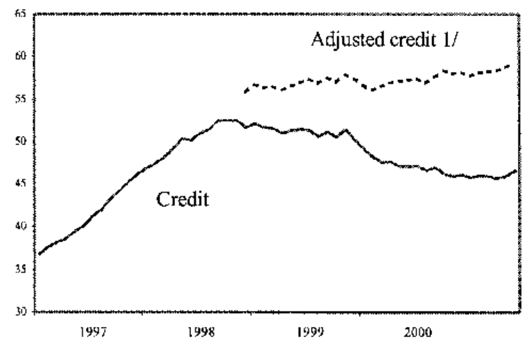
14. After heavy losses in recent years it is estimated that the financial system as a whole recorded moderate profits in 2001. Prudential indicators improved, except in the case of the mortgage banks, which have not recovered from the renewed deterioration that began in the second half of 2000 following the debt relief granted to mortgage holders at the beginning of that year (Figures 14 and 15).

Figure 12: Growth of Money
(12 month percentage change)



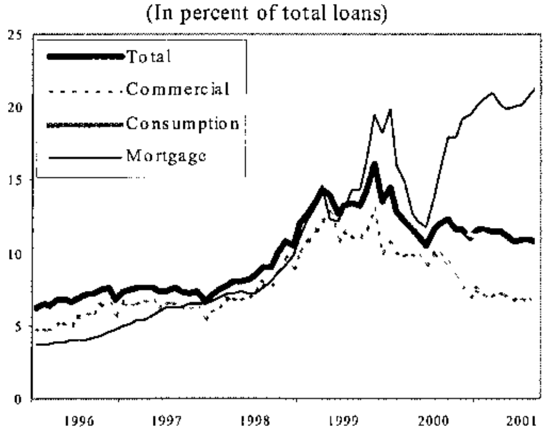
Source: Banco de la República.

Figure 13. Bank Credit to the Private Sector
(In trillions of pesos)



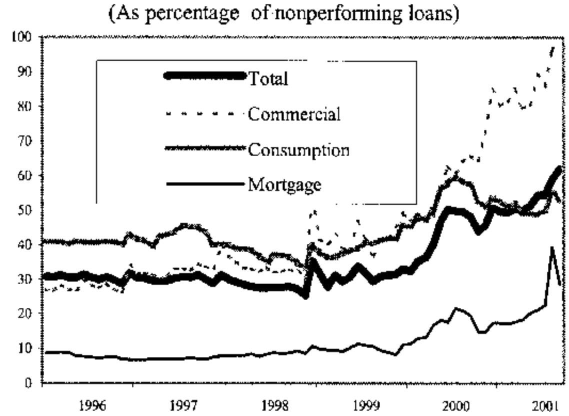
Source: Banco de la República.
1/ Credit adjusted for loan writeoffs and mortgage debt relief.

Figure 14. Nonperforming Loans of Financial System
(In percent of total loans)



Source: Superbancaria.

Figure 15. Loan Provisions
(As percentage of nonperforming loans)



Source: Superbancaria.

Extended Arrangement" (EBS/01/34, March 14, 2001) and in "Colombia—Selected Issues and Statistical Appendix" (SM/01/92, March 20, 2001).

15. In an effort to deal with the problems in the mortgage sector, Fogafin (the deposit insurance agency) launched a recapitalization program for the housing banks last year, under which it extends credit to the owners, against appropriate guarantees, to finance purchases of capitalization bonds issued by Fogafin. This program is similar to the one made available to the private commercial banks in 1999.[4] To provide liquidity to the mortgage sector, the government has approved a regulatory framework for the issuance of mortgage-backed securities, which will enter into operation in early 2002.

C. The Structural Reform Program

16. A number of structural reform measures have been introduced since the second program review in March 2001, reflecting steps to implement delayed reforms and to strengthen the reform agenda (Table 6).

17. In September the government presented to congress a proposal for a territorial tax reform, designed to yield 0.2 percent of GDP per year and to introduce certain basic principles and rules for all territorial government taxes. Also in September, amendments to the banking legislation were introduced that would strengthen the bank resolution mechanism by providing for the purchase and assumption of assets and liabilities of problem banks by healthy institutions (closed-bank resolution mechanism), and a legal framework for the assets management company was established to facilitate the timely sale of the assets acquired from the public banks that have been liquidated. Investment norms applicable to private pension funds have been revised to help stimulate the development of longer-term capital markets; legislation has been introduced in congress to strengthen the control over the use of revenue-sharing funds; and a regulatory framework has been established for the issuance of mortgage-backed securities, as noted above. All of these measures were structural benchmarks for March or June 2001 under the program.

18. The authorities had planned to propose a fiscal responsibility law to congress in September 2001, but this has been postponed to the first half of 2002. The planned sale or liquidation of all public banks (except Banco Agrario) had been a benchmark for December 2001, but the final disposition of the three banks that remain has been delayed, as discussed below. The plan to restructure/downsize the public sector, which was to have been promulgated by end-March 2001, has been merged with the considerable downsizing that has taken place over the past few years at the territorial government level, and especially in 2001 after legislation designed to strengthen their finances was passed in 2000 (Box 1).

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[4] The recapitalization program for commercial banks is described in "Colombia—Selected Issues and Statistical Appendix" (SM/01/92; March 20, 2001).

Box 1. Fiscal Strengthening of Territorial Governments

In October 2000 congress passed Law 617 in an effort to strengthen the territorial government finances by establishing a legal and economic framework for their financial operations and setting parameters for assistance by the central government in the restructuring of their finances.

The 1991 constitution provided for a decentralization of Colombia's public finances. A rising share of the government's revenue would be transferred to the territorial governments, which were given increased responsibilities for education and health services. From the beginning of the decentralization process, the central authorities have sought to help strengthen the territorial government finances through legislation and programs of support.

In 1997, Law 358 (*ley de semáforos*) set rules for territorial government indebtedness. The law established warning indicators to alert financial institutions about the debt servicing capacity of the different territorial governments. An implicit message of these signals was that the central administration would not help resolve any debt-service problems in cases where a warning had been issued. Nevertheless, most territorial governments increased their spending and debt sharply in the 1990s, as lenders were assured that revenue transfers from the central government would be increased year by year as established in the constitution. The easy access to credit during much of the 1990s led to debt-servicing problems for a number of these governments, particularly as economic conditions deteriorated towards the end of the decade.

As a result of the financial difficulties faced by a number of territorial governments, the Directorate for Fiscal Assistance (DAF), an office in the ministry of finance, helped put in place voluntary fiscal adjustment programs for territorial governments. Law 617 builds on the DAF experience with these programs and imposes limits on current expenditure by all territorial governments. The law establishes four categories of territorial governments determined by criteria such as tax collection and population. Governments classified in higher categories are permitted higher current outlays as a percentage of tax revenues. A government that exceeds the spending limit will need to increase tax collections to avoid a downward reclassification. The law requires that the comptroller general certify periodically that a territorial government is correctly classified, and imposes penalties on governments that do not conform with the restraint on current spending.

Law 617 also provides for the central government to guarantee territorial government debt that is being refinanced under adjustment programs overseen by DAF. It is expected that the debt restructuring and the fiscal adjustments called for under these programs will help the territorial governments achieve fiscal sustainability.

Implementation of Law 617

Law 617 took effect at the beginning of 2001, and since then 220 territorial governments (out of 1,132) have sought assistance under fiscal adjustment programs, accounting for about 75 percent of territorial government debt. It is expected that the adjustment programs will raise fiscal savings by 0.1 percent of GDP in 2001 and further to 0.4 percent of GDP by 2004. However, it is not assured that these savings will strengthen the overall fiscal balance since they can be used to boost public investment at the territorial level.

The initial impact of the adjustment programs has been a notable downsizing of the territorial governments. DAF estimates that some 20 percent of public workers at the territorial level are being made redundant. All territorial governments under fiscal adjustment programs have refinanced their debts with financial institutions on terms comparable to those obtained by the central government.

A large number of territorial governments suffer weak management capabilities, and standard accounting and control practices have not been uniformly applied. As a by-product of Law 617, these governments are making improvements in fiscal management and accounting and are providing better statistical information on their operations, debts, and contingent liabilities.

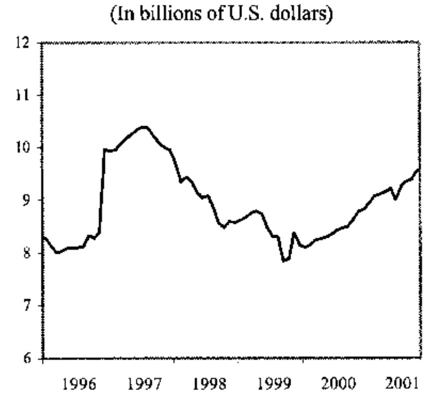
19. Most recently, the authorities have taken action on the key reforms of the pension system and the Social Security Institute's health service. Presentation to congress of the pension reform had been a structural benchmark under the program for December 1999, subsequently reprogrammed to December 2000, and then to June 2001. The presentation, which was made in December 2001, had been delayed because of lengthy consultations within the administration on the nature of the reform and extensive hearings with interested and affected groups in an effort by the government to mobilize support for its proposal. These key reforms are discussed in further detail below.

D. External Sector Developments

20. Following a small surplus in 2000 helped by high oil prices and the strong growth of nontraditional exports, the external current account is estimated to have posted a deficit of 2.6 percent of GDP in 2001 (Table 7). This turnaround reflected mainly a deterioration of Colombia's terms of trade and a drop of almost one-third in the volume of oil exports due to declining productivity of existing fields and increased sabotage. With the exception of coal, the prices of Colombia's traditional exports declined, with the price of coffee falling by more than 30 percent following increased sales from new producer countries. Notwithstanding the slowdown in economic growth in Colombia, imports are estimated to have risen by 12 percent, mainly reflecting strong capital goods imports.

21. The net capital inflow is estimated to have increased sharply in 2001 due to a turnaround in private flows and the public sector's success in executing its external financing plan. The rollover rate for private medium- and long-term debt was substantially higher than assumed under the program, and private direct investment (excluding privatizations) continued to recover from its low point in 1999. Overall, Colombia's net international reserves are estimated to have increased by US$770 million in 2001, more than double the amount projected under the program (Figure 16).

Figure 16. Net International Reserves
(In billions of U.S. dollars)



Source: Banco de la República.

III. Policy Discussions and the Program for 2002

22. The discussions took place against a backdrop of increasing uncertainty about the global economy, signs that Colombia's economic recovery was losing momentum, and a lack of progress in the peace process. They focused on the need to sustain the macroeconomic stabilization that has been achieved, while ensuring that further progress is made on fiscal consolidation and structural reforms through the forthcoming electoral period. The authorities reaffirmed their strong commitment to the program, but recognized that the fiscal effort and the pursuit of structural reforms would need to be continued by the new administration that takes office in August 2002.

23. The program for 2002 is based on a macroeconomic framework that envisages real GDP growth in the 2.5–3 percent range, and a further decline in inflation to 6 percent. The external current account deficit would widen to 3.2 percent of GDP, but with capital inflows projected to be slightly higher than in 2001, there would be a moderate accumulation of net international reserves.

A. Fiscal Policy

24. In discussing the program, the authorities underscored that the fiscal effort would be maintained as envisaged earlier, but noted that the automatic stabilizers should be allowed to work also in 2002, as economic growth would be lower than initially projected. Reflecting this, the combined public sector deficit would be reduced to 2.3 percent of GDP. This corresponds to the level established at the time of the second program review in March 2001, after allowing for the effect on revenue collections of two consecutive years of lower than envisaged economic growth (2001 and 2002). In addition, the government plans to increase its security-related outlays by 0.3 percent of GDP to strengthen the efforts to deal with the domestic insurgency and curb the trafficking in illicit drugs. After taking this additional spending into account, the deficit for 2002 would be 2.6 percent of GDP. The deficit will be more than financed from external sources, providing for a net reduction in domestic debt of 0.3 percent of GDP (see Table 3).

25. Public sector revenue would fall from 29.5 percent of GDP in 2001 to 29.1 percent of GDP, mainly as the operating surplus of the electricity companies is reduced and the state oil company faces lower oil prices. Tax revenue would increase on account of the increase last year in the rate of the presumptive income tax and the territorial government tax reform. The authorities noted that the latter is unlikely to be approved by congress during the forthcoming electoral period, but considered that the 0.2 percent of GDP that this reform was projected to yield in 2002 was unlikely to affect the fiscal balance since few, if any, territorial governments had taken these tax proceeds into account when drawing up their spending plans.

26. While total spending would exceed the earlier projection for 2002, due in large part to the additional security-related outlays, it would nonetheless be 1.3 percentage points of GDP lower than in 2001. The reduction reflects some lowering of investment spending, continued wage moderation, and a decline in separation payments after the initial year of adjusting to the law on fiscal strengthening of the territorial governments.

27. On this basis, the NFPS savings would improve from 4.4 percent of GDP in 2001 to 4.8 percent of GDP in 2002, while the primary surplus would rise from 1.1 percent to 2.4 percent of GDP. Over the three years of the program the primary balance would improve by 5.1 percentage points of GDP.

28. In drawing up the fiscal program, the authorities noted the greater uncertainty surrounding the global economy, particularly regarding access to the international financial

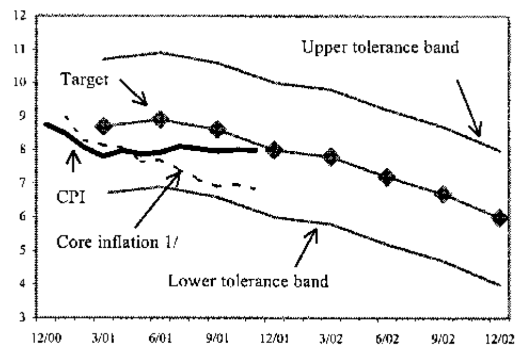
markets. In the event of adverse developments, they would adjust spending to achieve the quarterly fiscal targets of the program. If the external financing falls short of the target in the first half of 2002, low priority expenditure would be postponed, and the government would use most of its external portfolio before increasing the net use of domestic credit. This policy will be revisited at the time of the program review scheduled for September 15, 2002.

B. Inflation and Monetary Policy

29. The monetary framework based on inflation targeting that was adopted in late 2000 has been functioning well, and will be maintained in 2002. Fund staff will continue to be appraised of the central bank's assessment of the inflationary outlook and of any action taken to ensure that the inflation objectives are achieved. If inflation outcomes deviate by 2 percentage points or more from the quarterly targets, a review with the Fund would be triggered where discussions would focus on actions to be taken—if any—to ensure that inflation returns to the established path (Figure 17).

30. The authorities were confident that the inflation target of 6 percent for 2002 would be achieved, and noted that core inflation (CPI excluding foodstuffs) had been falling steadily since late 2000, and that achievement of the target would be facilitated by a slower-than-envisaged economic growth and expectations that inflation will continue to fall, as indicated by recent surveys. The authorities assured the staff that the interest rate reductions last year were consistent with the inflation target for 2002, but also underscored that the emergence of greater uncertainty about the economic environment called for close monitoring of developments and a prudent monetary policy stance.

Figure 17. Quarterly Inflation Targets
(In percent)



Sources: Banco de la República; and Fund staff estimates.
1/ CPI without foodstuffs.

31. The program for 2002 is based on a continued recovery in the growth of the broad monetary aggregates and a return to positive real growth of credit to the private sector. A recovery in credit was initiated—albeit modestly—in the last half of 2001, and the program provides for an acceleration in 2002. Credit demand is expected to increase, and the reduction in domestic financing of the public sector, together with the strengthening of banks' balance sheets, would provide for increased lending to the private sector.

C. Financial Sector Restructuring

32. While the financial system has continued to recover from the difficulties of 1998–99, the authorities are taking steps to strengthen the system further in 2002, mainly by implementing the restructuring program for mortgage banks. In addition, the efforts to bring prudential standards to international levels are continuing and a closed-bank resolution

strategy is being developed to minimize public costs and disturbances to the financial sector associated with the closing of problem banks.

33. The authorities indicated that they will continue to pursue the privatization or liquidation of all public banks, except Banco Agrario. Progress toward this objective was delayed by legal and administrative obstacles in 2001. Of the five public banks that had been slated for sale or liquidation, two were liquidated in 2000 and one is being brought to the point of sale by the end of 2001. The authorities intend to invite bids for one bank by mid-2002 while also taking action to prepare the sale or divestment of the other two.

D. Structural Issues and the Structural Reform Program[5]

34. As summarized above, most of the structural measures that had been delayed from March and June 2001 have since been implemented. Recently, the structural reform program has focused on the following:

- The reform of the Social Security Institute's (ISS) health service was initiated in July 2001 with the restructuring of its debts to health service providers. It continued in November, when the collective bargaining agreement with health workers was renegotiated and the ban on increasing the number of affiliates in the ISS health plan was lifted. The final step of the reform was adopted in December 2001 through the issuance of new regulations for the financing of high-cost medical treatments. These measures would provide fiscal savings of about 0.2 percent of GDP per year.

- In December 2001, the government presented to congress a proposal for a second-generation reform of the general pension system in Colombia. The proposal is designed to reduce the system's actuarial deficit from 206 percent of GDP to 159 percent of GDP, and improve its medium-term cash flow (to 2010) by 0.2 percent of GDP per year. In the discussions, the staff noted that while the proposed reform would serve to reduce the actuarial deficit, it would still remain high, and the cash deficit would continue to widen over the medium term during the transition to the new system. The authorities recognize this, but expect that additional fiscal savings and a further reduction in the actuarial deficit will result from a reform of the special (privileged) pension regimes that will be made public in April 2002, after a group of experts provides recommendations for such a reform. (A summary of Colombia's pension system and the government's reform proposal is provided in Appendix VI.)

- Legislation was passed in December 2001 to strengthen the control over the use of resources transferred to territorial governments under the recently revised revenue sharing system. To achieve this, the reform clarifies the responsibilities of

[5] A summary of structural conditionality appears in Appendix V.

departments and municipalities for the provision of education and health services, and the government will introduce standards for reporting and close monitoring of the provision of these services. This reform would not generate fiscal savings, but it is expected that the associated efficiency gains will provide for better quality and wider coverage in the provision of education and health services (mainly for the poor).

- Colombia's labor market lacks much of the flexibility needed to help address the rise in unemployment that has taken place in recent years. This inflexibility and the high payroll taxes also have contributed to a shift in employment towards the informal sector, which now accounts for more than 50 percent of the employed labor force. In an effort to deal with these problems, congress—with the support of the government—took the initiative in October 2001 to begin considering a labor market reform (Box 2).

Box 2. Unemployment and Labor Market Reform

Among the factors that contribute to the elevated unemployment rate in Colombia are high payroll taxes, a high minimum wage, and inflexible working arrangements.[1]

- Payroll taxes, currently 45 percent of wages, tend to drive a significant wedge between the cost of labor and the take-home pay, reduce labor demand, and push workers into the informal sector. These taxes provide funding, not only for pensions and health services, but also for social programs, training, and separation benefits. The National Planning Department estimates that for each percentage point increase in payroll taxes, the supply of jobs is reduced by around 0.3 percent, corresponding to nearly 50,000 jobs in the current labor market.[2]

- The legal minimum wage has increased sharply in real terms in the past several years, as inflation has decelerated while nominal increases have been based on past inflation. The high minimum wage has made it difficult to obtain jobs for less skilled labor market participants, and has tended to promote informal employment, which account for more than 50 percent of the employed labor force.

- Labor market regulations make it difficult to contract employees for part-time work or on an hourly basis. In addition, the definition of "regular" working hours is quite restrictive, and compensation for work outside the regular hours is generous, imposing high costs on businesses that operate outside the regular hours, particularly in the services sector.

Following lengthy public discussions in Colombia, a proposal for labor market reform is currently before congress. The proposal, which is supported by the government, calls for reducing payroll taxes by 3 percentage points; permitting wages below the legal minimum in the early stage of apprenticeship contracts; and reducing the cost of dismissing workers with long tenure.[3] The proposal also seeks to introduce a variety of alternative working arrangements, including hourly contracts, and clarifies the rules that define compensation for work outside the regular hours. It is expected that these measures will help reduce the cost of labor; facilitate the entry of new participants into the job market; eliminate certain distortions that impede the efficient functioning of the labor market; and promote employment in the formal sector.

[1] See analysis in the March 2001 "Selected Issues and Statistical Appendix," SM/01/92.
[2] At present, payroll taxes in Colombia are (as percent of the payroll): (i) pension contributions, 13.5 percent; (ii) health insurance, 12 percent; (iii) separation fund contributions, 8.3 percent; (iv) accident insurance, 2.5 percent; (v) training, 2 percent; and (vi) family welfare and other allowances, 7 percent. Total: 45.3 percent (36.2 percent paid by the employer and 9.1 percent paid by the employee).

[3] The higher cost that comes with tenure has created an incentive to dismiss first those workers who have not attained substantial seniority.

E. External Policies

35. Much of the projected increase in the external current account deficit to 3.2 percent of GDP in 2002 reflects a reduction in the export price of petroleum.[6] Nontraditional exports are expected to continue growing as Colombia has been increasing its market share in several product lines over the past few years, supported by the sharp real depreciation of the peso since 1997 (see Figure 4).

36. The net capital inflow would increase somewhat in 2002, as the public sector draws on the external portfolio that was built up in 2001. A positive net inflow of private capital is also projected, as direct investment would continue its moderate increase. The central bank's net international reserves would rise by about US$320 million, a level that can be achieved through interest earnings on reserves.

37. At the end of 2001, Colombia's external debt is estimated to be 46.4 percent of GDP, and it would decline to 45.8 percent of GDP at the end of 2002 due to an anticipated net repayment of private debt (Table 8). While still moderate, this external debt ratio is somewhat higher than the 44.3 percent of GDP that was envisaged when the three-year program was drawn up in 1999, mainly because of lower than envisaged proceeds from privatization, as companies in the electricity sector were not sold in 2000 and 2001 as planned due to sabotage against installations.

38. Colombia's external vulnerability indicators present a relatively favorable picture (Table 9). Barring a major shock, the net international reserves are expected to remain at a comfortable level in 2002, covering more than 100 percent of short-term debt by remaining maturity and 40 percent of broad money. Under circumstances where access to international financial markets were to become difficult, the public sector would remain fully financed through the first three quarters of 2002, using its external portfolio and projected disbursements from multilateral institutions. The program for 2002 assumes a net repayment of private external debt. Nevertheless, a complete closure of the markets in the first half of 2002 would open up a small financing gap in the balance of payments corresponding to the private sector that could put pressure on the exchange rate and trigger sales of reserves under the central bank's auction system.

39. Colombia continues to maintain an open trade regime with a rank of 2 on the Fund's index of trade restrictiveness, which has a scale of 1 through 10. Safeguard measures in the form of tariffs and quantitative import restrictions have been imposed on a limited number of

[6] The trend is for a decline in the volume of oil exports over the next few years as existing fields mature. An accelerated exploration program in response to more attractive contracting terms for oil companies is expected to boost production in the second half of the decade.

items since the end of 2000. In the discussions, the authorities explained that the import restrictions were temporary and would be removed by 2003. The subsidy components of the Plan Vallejo (mainly on imports of machinery used in export industries) and the free trade zones have been notified to and will be removed in agreement with the WTO. The authorities noted that Colombia continues to engage in discussions on a common external tariff among the Andean Community countries, which would involve a further simplification of the country's import tariffs. The staff welcomed the elimination of the customs service charge and the implicit VAT in 2001, and urged that the remaining import restrictions and subsidies be removed as soon as possible.[7]

IV. Medium-Term Outlook

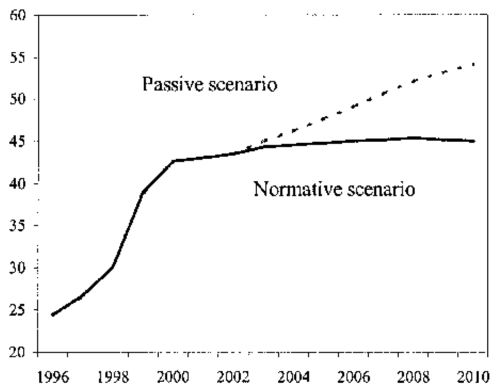
40. The staff discussed a medium-term scenario with the authorities, focusing on the public sector debt profile over the period to 2010. The scenario assumes a gradual increase in the rate of real GDP growth to 4 percent and a decline in inflation to around 4 percent. It also assumes that the structural reforms that have been adopted will be fully implemented, and that the general pension system will be changed along the lines of the government's proposal. The scenario further assumes that the fiscal consolidation effort is continued beyond the period of the EFF-supported program in order to avoid a significant rise in the public debt. The authorities expect that the forthcoming reform of the special pension regimes and the programs to strengthen the finances of the public sector will help in this regard. In addition, a high-level Public Revenue Commission set up last year will present recommendations to the new administration in August for additional measures to strengthen the public finances and help stabilize the debt. On this basis, after an initial widening due to several factors, including a further decline in oil production and capital spending on an oil refinery, the combined public sector deficit would be reduced to the range of 2.0–2.5 percent of GDP towards the end of the decade, helped by a rebound in oil production. This would stabilize the public debt at around 45 percent of GDP (Table 10, Figures 18 and 19). In the discussions the staff underscored the importance of continuing the fiscal adjustment process, noting that the public debt could otherwise rise by as much as 1 percentage point of GDP per year over the period to 2010 (see Figures 18 and 19).

V. Other Issues

41. Colombia has maintained strong policies against money laundering since the early 1990s and has adopted legislation and norms consistent with the 40 recommendations suggested by the Financial Action Task Force. In the late 1990s a Financial Intelligence Unit

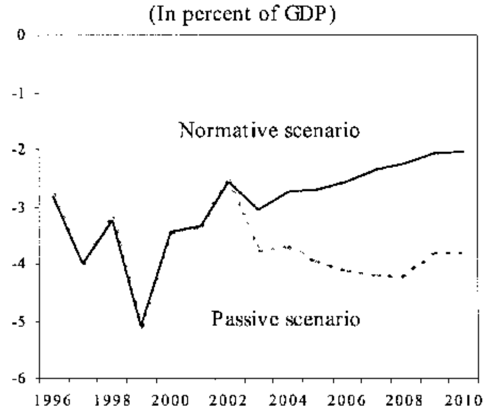
[7] Some domestic producers of VAT-exempt items pay VAT on their inputs, while importers of the same items pay no VAT; the "implicit" VAT was levied to offset the cost difference (based on elaborate calculations of the equivalent tax rates, item by item).

Figure 18. Medium-Term Total Public Debt, 1996-2010
(In percent of GDP)



Source: Fund staff estimates.

Figure 19. Medium-Term Combined Public Sector balance, 1996-2010
(In percent of GDP)



Source: Fund staff estimates.

was established with its main task to detect funds originating from narcotrafficking, arms trade, extortion, and corruption (Box 3).

Box 3. Money Laundering Control in Colombia

The legal framework to control money laundering dates from the early 1990s, when executive orders were issued that called for financial institutions to adopt "know-your-customer" policies and established procedures for monitoring and reporting selected cash or suspicious transactions. In 1995, congress expanded the criminalization of money laundering and, in 1996, the bank superintendency (*Superbancaria*) issued comprehensive regulations (Circular 007) on the policies and procedures for the control and prevention of money laundering. Finally, the criminal code, revised in 2000, again expanded the definition of money laundering for criminal prosecution.

Superbancaria notes that Colombia, while not formally belonging to the Financial Action Task Force (FATF), has adopted all the recommendations that pertain to the regulation and supervision of the financial system. Circular 007 is currently being reviewed with a view to strengthening further the policies and regulations on money laundering. In addition, Colombia has taken a leadership role in the South American Task Force on Money Laundering, which has taken the 40 recommendations of the FATF as its standard.

Regarding enforcement, the Financial Intelligence Unit (FIU) was significantly strengthened and granted increased autonomy by congress in 1999. The FIU collects, analyzes, and disseminates financial information to assist the Attorney General's Office in the prosecution of financial crimes. Its main function is to detect funds originating from the narcotics and arms trade, crimes against government institutions, illegal wealth acquisition, extortion, financial crimes, rebellion, and acquiescence to crime.

42. Under its current arrangement with the Fund, Colombia is subject to the transitional procedures governing safeguards assessments. These procedures require the Banco de la República (BR) to publish annual financial statements that are independently audited in accordance with internationally accepted standards.

43. The staff has reviewed the documentation provided by the BR in regard to its auditing procedures and noted that the BR's financial statements are not independently audited by auditors external to the central bank, using the criteria of International Standards on Auditing (ISA). The staff, therefore, has recommended that the authorities: (i) modify the audit mechanism in line with ISA; and (ii) publish the audit opinion together with the BR's annual financial statements. The authorities, in their letter dated December 20, 2001 to the Managing Director, have committed to these two steps beginning with the financial year 2002. The central bank's commitment to introducing an external audit will lend additional credibility to the existing audit mechanism, which has served the bank well.

VI. Performance Criteria, Purchases, and Reviews

44. As specified in the technical memorandum attached to the letter from the Colombian authorities (Appendix VII), the program will continue to be monitored by quarterly performance criteria on the overall deficit of the combined public sector; the net international reserves (NIR) of the central bank; the increase in medium- and long-term external public debt; the outstanding amount of short-term external debt of the public sector; the issuance of guarantees by the public sector for private external debt; and by reviews with the Fund if the 12-month inflation rate deviates significantly from its quarterly targets. A structural performance criterion related to pension reform has been added. Compliance with the program's structural benchmarks will be assessed under the fourth review, scheduled for September 15, 2002, at which time the quantitative performance criteria for end-September also will be set (see Table 6). Four purchases would be available in 2002, as set out in Appendix I.

VII. Staff Appraisal

45. Colombia has achieved considerable macroeconomic stabilization under its economic program. Inflation has been reduced, fiscal consolidation has advanced, and significant structural reforms have been implemented. As a result, confidence in Colombia's economic management has improved and the country enjoyed access to international financial markets throughout 2001.

46. The program presented by the authorities in 1999 set an ambitious three-year agenda of fiscal consolidation and structural reforms with a view to addressing the considerable economic imbalances that emerged during the 1990s and correcting a number of inefficiencies that had been allowed to develop. With full implementation of the program for 2002, the authorities will have come a long way toward achieving the objectives set out in 1999.

47. At the same time, domestic events and a deteriorating external environment have reduced the momentum of Colombia's recovery from the recession of 1998–99, and made the full achievement of some program objectives more difficult. Nevertheless, the authorities remain committed to the program and intend to continue the fiscal consolidation process and pursue their reform agenda through the electoral period ahead. The recent action to advance

on structural reforms attests to their determination, as evidenced by the progress, after some delay, with pension reform. The staff will encourage the authorities to make every effort to secure political support for the reform legislation currently before congress.

48. While the staff recognizes that the fiscal effort is not diminished by allowing the automatic stabilizers to work in the face of slower-than-projected economic growth in 2001 and 2002, it would caution that the resulting deficits will raise the public debt more than anticipated and add to the existing concerns over the medium-term outlook for the public debt. Hence the authorities should ensure that fiscal action is taken to maintain the control over the public debt dynamics. In this regard, the staff welcomes the appointment of the Public Revenue Commission to help map out the fiscal agenda over the medium term.

49. The staff welcomes the elimination of the customs service charge and the "implicit" value-added tax on some imports, as well as the presentation to congress of the territorial tax reform. The latter represents the final of three tax packages contemplated under the program, and the staff urges the authorities to mobilize the necessary support in congress for its passage.

50. The staff welcomes the progress that has been made in restructuring the financial system since the crisis in 1998–99, particularly the strengthening of prudential norms and the development of new instruments designed to avoid future problems and deal with them should they arise. Nevertheless, further improvements in loan quality may be more difficult to achieve in the uncertain economic environment that is now in prospect, and the authorities should continue their efforts to strengthen the system. The staff also will urge the authorities to move quickly to privatize or liquidate the remaining public banks.

51. The central bank reduced its interest rates in 2001, consistent with its inflation objectives and in parallel with a lowering of rates in major foreign markets. Longer-term rates also have come down, and the yield-curve for domestic public debt has flattened. While these developments augur well for the recovery, the staff would advise the authorities to continue to monitor developments carefully and act cautiously on interest rate policy, given the uncertainty surrounding the global economic outlook.

52. The staff underscores the need to strengthen the pension reform by elaborating and implementing a reform plan for the special pension regimes. As regards other structural reforms, the staff welcomes the efforts that have been made to strengthen the finances of the Social Security Institute's health service and the downsizing of the public sector that is being achieved—mainly at the territorial government level.

53. The staff welcomes the initiative under way to enact a labor market reform. Such reform should seek to make the labor market more flexible and reduce the payroll taxes in an effort to promote job creation in the formal sector, thereby also lending support to the fiscal consolidation process. The latter can be achieved through a restructuring of certain programs

not related to health and pensions that currently absorb more than one-third of the payroll taxes.

54. 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 the time of the next review, as agreed under the program. Since these practices were not introduced for balance of payments reasons, the staff does not recommend their approval.

55. Despite the adverse domestic security situation and the more difficult external environment, Colombia's three-year program is being implemented about as envisaged, with an appropriate focus on fiscal adjustment and structural reform. The authorities are taking courageous steps to face the challenges posed by the financial deterioration of the public pension and health systems, and the rise in unemployment, and they have taken initiatives to chart the course for further improvements in the public finances over the medium term.

56. In view of the strong program presented by the authorities for 2002, the staff supports their request for a waiver of the excess over the end-June 2001 ceiling on the fiscal deficit; for making available in 2002 the purchases corresponding to the performance dates of September and December 2001 for which performance criteria were not set; and for changing the fourth program review from February 15, 2002 to September 15, 2002. On this basis, the staff recommends completion of the third review under the extended arrangement.

Table 1. Colombia: Performance Criteria 1/

	2001			2002			
			Indic. 2/			Indicative	
	Mar. 31	Jun. 30	Dec. 31	Mar. 31	Jun. 30	Sept. 30 3/	Dec. 31
	Cumulative flows from beginning of calendar year (In billions of Colombian pesos)						
Overall balance of the combined public sector							
Floor	-1,000	-2,600	-6,550	-950	-2,100	-2,700	-5,356
Outcome	-1,008	-2,614	...	...	...	...	...
Margin or deviation (-)	-8	-14	...	...	...	...	...
	Inflation rate (12-month inflation rate)						
Inflation target							
Ceiling	8.7	8.9	8.0	7.8	7.2	6.7	6.0
Outcome	7.8	7.9	...	...	...	...	...
Margin or deviation (-)	0.9	1.0	...	...	...	...	...
	(In millions of U.S. dollars)						
Net international reserves of the Banco de la Republica							
Target	8,900	8,980	9,500	9,580	9,660	9,740	9,823
Outcome	9,077	9,203	...	...	...	...	...
Margin or deviation (-)	177	223	...	...	...	...	...
	Cumulative net disbursement from beginning of calendar year (In millions of U.S. dollars)						
Net disbursement of medium- and long-term external debt by the public sector							
Ceiling	460	1,210	2,680	1,100	1,800	2,400	2,573
Outcome	437	725	...	...	...	...	...
Margin or deviation (-)	23	485	...	...	...	...	...
Change in the outstanding stock of short-term external debt of the public sector							
Ceiling	80	80	180	180	180	80	80
Outcome	0	80	...	...	...	...	...
Margin or deviation (-)	80	0	...	...	...	...	...

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.
2/ Indicative as revised in the context of the present review. Performance criteria for September and December 2001 were not established under the third review because of the delay in the review process.
3/ Last date for testing quarterly performance criteria (to be set at the time of the review scheduled for September 15, 2002).

Table 2. Colombia: Selected Economic and Financial Indicators

	1997	1998	1999 Prog.	1999 Prel.	2000 Prog.	2000 Prel.	2001 Prog.	2001 Est.	Proj. 2002
(Percentage changes, unless otherwise indicated)									
National income and prices									
Real GDP	3.4	0.6	-3.5	-4.1	3.0	2.8	3.8	1.8-2.0	2.5-3.0
GDP deflator	16.8	15.2	11.6	10.2	11.5	10.7	9.0	8.8	7.8
Consumer prices (average)	18.5	18.7	11.3	10.9	11.2	9.2	8.8	8.0	7.6
Consumer prices (end of period)	17.7	16.7	11.0	9.2	10.0	8.8	8.0	8.0	6.0
External sector (on the basis of U.S. dollars)									
Exports (f.o.b.)	10.0	-4.8	8.9	4.8	9.2	13.2	-2.0	-6.0	2.1
Imports (f.o.b.)	12.6	-5.3	-29.8	-26.3	20.2	8.1	7.7	12.0	5.1
Export volume	6.2	7.7	5.1	0.8	6.0	1.1	3.5	-0.6	8.4
Import volume	16.7	-0.4	-28.9	-25.0	18.4	1.7	6.1	15.8	5.1
Terms of trade (deterioration -)	7.3	-7.1	5.0	5.9	1.5	5.5	-6.7	-2.2	-5.9
Nominal exchange rate to U.S. dollar 1/ (depreciation -)	-9.1	-20.0	...	-18.9	...	-15.8	...	...	...
Real effective exchange rate 2/ (depreciation -)	-5.1	-4.6	...	-9.4	...	-2.4	...	...	...
Central administration									
Revenue	27.9	9.8	9.2	8.1	20.7	25.3	26.6	23.2	9.7
Expenditure 3/	16.9	25.4	23.5	15.7	2.5	12.6	11.2	14.2	6.8
Money and credit 4/									
Broad money	24.5	17.6	12.8	8.4	18.2	1.3	19.2	6.5	7.7
Private sector credit 5/	25.6	11.9	5.9	2.9	16.7	1.2	10.8	5.5	7.4
Income velocity of money (ratio of M3 to GDP)	2.7	2.8	2.7	2.7	2.6	3.1	2.9	3.2	3.3
Interest rate (90-day time deposits; percent per year)									
Nominal	24.3	34.1	...	15.4	...	12.7	...	...	...
Real	5.6	14.9	...	5.6	...	3.3	...	...	...
Broad money (as ratio to net international reserves) 6/	3.6	3.8	3.5	3.5	3.3	2.9	3.1	2.6	2.5
(In percent of GDP)									
Central administration balance 3/	-3.4	-5.4	-7.3	-7.5	-5.1	-5.9	-4.3	-5.0	-4.2
NFPS savings 3/	5.6	4.0	2.7	2.9	4.4	4.6	5.1	4.4	4.8
Nonfinancial public sector balance 3/	-3.9	-4.6	-6.5	-6.5	-3.7	-3.6	-2.7	-3.4	-2.5
Combined public sector balance 3/	-3.9	-3.8	-6.0	-5.6	-3.6	-3.5	-2.9	-3.3	-2.6
Foreign financing	0.6	2.6	1.7	1.3	0.5	1.9	2.4	3.2	2.9
Domestic financing 7/	2.0	1.1	3.7	3.6	-0.5	1.3	0.6	0.1	-0.3
Privatization	1.3	0.1	0.7	0.7	3.7	0.3	-0.1	0.0	-0.1
Public debt 8/9/	26.7	29.9	34.5	38.2	34.4	42.4	41.7	43.0	43.5
Gross domestic investment	20.9	19.6	15.3	12.5	18.4	10.1	17.0	14.6	15.8
Gross national savings	15.4	14.3	14.0	12.7	16.0	10.5	15.2	12.0	12.6
Current account (deficit -)	-5.5	-5.3	-1.3	0.2	-2.4	0.4	-1.8	-2.6	-3.2
External debt 10/	31.6	36.3	41.1	42.5	43.1	44.1	41.6	46.4	45.8
Of which: Public sector 10/	16.1	19.4	23.3	24.3	24.8	25.9	26.2	28.4	29.3
Total short-term external debt to reserves	86.2	98.8	72.0	106.3	57.2	97.6	96.2	92.4	96.2
(In percent of exports of goods, services, and income)									
External debt service 10/	47.1	49.0	50.0	51.3	49.0	50.5	52.8	53.9	52.9
Of which: Public sector	24.0	23.2	22.6	23.3	21.1	22.2	28.0	29.2	31.8
Interest payments 10/	16.9	18.0	16.9	17.7	16.4	16.5	19.1	18.2	19.7
Of which: Public sector	8.4	8.6	8.9	8.9	9.3	9.3	11.0	10.9	12.6
(In millions of U.S. dollars)									
Overall balance of payments	277	-1,388	-750	-320	744	869	326	771	323
Gross official reserves 9/	9,908	8,740	8,215	8,103	8,847	9,006	9,332	9,639	9,962
Gross official reserves (in months of imports of goods and services)	5.9	6.6	5.8	5.5	5.4	5.5	5.5	5.6	5.7

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

1/ Annual average.

2/ Based on the Information Notice System; end of period.

3/ Includes floating debt defined as unpaid bills plus outstanding budgetary 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 quasi-fiscal balance of Banco de la Republica, sales of assets, phone licenses, and statistical discrepancy.

8/ Includes bonds issued to recapitalize financial institutions.

9/ Assuming no purchases under the current EFF arrangement.

10/ Includes short-term debt. Ratio to GDP calculated using average exchange rate.

Table 3. Colombia: Operations of the Combined Public Sector

(In percent of GDP)

	1997	1998	1999 Prog.	1999 Actual	2000 Prog.	2000 Actual	2001 Prog.	2001 Est.	2002 Prog. 1/	2002 Rev. Prog.
Total revenue	**27.4**	**26.8**	**28.1**	**27.8**	**28.6**	**28.9**	**29.8**	**29.5**	**29.3**	**29.1**
Current revenue	**27.4**	**26.8**	**28.1**	**27.8**	**28.6**	**28.9**	**29.8**	**29.5**	**29.3**	**29.1**
Tax revenue 2/	17.7	17.5	17.0	17.2	18.8	17.8	20.4	19.5	20.3	19.8
Nontax revenue	9.7	9.2	11.1	10.6	9.7	11.1	9.5	10.0	9.0	9.3
Property income	0.9	0.9	0.9	1.1	1.0	1.1	1.1	1.2	1.0	1.0
Operating surplus of public enterprises	3.5	3.3	4.1	4.0	3.9	4.3	4.1	4.4	4.0	4.0
Of which										
Ecopetrol	1.5	1.6	2.4	2.5	2.6	3.1	2.8	2.7	2.6	2.4
Other 3/	5.4	5.1	6.1	5.5	4.8	5.7	4.3	4.4	4.0	4.3
Total expenditure and net lending 2/	**31.4**	**30.8**	**34.6**	**33.8**	**32.3**	**32.5**	**32.5**	**33.0**	**31.2**	**31.7**
Current expenditure	**21.8**	**22.8**	**25.5**	**24.9**	**24.1**	**24.3**	**24.8**	**25.1**	**24.4**	**24.3**
Wages and salaries	6.7	7.0	7.8	7.8	7.3	7.4	7.6	7.5	7.3	7.3
Goods and services 4/	3.7	3.5	3.5	3.7	3.1	3.4	3.3	3.7	3.1	3.3
Interest	2.6	3.3	4.1	3.8	4.3	4.5	4.7	4.5	4.7	4.9
External	1.0	1.1	1.5	1.5	1.7	1.6	2.0	2.2	1.8	2.5
Domestic	1.6	2.2	2.6	2.4	2.7	2.9	2.7	2.3	2.9	2.4
Transfers to private sector	7.9	8.5	9.9	9.3	9.3	9.3	9.6	10.1	9.7	9.7
Of which										
From social security	3.9	5.0	6.0	5.6	6.0	5.7	6.2	6.5	6.3	6.3
Other 4/	1.0	0.4	0.1	0.2	0.0	-0.3	-0.4	-0.7	-0.5	-0.8
Capital expenditure	**9.6**	**7.9**	**8.9**	**8.8**	**8.2**	**8.1**	**7.7**	**7.8**	**6.9**	**7.4**
Fixed capital formation 5/	9.1	7.8	8.7	8.7	8.0	8.0	7.7	7.8	6.8	7.3
Transfers	0.4	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.0	0.1
Net lending	0.0	0.0	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Statistical discrepancy 6/	0.1	-0.6	0.0	-0.5	0.0	0.0	0.0	0.0	0.0	0.0
Nonfinancial public sector balance	**-3.9**	**-4.6**	**-6.5**	**-6.5**	**-3.7**	**-3.6**	**-2.7**	**-3.4**	**-1.9**	**-2.5**
Quasi-fiscal balance (BR cash profits)	-0.1	0.8	0.4	0.4	0.6	0.5	0.5	0.7	0.5	0.4
Fogafin balance	...	...	0.3	0.6	-0.2	0.0	0.1	0.1	0.1	0.1
Net cost of financial restructuring 7/	...	...	-0.2	0.0	-0.2	-0.4	-0.9	-0.7	-0.6	-0.5
Overall balance	**-3.9**	**-3.8**	**-6.0**	**-5.6**	**-3.6**	**-3.5**	**-2.9**	**-3.3**	**-1.9**	**-2.6**
Overall financing	**3.9**	**3.8**	**6.0**	**5.6**	**3.6**	**3.5**	**2.9**	**3.3**	**-1.9**	**2.6**
Foreign, net	0.6	2.6	1.7	1.3	0.5	1.9	2.4	3.2	2.3	2.9
Of which										
Changes in assets held abroad (- increase)	-0.6	0.1	-0.7	-0.9	-1.3	0.0	0.4	-1.1	-0.8	1.6
Domestic, net	2.0	1.1	3.7	3.6	-0.5	1.3	0.6	0.1	-0.3	-0.3
Financial system and bonds	0.1	-0.7	0.4	0.4	-0.2	-0.2	-0.1	0.1	-0.1	0.2
Other domestic financing, net 8/	1.9	1.9	3.2	3.2	-0.3	1.5	0.7	0.0	-0.2	-0.5
Privatization (including concessions) 9/	1.3	0.1	0.7	0.7	3.7	0.3	-0.1	0.0	-0.2	-0.1
Memorandum item:										
Nonfinancial public sector saving	5.6	4.0	2.7	2.9	4.4	4.6	5.1	4.4	5.0	4.8
Nonfinancial public sector primary balance	-1.3	-1.3	-2.4	-2.7	0.6	0.9	2.1	1.1	2.8	2.4
Nonfinancial public sector primary balance (exluding oil and social security balances)	-0.7	-0.8	-1.3	-2.2	0.8	1.1	3.4	3.1	4.5	4.1
Oil stabilization fund (deposits in FAEP)	0.0	0.1	0.5	0.4	0.6	1.0	0.1	0.3	0.0	0.0

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

1/ As established in the second program review, March 2001.

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

3/ Includes local fees, penalties, and oil stabilization fund.

4/ From year 2000 includes the unpaid bills of Instituto del Seguro Social.

5/ Includes change in the budget carryover of the central administration and in the unpaid bills of selected nonfinancial public enterprises. A negative number corrects for current cash payments of expenditures incurred in previous periods.

6/ Includes residual differences between items above and below the line.

7/ Transfer to Caja Agraria in 1999, interest payments on public banks restructuring bonds and mortgage debt relief related costs.

8/ Includes accrual adjustments and floating debt of selected nonfinancial public enterprises and of the *Instituto del Seguro Social.*

9/ Includes nonrecurrent fees from telecommunications licensing.

Table 4. Colombia: Operations of the Central Administration

(In percent of GDP)

	1997	1998	1999 Prog.	1999 Actual	2000 Prog.	2000 Actual	2001 Prog.	2001 Est.	2002 Prog. 1/	2002 Rev. Prog.
Total revenue	**12.6**	**11.9**	**12.3**	**12.2**	**13.0**	**13.4**	**15.3**	**14.9**	**15.0**	**14.8**
Current revenue	**12.6**	**11.9**	**12.3**	**12.2**	**13.0**	**13.4**	**15.3**	**14.9**	**15.0**	**14.8**
Tax revenue 2/	10.8	10.5	10.4	10.2	11.4	11.6	13.7	13.3	13.5	13.3
Net income tax and profits	4.4	4.3	4.4	4.3	4.1	4.4	5.5	5.5	5.3	5.6
Goods and services	5.3	5.0	5.1	4.9	5.4	5.5	6.1	5.7	6.1	5.7
Value-added tax	4.8	4.5	4.5	4.5	4.8	5.0	5.4	5.1	5.5	5.1
Gasoline tax	0.5	0.5	0.5	0.5	0.6	0.5	0.7	0.6	0.5	0.5
International trade	1.0	1.2	0.9	0.9	1.3	1.0	1.2	1.2	1.3	1.2
Financial transaction tax	0.0	0.0	0.0	0.0	0.6	0.6	0.8	0.7	0.8	0.7
Stamp and other taxes	0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0
Nontax revenue and transfers	1.8	1.4	2.0	2.0	1.6	1.9	1.6	1.7	1.5	1.5
Property income	0.3	0.3	0.2	0.3	0.3	0.5	0.4	0.5	0.4	0.4
Other	1.5	1.1	1.7	1.7	1.3	1.4	1.2	1.2	1.1	1.0
Total expenditure and net lending	**16.0**	**17.3**	**19.6**	**19.7**	**18.2**	**19.4**	**19.6**	**20.0**	**18.9**	**18.8**
Current expenditure	**12.2**	**13.9**	**15.5**	**15.3**	**14.9**	**15.7**	**16.1**	**16.3**	**15.8**	**16.5**
Wages and salaries	2.5	2.7	3.0	2.9	2.8	2.9	3.1	2.9	3.0	2.8
Goods and services	1.6	1.4	1.3	1.4	1.2	1.3	1.3	1.5	1.3	1.2
Interest	1.2	1.9	2.4	2.1	2.8	3.1	3.3	3.1	3.3	3.6
External	0.6	0.7	1.0	1.0	1.2	1.3	1.7	1.6	1.6	1.9
Domestic	0.6	1.2	1.4	1.1	1.6	1.8	1.7	1.5	1.7	1.7
Other expenditure 3/	0.1	0.4	0.1	0.2	0.0	-0.1	-0.4	-0.7	-0.5	-0.8
Current transfers 4/	6.8	7.5	8.7	8.6	8.2	8.5	8.8	9.5	8.6	9.7
Capital expenditure	**3.7**	**3.2**	**3.5**	**3.9**	**3.0**	**3.1**	**3.1**	**3.0**	**2.8**	**2.1**
Fixed capital formation 3/	1.5	1.1	1.2	1.6	0.9	1.0	1.0	1.2	0.9	0.9
Capital transfers	2.2	2.0	2.4	2.3	2.1	2.1	2.1	1.9	1.8	1.1
Net lending	**0.2**	**0.2**	**0.5**	**0.5**	**0.2**	**0.5**	**0.4**	**0.7**	**0.3**	**0.4**
Overall balance	**-3.4**	**-5.4**	**-7.3**	**-7.5**	**-5.1**	**-5.9**	**-4.3**	**-5.0**	**-3.9**	**-4.2**
Memorandum item:										
Transfers to local governments	4.0	4.3	4.8	5.1	4.5	4.8	5.0	4.9	4.8	5.4

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

1/ As established in the second program review, March 2001.

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

3/ Includes change in the budget carryover. A negative number corrects for current cash payments of expenditures incurred in previous periods.

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

Table 5. Colombia: Summary Accounts of the Financial System 1/

	1998	1999	2000	Est. 2001	Prog. 2002
(In millions of Colombian pesos)					
I. Central Bank					
International reserves (net)	**17,548**	**16,633**	**18,040**	**19,680**	**20,342**
(in millions of U.S. dollars)	8,560	8,113	8,800	9,600	9,923
Net domestic assets	**-10,639**	**-6,893**	**-7,330**	**-8,320**	**-7,641**
Credit to the NFPS	741	2,191	2,401	2,454	1,602
Central government	742	2,191	2,402	2,455	1,603
Rest of public sector	0	-1	-1	-1	-1
Credit to Fogafin	-7	-26	484	35	35
Credit to the financial system	-469	-1,078	-1,956	-3,268	-4,147
Net credit to the private sector	982	1,122	1,193	1,113	1,113
Quasi-fiscal deficit	-469	-1,078	-1,956	-3,268	-4,147
Medium-term external liabilities	-277	-246	-202	-187	-163
Capital and other assets	-12,915	-11,842	-11,137	-9,351	-7,927
Monetary base	**6,910**	**9,740**	**10,710**	**11,360**	**12,701**
II. Financial System					
International reserves (net)	**11,690**	**15,473**	**17,213**	**18,897**	**19,650**
Domestic assets	**38,504**	**38,872**	**37,861**	**39,751**	**43,493**
Credit to the NFPS (net)	6,103	6,826	8,400	6,675	6,538
Central government	2,466	3,994	6,017	5,667	5,659
Rest of public sector	3,637	2,833	2,383	1,008	879
Credit to Fogafin	19	3,956	4,977	5,355	4,964
Net credit to the private sector	53,527	50,572	45,870	47,720	52,019
Official capital and other assets (net)	-21,145	-22,482	-21,386	-19,999	-20,028
Liabilities to the private sector	**50,193**	**54,345**	**55,074**	**58,648**	**63,143**
Broad money (M3)	50,019	54,213	54,923	58,518	63,005
Money (M1)	8,980	11,483	14,712	14,110	15,624
Currency in circulation	4,566	6,004	7,317	7,901	9,005
Demand deposits	4,414	5,479	7,395	6,209	6,619
Quasi-money and other	35,236	38,562	37,357	41,693	44,483
Bonds	5,803	4,168	2,854	2,716	2,897
Other liabilities	174	133	151	130	138
(Annual changes, as percent of liabilities to private sector at beginning of period)					
International reserves (net)	-3.1	7.5	3.2	3.1	1.3
Domestic assets (net)	20.1	0.7	-1.9	3.4	6.4
Credit to the public sector	8.9	1.4	2.9	-3.1	-0.2
Credit to the private sector	11.1	-5.9	-8.7	3.4	7.3
(Annual percentage changes)					
Credit to the private sector	9.8	-5.5	-9.3	4.0	9.0
Broad money (M3)	17.6	8.4	1.3	6.5	7.7
M1	26.4	27.9	28.1	-4.1	10.7
Currency in circulation	39.2	31.5	21.9	8.0	14.0
Demand deposits	15.4	24.1	35.0	-16.0	6.6
Quasi-money	21.3	9.4	-3.1	11.6	6.7
(In percent of GDP)					
Domestic credit	42.3	41.2	34.9	31.7	30.4
Credit to the public sector	4.3	4.6	4.9	3.5	3.1
Credit to the private sector	38.0	33.9	27.0	25.3	24.9
Broad money	35.5	36.4	32.4	31.1	30.1
Monetary base	4.9	6.5	6.3	6.0	6.1
Memorandum items:					
Private sector financial portfolio 2/	...	13.7	4.3	8.0	7.7
Velocity of money (M1)	15.7	13.0	11.5	13.3	13.4
Velocity of money (M3)	2.8	2.7	3.1	3.2	3.3
Annual growth of adjusted credit to the private sector 3/	...	2.9	1.2	5.5	7.4

Source: Banco de la Republica.

1/ Valued at constant exchange rates.

2/ Annual growth of financial institutions' liabilities to the private sector, equity investments in financial institutions, and purchases of government securities by the private nonfinancial sector.

3/ Figures adjusted for loan write-offs resulting from the mortgage debt reduction and bank restructuring programs in 1999 and 2000.

Table 6. Colombia: Performance Criterion and Structural Benchmarks Under the Program

	Performance Criterion	Status
By April 15, 2002	The government will make public reform plans for the special pension regimes (exceptuados, not under collective bargaining agreements) that will reduce the actuarial deficit of these regimes taken as a whole in a proportion similar to that proposed by the government for the general regime, and raise additional cash savings.	
	Benchmarks	
By December 31, 1999	Present to congress a proposal for a second generation pension 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. 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. 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 pension 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).	Done. Presented to congress in September 2001.

Table 6. Colombia: Performance Criterion and Structural Benchmarks Under the Program

	Present to congress for last reading a constitutional reform which delinks transfers to territorial governments from current income of the central government.	Done. Congress approved the reform in June 2001, with changes taking effect in January 2002.
	Government ministries to present to cabinet their plans for restructuring/downsizing of the ministries and their dependent entities.	Replaced by Law 617 and DAF programs.
	Design a legal framework for CISA (asset management company) to facilitate sale of foreclosed assets.	Done. Legislation introduced in congress in October 2001.
By June 30, 2001	Put into effect a reform of the health system under the social security institute.	Initiated in June and expected to be completed in December 2001.
	Present to congress a proposal for a second generation pension reform (modifying Law 100 of 1993).	Postponed to December 2001.
	Revise investment norms applicable to private pension funds to help stimulate the development of longer term capital markets.	Done.
	Introduce legislation (revision of Law 60 regarding public education and health) to strengthen control over the public finances and resource allocation.	Done. Law approved in December 2001.
	Approve regulatory framework for mortgage-backed securities.	Done.
	Develop framework to facilitate the purchase and assumption of assets and liabilities of financial institutions.	Done.
By September 30, 2001	Present to congress a draft fiscal responsibility law.	Postponed to June 2002.
By December 31, 2001	Full disinvestment of all remaining public banks, excluding Banco Agrario.	Postponed/Revised; see below.
	Bring to the point of sale at least one public bank.	
	Present to congress a proposal for a second generation pension reform (modifying Law 100 of 1993).	Done.
	Final decision on the remaining elements in the plan to reduce the deficit of the health system under the social security institute.	Done.
By June 30, 2002	Final report of the Public Revenue commission.	Postponed to September 2002.
	Introduce reform of special (privileged) pension regimes, if required by presenting legislation to congress.	
	Invite bids for the sale of at least one public bank.	
	Submit all legal issues to permit decisions by courts or tribunals with a view to liquidating or divesting all remaining public banks except Banco Agrario, and bring those that are to be divested to the point of sale.	

Table 6. Colombia: Performance Criterion and Structural Benchmarks Under the Program

	Present to congress a draft fiscal responsibility law.
By program review scheduled for September 15, 2002	Complete the 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.
	Final report of the Public Revenue commission to be made public.

Table 7. Colombia: Summary Balance of Payments

	1997	1998	1999	2000	2001 Prog.	2001 Est.	Proj. 2002
	(In millions of U.S. dollars)						
Current account balance	**-5,867**	**-5,235**	**190**	**305**	**-1,604**	**-2,117**	**-2,722**
Trade balance	-2,638	-2,450	1,768	2,531	1,463	389	16
Exports, f.o.b.	12,065	11,480	12,030	13,620	13,507	12,807	13,069
Coffee	2,259	1,893	1,324	1,069	1,119	819	810
Petroleum products	2,707	2,329	3,757	4,569	3,797	3,190	2,792
Nontraditional	5,197	5,420	5,279	6,200	6,796	6,696	7,147
Other	1,901	1,838	1,670	1,782	1,795	2,101	2,319
Imports, f.o.b.	14,703	13,930	10,262	11,090	12,043	12,418	13,053
Services (net)	-1,518	-1,471	-1,269	-1,237	-1,149	-1,413	-1,427
Income (net)	-2,325	-1,760	-1,649	-2,577	-2,779	-3,144	-3,409
Interest (net)	-1,728	-1,763	-1,889	-1,933	-2,127	-2,145	-2,527
Of which							
Public sector	-597	-631	-808	-928	-1,204	-1,192	-1,580
Other Income (net)	-597	3	241	-644	-652	-999	-882
Current transfers (net)	614	446	1,340	1,589	861	2,051	2,097
Capital and financial account balance	**7,034**	**3,503**	**-108**	**638**	**1,929**	**2,888**	**3,045**
Financial account balance	7,034	3,503	-108	638	1,929	2,888	3,045
Public sector (net)	500	1,445	973	677	1,963	2,217	2,496
Nonfinancial public sector	808	1,780	1,301	1,488	2,056	2,661	2,511
Medium- and long-term (net)	1,268	1,994	1,976	1,697	1,640	3,478	1,141
Disbursements	2,955	3,594	3,721	3,287	4,017	5,774	4,004
Amortization	1,687	1,601	1,746	1,590	2,377	2,296	2,863
Other long-term flows	-23	-15	0	0	0	0	0
Short term 1/	-436	-200	-675	-210	416	-817	1,370
Financial public sector	-308	-334	-328	-811	-93	-444	-15
Private sector (net)	6,533	2,058	-1,081	-40	-33	671	550
Nonfinancial private sector (net)	5,860	2,805	45	344	-127	939	630
Direct investment	4,830	2,033	1,353	2,051	1,002	1,815	2,010
Of which							
Privatization	2,989	511	0	465	80	0	0
Leasing finance	257	266	77	-234	-27	-127	110
Long-term loans	1,524	285	-270	-421	-1,051	77	-857
Short term 2/	-751	222	-1,114	-1,052	-51	-827	-633
Financial private sector (net)	673	-748	-1,126	-384	94	-267	-80
Net errors and omissions	**-890**	**344**	**-403**	**-74**	**0**	**0**	**0**
Changes in net international reserves	**277**	**-1,388**	**-320**	**869**	**326**	**771**	**323**
	(In percent of GDP)						
Current account balance	-5.5	-5.3	0.2	0.4	-1.8	-2.6	-3.2
(In months of imports of goods and services)							
Gross international reserves 3/	5.9	6.6	5.5	5.5	5.5	5.6	5.7

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 and private short term asset movements.

3/ Not including Fund purchases under the current EFF arrangement.

Table 8. Colombia: External Debt and Debt-Service

	1997	1998	1999	Prel. 2000	Est. 2001	Proj. 2002
	(In millions of U.S. dollars)					
Total debt outstanding	**33,700**	**35,867**	**36,010**	**35,851**	**38,176**	**39,081**
Medium and long term 1/	29,586	32,169	33,023	32,601	34,485	35,328
Short term	4,114	3,697	2,987	3,250	3,690	3,753
Public sector debt outstanding	**17,143**	**19,198**	**20,577**	**21,023**	**23,337**	**24,963**
Medium- and long-term 1/	16,207	18,222	19,907	20,824	23,000	24,706
Short term	936	976	670	199	337	257
Private sector debt outstanding	**16,556**	**16,668**	**15,433**	**14,828**	**14,839**	**14,118**
Medium and long term 1/	13,379	13,947	13,116	11,777	11,485	10,622
Short term	3,177	2,721	2,317	3,051	3,353	3,496
Leasing	**1,727**	**2,079**	**2,034**	**1,850**	**1,700**	**1,877**
Public sector	398	479	473	524	501	568
Private sector	1,329	1,600	1,560	1,326	1,199	1,309
Total debt service	**7,101**	**7,004**	**7,537**	**8,349**	**8,371**	**8,323**
Public sector	3,620	3,323	3,418	3,675	4,531	5,003
Amortization	2,359	2,098	2,114	2,142	2,831	3,019
Interest	1,261	1,225	1,304	1,533	1,701	1,984
Private sector	3,482	3,681	4,119	4,675	3,840	3,320
Amortization	2,188	2,333	2,827	3,485	2,707	2,200
Interest	1,293	1,348	1,292	1,189	1,133	1,120
	(In percent of GDP)					
Total debt 2/	**31.6**	**36.3**	**42.5**	**44.1**	**46.4**	**45.8**
Public sector 2/	16.1	19.4	24.3	25.9	28.4	29.3
Private sector 2/	15.5	16.9	18.2	18.2	18.1	16.6
	(In percent of exports of goods, services, and income)					
Total debt stock	223.3	250.7	245.2	216.9	245.6	248.4
Total debt service	47.1	49.0	51.3	50.5	53.9	52.9
Public sector	24.0	23.2	23.3	22.2	29.2	31.8
Private sector	23.1	25.7	28.0	28.3	24.7	21.1
Interest	16.9	18.0	17.7	16.5	18.2	19.7
Public sector	8.4	8.6	8.9	9.3	10.9	12.6
Private sector	8.6	9.4	8.8	7.2	7.3	7.1
Amortization	30.1	31.0	33.6	34.0	35.6	33.2
Reserves to short-term external debt 3/	1.2	1.0	0.9	1.0	1.1	1.0

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

1/ Includes leasing.
2/ Ratio to GDP calculated using average exchange rate.
3/ Short-term debt by remaining maturity.

Table 9. Colombia: Indicators of External Vulnerability

(In percent of GDP, unless otherwise indicated)

					2001			
	1997	1998	1999	2000	Latest Obs.	Date of Obs.	Est.	Proj. 2002
Financial indicators								
Public sector debt (domestic and external) 1/	26.7	30.0	39.0	42.6	...	...	43.0	43.5
Broad money (percent change, 12-month basis)	24.5	17.5	8.4	1.3	4.6	Q2/01	6.5	7.7
Private sector credit (percent change, 12-month basis)	25.6	11.9	2.9	1.2	3.6	Q2/01	5.5	7.4
90-day time deposit rate	24.3	34.1	15.4	13.4	11.4	Oct-01	...	...
90-day time deposit rate (real)	5.6	14.9	5.7	4.7	3.4	Oct-01	...	...
External indicators								
Exports (percent change, 12-month basis in U.S. dollars)	10.0	-4.8	4.8	13.2	-3.2	Oct-01	-6.0	2.1
Imports (percent change, 12-month basis in U.S. dollars)	12.6	-5.3	-26.3	8.1	13.0	Oct-01	12.0	5.1
Terms of trade (percent change, 12-month basis)	7.3	-7.1	5.9	5.5	-2.3	Q3/01	-2.2	-5.9
Non-Oil terms of trade (percent change, 12-month basis)	12.7	0.3	-5.7	-9.8	-0.9	Q3/01	-0.6	-0.1
Current account balance	-5.5	-5.3	0.2	0.4	-1.1	Q3/01	-2.6	-3.2
Capital and financial account balance	6.6	3.5	-0.1	0.8	0.9	Q3/01	3.5	3.6
Of which								
Inward short-term portfolio investment (debt securities, etc.)	-0.2	0.4	-1.7	-1.2	-1.1	Q3/01	-1.7	0.3
Other investment (loans, trade credits, etc.)	-0.5	-0.6	-1.2	-0.8	-0.4	Q3/01	0.1	0.1
Inward foreign direct investment and long-term flows	7.3	3.8	2.7	2.8	2.4	Q3/01	5.1	3.1
Gross official reserves (billions of U.S. dollars) 1/	9.9	8.7	8.1	9.0	10.0	Nov-01	9.6	10.0
Central bank short-term foreign liabilities (millions of U.S. dollars)	-2.4	0.7	1.4	0.5	3.0	Nov-01	3.2	0.0
Short-term net foreign assets of the financial sector (billions of U.S. dollars)	6.1	5.5	6.2	8.4	8.7	Q2/01	9.2	9.6
Official reserves in months of imports of goods and services 2/	5.9	6.6	5.5	5.5	5.8	Nov-01	5.6	5.7
Broad money to reserves	3.6	3.8	3.5	2.9	2.6	Q2/01	2.6	2.5
Total short-term external debt to reserves 3/	86.2	98.8	106.3	97.6	88.7	Q2/01	92.4	96.2
Total external debt 4/	31.6	36.3	42.5	44.1	45.8	Q2/01	46.4	45.8
Of which								
Public sector debt 4/	16.1	19.4	24.3	25.9	27.5	Q2/01	28.4	29.3
Total external debt to exports of goods, services, and income	223.3	250.7	245.2	216.9	242.2	Q2/01	245.6	248.4
External interest payments to exports of goods, services, and income	16.9	18.0	17.7	16.5	17.9	Q2/01	18.2	19.7
External amortization payments to exports of goods, services, and income	30.1	31.0	33.6	34.0	36.4	Q2/01	35.6	33.2
Exchange rate (per U.S. dollar, period average)	1,141	1,426	1,756	2,088	2,300	Dec-01	...	...
Real effective exchange rate appreciation (+) (end of period) 5/	-5.1	-4.6	-9.4	-2.4	2.1	Sep-01	...	...
Financial market indicators								
Stock market index 6/	1,417	1,086	998	713	1,070	Dec-01	...	...
Foreign currency debt rating 7/	BBB-	BBB-	BB+	BB	BB	Dec-01	...	...
Spread of benchmark bonds (basis points, end of period) 8/	...		423	755	514	Dec-01	...	...

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

1/ Ratio calculated using end-of-period exchange rate.
2/ Not including purchases under the current EFF arrangement.
3/ Short-term debt is defined by its remaining maturity.
4/ Ratio calculated using average exchange rate.
5/ Source: INS.
6/ The index was changed in July 2001, so that the December 2001 number is not strictly comparable to earlier figures.
7/ Standard & Poors.
8/ J. P. Morgan Emerging Market Bond Index (EMBI+).

Table 10. Colombia: Medium-Term Normative Scenario, 2001-10

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
I. Output and Prices										
(Annual percentage changes)										
Real GDP	2.0	3.0	3.3	3.7	4.0	4.0	4.0	4.0	4.0	4.0
Consumer prices, end of period	8.0	6.0	5.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
(In percent of GDP, unless indicated otherwise)										
II. Saving and Investment										
Gross national saving	12.0	12.6	12.5	12.8	13.1	13.4	13.9	14.3	14.5	14.8
Private sector	9.5	9.3	9.6	9.5	9.7	9.8	10.1	10.4	10.4	10.7
Public sector	2.5	3.4	2.9	3.3	3.4	3.6	3.8	3.9	4.1	4.1
Gross domestic investment	14.6	15.8	16.0	16.2	16.4	16.6	16.8	17.0	17.2	17.4
Private sector	8.7	9.9	10.0	10.2	10.3	10.4	10.6	10.8	11.0	11.2
Public sector capital expenditure	5.9	5.9	6.0	6.0	6.1	6.2	6.2	6.2	6.2	6.2
External current account balance	-2.6	-3.2	-3.5	-3.4	-3.3	-3.2	-2.9	-2.7	-2.7	-2.6
Private sector	0.8	-0.6	-0.4	-0.7	-0.6	-0.6	-0.5	-0.5	-0.6	-0.6
Nonfinancial public sector	-3.3	-2.6	-3.0	-2.7	-2.7	-2.6	-2.4	-2.2	-2.1	-2.0
III. Nonfinancial and Consolidated Public Sector										
Nonfinancial public sector										
Revenue	29.6	29.1	28.6	28.6	28.7	28.7	28.7	29.0	29.4	29.8
Expenditure	32.9	31.7	31.7	31.3	31.4	31.2	31.0	31.3	31.5	31.8
Primary balance	1.1	2.4	2.0	1.2	1.3	1.1	1.2	1.2	1.3	1.2
Combined public sector balance	-3.3	-2.6	-3.0	-2.7	-2.7	-2.6	-2.4	-2.2	-2.1	-2.0
IV. Balance of Payments										
External current account balance	-2.6	-3.2	-3.5	-3.4	-3.3	-3.2	-2.9	-2.7	-2.7	-2.6
Capital and financial account balance	3.5	3.6	4.1	4.2	4.2	4.2	3.7	3.6	3.7	3.6
Public sector	2.7	2.9	2.5	2.1	2.3	2.3	2.3	2.3	1.8	1.9
Private sector	0.8	0.6	1.6	2.1	2.0	1.9	1.5	1.4	1.8	1.7
Overall balance	0.9	0.4	0.6	0.9	1.0	1.0	0.8	0.9	1.0	1.0
V. Debt										
Total external debt 1/	47.2	47.8	47.5	47.1	46.6	46.2	45.8	45.8	45.9	46.2
Public debt 1/	28.8	30.6	31.7	32.2	32.9	33.5	34.1	34.6	34.8	35.0
Private debt 1/	18.3	17.3	15.8	14.9	13.7	12.7	11.7	11.1	11.1	11.2
Total public debt 1/	43.0	43.5	44.2	44.4	44.8	45.0	45.1	45.1	45.1	45.0
Domestic debt 1/	14.2	12.9	12.5	12.2	11.9	11.5	11.1	10.5	10.3	10.0
External debt 1/	28.8	30.6	31.7	32.2	32.9	33.5	34.1	34.6	34.8	35.0

Sources: Colombian authorities; and Fund staff estimates.

1/ Ratio calculated using the end-of-period exchange rate.

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

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

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

		SDR Million	Percent Allocation
III.	**SDR Department:**		
	Net cumulative allocation	114.27	100.0
	Holdings	110.93	97.1

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. Safeguards Assessment:

Under the Fund's safeguards assessment policy, the Banco de la República is subject to the transitional procedures with respect to the extended arrangement approved in December 1999. The transitional procedures require a review of the Banco de la Republica's external audit mechanism. This review determines whether the Banco de la República publishes annual financial statements that are independently audited in accordance with internationally accepted standards.

The external audit assessment was completed on May 28, 2001, and concluded that the Banco de la República's current external audit mechanism may not be adequate in certain respects and appropriate recommendations have been made to the authorities.

VIII. 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 the band was again devalued by 9 percent, the width increased to 20 percent points, and the slope reduced from 13 percent to 10 percent per year. 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-December 2001, the exchange rate was Col$2,301.3 per U.S. dollar.

IX. Last Article IV consultation:

The 2001 Article IV consultation was concluded by the Executive Board on March 28, 2001. The second review under the Extended Arrangement was completed by the Executive Board on March 28, 2001.

X. FSAP participation:

A joint IMF-World Bank mission visited Colombia in April, June, and July 1999 to conduct an assessment of the vulnerabilities of the financial system and propose the implementation of relevant financial standards. The Executive Board discussed the Financial Sector Assessment Program (FSAP) report (FO/DIS/99/172) at the time of the approval of the Extended Fund Facility (December 20, 1999).

XI. Recent Technical Assistance:

Dept.	Purpose	Time of Delivery
MAE	Financial sector stability assessment (FSSA)	May 1999
STA	Advice on government finance statistics	August 1999
STA	Advice on banking statistics	October 1999
FAD	Advice on tax policy	November 1999
FAD	Advice on tax administration	December 1999
FAD	Follow-up on customs administration	February 2000
MAE	Advice on the deposit insurance system	March 2000

STA	Advice on national accounts statistics	March 2000
FAD	Advice on the measurement of the deficit of the nonfinancial public sector	May 2000
FAD	Follow-up on customs administration	June 2000
STA	Advice on money and banking statistics	September 2000
MAE	Advice on banking restructuring issues	September 2000
MAE	Advice on banking supervision and regulation	December 2000
STA	Advice on national accounts statistics	March 2001
FAD	Follow-up on customs administration	May 2001
STA	Regional visit on data template	September 2001

XII. Resident Representative: None.

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

Colombia: Schedule of Purchases Under the Extended Fund Facility 1999-2002 1/

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.
May 15, 2002	251.0	Observance of end-March 2002 performance criteria, and structural performance criterion.
September 15, 2002	251.0	Observance of end-June 2002 performance criteria and completion of fourth review.
November 15, 2002	251.0	Observance of end-September 2002 performance criteria.

1/ Performance criteria for end-September and end-December 2001 were not established and their related purchases have been rephased to 2002.

Colombia: Projected Payments to the Fund as of December 31, 2001
(Purchases under Obligation Scheduled)

(In millions of SDRs)

	Dec. 2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Beyond	Total
Obligations from existing drawings												
1. Principal												
a. Repurchases	0.0	0.0	0.0	0.0	0.0	0.0	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	0.0	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	0.0	0.0	0.0	0.0	0.0	0.0
b. on use of SDRs	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.0	1.9
Total obligations	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.0	1.9
(percent of quota)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.2
Obligations from prospective drawings												
1. Principal 2/												
a. Repurchases	0.0	0.0	0.0	0.0	200.7	401.3	401.3	200.7	0.0	0.0	0.0	1204.0
b. PRGF/SAF repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Charges and interest 1/												
a. on Fund credit	30.8	33.0	33.0	33.0	31.6	21.9	10.9	1.4	0.0	0.0	0.0	195.6
b. on use of SDRs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total obligations	30.8	33.0	33.0	33.0	232.3	423.2	412.2	202.1	0.0	0.0	0.0	1399.6
(percent of quota)	4.0	4.3	4.3	4.3	30.0	54.7	53.3	26.1	0.0	0.0	0.0	180.9
Total obligations (existing and prospective)												
1. Principal												
a. Repurchases	0.0	0.0	0.0	0.0	200.7	401.3	401.3	200.7	0.0	0.0	0.0	1204.0
b. PRGF/SAF repayments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2. Charges and interest 1/												
a. on Fund credit	30.8	33.0	33.0	33.0	31.6	21.9	10.9	1.4	0.0	0.0	0.0	195.6
b. on use of SDRs	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.0	1.9
Total obligations	30.9	33.2	33.2	33.2	232.5	423.4	412.4	202.3	0.2	0.2	0.0	1401.5
(percent of quota)	4.0	4.3	4.3	4.3	30.0	54.7	53.3	26.1	0.0	0.0	0.0	181.1

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/ Projections are based on the assumption that the authorities would purchase SDR 1,204 million at end-January 2002, the amount that would be available after completing the third review.

COLOMBIA: RELATIONS WITH THE WORLD BANK GROUP

(As of November 30, 2001)

I. BACKGROUND

Between the 1997 and 1999 fiscal years of the World Bank[1], Colombia made average net repayments of US$80.6 million a year. Over the past two fiscal years (2000 and 2001) the Bank made average net disbursements to Colombia of US$115.8 million annually. The range of programs supported by bank lending 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

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

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 US$433 million on average for the fiscal years 1998–2001. Commitments in FY 2000 amounted to US$941 million, while in 2001 these totaled US$185.5 million. Recently approved loans (FY2000–FY2001) include Cartagena Water and Sewerage (US$85 million), Rural Education (US$20 million), Financial Sector Adjustment (US$506 million), Earthquake Reconstruction (US$225 million), Sierra Nevada Sustainable Development (US$5 million), Community Works and Employment Generation (US$100 million), Human Capital Protection (US$150 million), and Public Financial Management II (US$35.5 million) loans. A policy-based guarantee of a sovereign bond issue, using resources from the Financial Sector Adjustment Loan, was also approved in FY2001, and assisted the Government of Colombia in obtaining resource of about US$1 billion from international capital markets in April 2001. A fiscal structural adjustment loan is under preparation for FY 2002, and new loans in the areas of judicial reform, peace and development, social sector reform and in the water and education areas are also in the project pipeline.

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[1] World Bank fiscal years start July 1.

IV. Nonlending Services (NLS)

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 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 difficult economic situation. Other studies deal with regional trade integration, corruption, and emissions of greenhouse gases. In addition, several ongoing studies address issues in the rural sector, including rural finance, environmental and land issues, and topics in agro-ecology. A comprehensive analysis of the labor market is also underway.

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)

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

IFC commitments in Colombia have increased to US$168 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

Colombia became a full member of MIGA on November 30, 1995. As of September 30, 2001, MIGA's gross exposure in Colombia amounts to US$167 million, with three outstanding contracts in the following sectors: one in finance and two in infrastructure. During FY97-FY01, MIGA issued six contracts of guarantees for a total guaranteed amount of US$255 million covering five projects (two in the financial sector, two in infrastructure, and one in mining). The agency's latest guarantee was in FY01, for a US$100 million financial sector project supporting low-cost, medium-term financing to small and medium size enterprises.

Colombia: Financial Relations with the World Bank Group
(In millions of U.S. dollars)

	Commitments (Net of Cancellations)	Disbursements	Undisbursed Amounts
I. IBRD Operations (active, as of November 30, 2001)			
Loans fully disbursed 1/	**7566.7**	**7566.7**	**0.0**
Current operations	**1296.0**	**617.6**	**678.4**
Agricultural and rural development	61.0	41.5	19.5
Public sector management	48.0	7.6	40.4
Education	72.2	20.9	51.3
Population, health, and nutrition	250.0	4.0	246.0
Urban development	95.0	35.8	59.2
Water supply and sewerage	270.0	121.3	148.7
Power	260.3	258.8	1.5
Financial sector	9.5	6.3	3.2
Multi-sector	230.0	121.4	108.6
Total	**8862.7**	**8184.3**	**678.4**

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

	Loans	**Equity (+Quasi)**	**Partici-pation**	**Total**
Total commitments 1/	67.5	66.3	34.0	167.8
Total undisbursed	33.6	11.1	10.7	55.4

III. IBRD Loan Transactions, per fiscal year (July 1-June 30)

	1996	**1997**	**1998**	**1999**	**2000**	**2001**
Disbursements	192.8	152.0	172.2	237.5	471.0	263.8
Repayments	344.5	379.8	394.3	238.8	278.1	225.1
Net disbursements	-151.7	-227.8	-221.6	-1.4	192.8	38.8

Source: World Bank.

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

COLOMBIA: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of November 30, 2001)

I. BACKGROUND AND OBJECTIVES

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

As of November 30, 2001, the IDB is implementing 31 loans for an amount equivalent to US$2,071.7 millions. These loans include projects to support the private sector, technical assistance, and investment projects in the agricultural sector, transportation, water supply and sewerage, management of natural resources, and development of human capital.

COLOMBIA: FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK

(As of November 30, 2001)

I. IDB OPERATIONS

(In millions of U.S. dollars)

	Commitments	Disbursements	Undisbursed amounts
Agricultural and rural development	141.5	48.8	92.7
Public sector management	487.4	231.3	256.1
Education	26.0	3.4	22.6
Population, health and nutrition	640.9	328.2	312.7
Urban development	160.0	74.8	85.2
Water supply and sewerage	62.9	15.2	47.7
Natural resource management	146.0	107.0	39.0
Energy	307.0	246.5	60.5
Multi sector	100.0	89.2	10.8
Grand total	2,071.7	1,444.4	927.3

II. IDB LOAN TRANSACTIONS

(In millions of U.S. dollars)

	1996	1997	1998	1999	2000	2001*
Gross disbursement	262.7	271.6	412.9	952.4	241.2	887.8
Amortization	458.6	575	366.9	441.8	447.7	417.2
Net disbursements	-195.9	-303.4	46	510.6	-206.5	470.6

*Estimated.

COLOMBIA: STATISTICAL ISSUES

The data provided by the authorities to the Fund are generally adequate for surveillance; recent coordination among compiling agencies has 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

The National Department of Statistics (DANE) is responsible for the compilation of the national accounts, although the Banco de la República (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. In line with the recommendations of the March 2001 technical assistance mission, the DANE plans to start using 2000 as a base year. Substantial differences remain between national accounts statistics and corresponding items in external and particularly fiscal accounts, despite efforts directed at resolving these issues.

A new employment survey was introduced in January 2001. Compared with the old one, the new survey has greater frequency of observation and greater geographic coverage, and it changes the definitions of employment and unemployment to make them compatible with the ILO definitions.

Government finance statistics

In an effort to reconcile above-the-line data on revenue and expenditure with financing data, the authorities have prepared a new and more comprehensive methodology to monitor and report public finance data. In particular, data on the financing of the nonfinancial sector has become more complete and reliable, but a significant effort is required to improve the timeliness of fiscal information.

Additional improvements are needed to:

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

- improve monitoring of floating debts by extending the coverage, which at present is restricted to the central government and selected public enterprises.

- incorporate the recommendations of the 1999 STA technical assistance mission regarding coverage of the public sector, consolidation of central government by including extrabudgetary accounts, classification of financing by debt holder, and revision of the legal framework for compilation and dissemination of fiscal data.

Financial sector statistics

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, the need to promote inter-agency cooperation, implement procedures for ensuring consistency of the data, and define revision policies.

Balance of payments and external debt

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 the DANE and, as regards external debt, between the BR and public sector agencies; 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 December 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	12/26/01	12/26/01	12/26/01	06/31/01	6/31/01	12/28/01	Nov. 2001	Dec. 2001	Jun. 2001	Sep. 2001	Sep. 2001	Jun 2001
Date received	12/28/01	12/28/01	12/28/01	08/15/01	8/5/01	12/28/01	12/5/01	Dec. 2001	Sep. 2001	Nov. 2001	Dec. 2001	Sep. 2001
Frequency of data	Daily	Daily	Daily	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Quarterly
Frequency of reporting	Weekly	Weekly	Weekly	Quarterly	Quarterly	Weekly	Monthly	Monthly	Quarterly	Quarterly	Quarterly	Quarterly
Source of data 2/	BR	BR	BR	BR	BR	BR	BR	BR/DANE	BR	CONFIS	DANE	BR
Mode of reporting	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	E-mail	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	Quarterly

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

Colombia: Structural Conditionality

1. Coverage of structural conditionality in the current program

Structural conditionality for the third year of the EFF (2002) is concentrated in three main areas: pension reform, fiscal policy, and financial sector restructuring. The pension reform will modify the parameters of the general pension regime and introduce reforms of the special regimes with a view to reducing the system's actuarial and cash deficits. A Public Revenue Commission will make recommendations for reducing tax distortions and revenue earmarking and, more generally, help chart the course for future fiscal consolidation. A fiscal responsibility law will, *inter alia*, require casting yearly budgets in a medium-term context. These measures are critical for strengthening the public finances and stabilizing the public debt. Financial sector restructuring, which calls for privatization or liquidation of public banks and for raising provisioning standards to international levels, is part of the ongoing effort to help reduce the banking system's—and the country's—vulnerability to a financial crisis.

2. Status of structural conditionality

The status of the structural benchmarks established under the program is reflected in Table 6 of the staff report. No structural benchmarks have been dropped, although the plans to privatize a number of public enterprises were scaled back in the face of sabotage against electricity installations. Some structural reforms have been added as the authorities have continued to develop their reform agenda in the period since the extended arrangement was approved in December 1999. Some structural measures—mainly the pension reform—are being implemented behind schedule. Structural action to downsize the central administration and its dependent agencies has been replaced by a downsizing program at the territorial government level.

3. Structural areas covered by World Bank lending and conditionality[1]

The following loan projects have objectives and conditionality with immediate macroeconomic relevance:

A US$500 million Financial Sector Adjustment Loan approved in 1999 supports a comprehensive program of financial sector reform coordinated by the government. The program is aimed at enhancing competition and efficiency in the financial system. The conditions of the loan are related to the establishment of appropriate prudential norms, effective bank supervision, deposit insurance, and resolution mechanisms for distressed institutions. Resolution of state-owned banks and other banking institutions, including the

[1] Colombia's relations with the World Bank group are summarized in Appendix II.

financial cooperatives, as well as the streamlining of the operations of the second-tier banks also were included among the conditions for the loan.

Two Public Financial Management Projects, supported by two relatively small loans, seek to help strengthen revenue collection and expenditure management of the national government. The loans support modernization of the tax administration's information systems; introduction of an integrated financial management system; implementation of a national system for evaluation of public sector performance; strengthening of the organization and management of the Directorate of National Taxes and Customs; and implementation of second-generation reforms in the tax and customs administration.

A US$400 million Structural Fiscal Adjustment Loan, approved on December 18, 2001, supports policies aimed at strengthening the management of the public finances. The conditions call for rationalizing the system of revenue transfers to local governments; establishing mechanisms to control the cost of public health services; halting the accumulation of unfunded pension liabilities; advancing on the reorganization of public agencies and their current expenditures; and setting up a better system for public debt management.

4. **Other relevant structural conditions not included in the current program**

Labor market reform is key to improving the efficiency of the Colombian economy and supporting the fiscal consolidation effort. The authorities had not committed to a labor reform under the program, but the persistence of high unemployment has forced the issue. As a result, congress—with the support of the government—took the initiative in the last half of 2001 to consider a labor market reform (summarized in Box 2).

COLOMBIA: PENSIONS - A SECOND GENERATION REFORM

Colombia's pay-as-you-go (PAYG) pension system is generating cash deficits and large and increasing actuarial deficits. The system covers about 30 percent of the economically active population, including those affiliated with the private capitalization funds.

Before the first pension reform in 1993 (Law 100), all pensions were organized on a PAYG basis. Contribution rates were low compared to benefits, and some groups enjoyed very generous pensions. The potential problems faced by the pension system in the early 1990s reflected faster than expected demographic change, the existing imbalance between contributions and benefits, inefficient management of many pension plans, a lack of adequate control, and corruption in some cases. The need for a change was brought on by the emerging cash imbalances, the widening actuarial deficits, and the inequities.

The first generation reform

The 1993 reform sought to increase the coverage of the pension system, strengthen its finances, reduce inequities, and provide adequate and sustainable retirement benefits. The reform established a dual system by maintaining the PAYG regime under the Institute of Social Security (ISS) and introducing, as an alternative, a regime of defined contributions managed by private institutions (capitalization funds). The numerous independent PAYG pension plans in the public sector would be closed down as the cohort died out. The pensions would continue to be funded by payroll taxes; the private pension funds would invest the contributions (payroll taxes) on behalf those who chose this alternative. Contribution arrangements for the smaller public plans varied, several being noncontributory. The ISS and the private capitalization funds would compete for affiliates who could move back and forth between the two regimes every three years. The resources of the private capitalization funds would be invested in equities, bonds, and money market instruments. At the time of retirement, participants in these funds would use their accumulated contributions to purchase annuities from an insurance company or combine the annuity with withdrawals.

Law 100 provided for a transition period to 2014, with men older than 40 years and women older than 35 years in 1994 retiring under the former pension regime. Younger contributors could move to the capitalization funds, or remain in the ISS system. Those who changed affiliation would be provided with recognition bonds.

The law also introduced a minimum pension, guaranteed by the government, for all contributors in the ISS and the private pension funds, equal to the minimum wage at the time of retirement, subsequently adjusted by changes in consumer prices or the minimum wage, whichever was larger.

The contribution rate was set initially at 8 percent of wages, but was raised gradually to 13.5 percent by 1996 (25 percent paid by employees and 75 percent paid by employers compared with 33 and 67 percent, respectively, before Law 100). The minimum number of contributions was raised by 500 weeks to 1,000 weeks for the ISS, and to 1,250 weeks for those in the private pension funds. At the same time, the replacement rate under the ISS system was set at 65 percent of the average income for the last 10 years, to take effect in 2014. For contributors to the ISS, the retirement ages were raised to of 55 years for women and 60 for men. In the private funds the retirement ages were of 57 years for women and 62 for men.

Under Law 100, public pension plans that were considered insolvent were to be closed, with new affiliates going to the general ISS system or the private capitalization plans, but many were kept open and there are indications that the number of irregularities in the granting of benefits may have been growing. There is no institution in Colombia that audits compliance with the provisions of the original plans and certifies the benefits.

As designed, the reform enacted in 1993 left many of the problems with the PAYG regime unresolved, and some of the principles set down in the reform have not been fully applied. Hence, the actuarial deficit has increased and cash imbalances have emerged. Despite the increase in the contribution rates in the 1990s the balance of the ISS has worsened. The main reason for this is the reduction in the number of affiliates, which has been more pronounced than expected, mainly as younger people (net contributors) have chosen the private capitalization plans.

The reform enacted in 1993 left a number of public sector regimes permanently outside the general system. The pension plans for ISS employees (mainly health workers), teachers, oil workers, the security forces, and others were explicitly excluded. As regards pensions for workers of the public oil company (ECOPETROL), a portion of the oil-price windfall of 1999 and 2000 was allocated to fund the pension liabilities of the company, and in 2000 a plan to begin funding the pension liabilities of territorial governments was set up. In addition, collective bargaining agreements in public entities and enterprises provide for more generous benefits than established by Law 100.

Two indicators summarize the imbalances that have developed in the ISS and the other public pension systems. The National Planning Department estimates the cash deficit of Colombia's PAYG pension systems at 3 percent of GDP in 1999 (corresponding to about half of the NFPS deficit) and at 3.8 percent of GDP in 2001 (more than 100 percent of the NFPS deficit). In 2001, the actuarial deficit for the period to 2050 exceeded 200 percent of GDP.

The second generation pension reform proposal

To help safeguard the viability of Colombia's pension system, the government in December 2001 presented to congress a proposal for a second generation pension reform. The main features of the proposal are:

- With the exception of new public employees, who will be required to join the ISS pension system, contributors can continue to choose freely between the ISS and private pension plans. The reform restricts the possibility of switching between the regimes, and calls for some reduction in the value of the recognition bonds issued to those who transfer to the private plans.

- From 2014, the retirement ages will be raised to 58 years for women and 60 years for men; and further to 60 years for women and 65 years for men from 2020.

- The contribution rate will be increased by 1 percentage point to 14.5 percent of salaries immediately and then gradually to 15.5 percent in 2008. The increase in contributions under the PAYG regime will support the finances of the ISS, while those corresponding to the private pension funds will be managed by the ministry of finance to support the guaranteed minimum pensions (payable to affiliates of the ISS or the private capitalization funds).

- The minimum period of contributions to qualify for a pension will remain at 1,000 weeks until 2013, thereafter increasing by 35 weeks annually to 1,210 weeks in 2019. From 2020, the minimum period will be 1,250 weeks, in both pension regimes.

- Up to 2014, the replacement rate corresponding to the minimum contribution period of 1,000 weeks will be 75 percent of the average income of the last 10 years; with 1,250 weeks of contributions the replacement rate will be 90 percent. From 2014, the replacement rate with the minimum contribution period will fall to 65 percent of the average income of the last 20 years; with the maximum period of contributions the replacement rate will be 85 percent.

- The proposed reform calls for a tax on pensions, which have remained exempt from income taxes. For pensions higher than 20 minimum salaries, the rate will be 8 percent; for pensions between 15 and 20 minimum salaries, 5 percent; and for pensions between 10 and 15 minimum salaries, 3 percent.

- Under the PAYG regime, the reform establishes a maximum for new pensions at 20 minimum salaries.

- The proposal also calls for the creation of a fund to support indigent people 65 years or older who do not have a pension by providing annual stipends of up to 40 percent of the minimum salary. This fund will be financed by a tax of 1 percent paid by those earning more than 20 minimum salaries. In addition, 1 percentage point of the current 3 percent payroll tax earmarked for the Family Welfare Fund will be reallocated to the new fund.

- The maximum premium that private capitalization funds can charge on survivorship and disability insurance would be reduced from 3.5 percent of salaries to 2.5 percent. The difference would help fund the guaranteed minimum pensions.

Further challenges

Preliminary projections indicate that the new parameters (contribution rates, retirement ages, and replacement rates) would balance contributions and pension payments for the new cohorts of the PAYG regime and reduce the actuarial deficit to around 150 percent of GDP. However, the PAYG regime is projected to continue generating cash deficits during the transition period, i.e., to 2014. Consequently, and unless the plan for reform of the special pension regimes that will be made public in March 2002 provides significant additional savings, a further pension reform would be needed.

Bogotá, Colombia
December 20, 2001

Mr. Horst Köhler
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Köhler:

1. Colombia has continued to make progress under its economic program in a domestic and global environment that has become increasingly difficult. Nevertheless, there has been compliance with the performance criteria established under the program and there has been significant advances on structural reforms. The authorities are committed to continuing the reform effort and to adjusting the fiscal deficit despite the urgent need to increase expenditures to promote the peace effort in the coming year. Significant macroeconomic stabilization has been achieved under the three-year program so far and the exchange rate has shown remarkable stability despite global and regional turmoil, and Colombia's access to the international capital markets is evidence of confidence in the country's economic management. The Fund's involvement with advice and support of the Colombian program has been a key element in the sustained economic recovery effort.

I. Recent Developments

2. The pace of Colombia's economic recovery has slowed in 2001 as both external and domestic factors combined to reduce real GDP growth in the first nine months of the year. To a considerable extent, the slowdown reflected a weakening of both external and domestic demand. In particular, the growth in external markets has weakened, affecting both coffee exports and—most recently—the export of manufactures. Colombia also suffered supply shocks: oil exports were disrupted by sabotage in the first half of the year, and strikes affected economic activity. Inflation has remained in line with the program target of 8 percent for 2001, but the unemployment rate remains high, around 18 percent.

3. Policy implementation under the program has been satisfactory. The quantitative program has evolved as anticipated and a number of significant reforms have been implemented, including the change in the system of revenue sharing with territorial governments. However, some of the structural reforms that were to have been submitted to congress in the first half of this year were delayed, mainly as the government sought to build

consensus and mobilize political support for the reforms. Action to implement most of these reforms has since been taken, as described below.

4. The fiscal program has remained on track, despite a shortfall in revenue collections induced by the cyclical downturn, the disruption of oil exports, and some initial delays in implementing the tax package that was approved last year. The revenue shortfall was largely compensated by a reduction in spending, lower-than-projected bank restructuring costs, and larger-than-projected quasi-fiscal profits of the central bank. By allowing for the effect on revenue collections of the cyclical downturn and the temporary reduction in oil exports in the first half of the year, totaling 0.4 percent of GDP, the fiscal deficit for 2001 would meet the indicative target presented at the time of the second program review in March 2001.

5. Colombia has enjoyed successful access to the international capital markets in 2001 even after the events of September 11 in the United States; its sovereign bonds were in strong demand—as reflected in the narrowing of spreads—despite the difficult market conditions faced by some other economies in the region. By mid-May, the government had completed its foreign market-borrowing program for 2001 through the placement of bonds for US$2.7 billion, of which US$1 billion carried a partial World Bank guarantee. Since then nearly US$1.5 billion in prefinancing of the 2002 market requirements, which total US$2.8 billion, has been obtained, most recently through a bond placement of US$500 million in mid-November. Most of the prefinancing funds will be held abroad until 2002. The government's strategy for the remaining financing needs for next year is to access the markets as early as feasible given the uncertainties surrounding the access for emerging market economies, although the most recent placement is reassuring for Colombia.

6. Monetary trends in the past 18 months have been characterized by the slow growth of deposits and credit. The private sector's financial portfolio is projected to grow by 8 percent in 2001, and broad money would increase by 6.5 percent, up from 1.3 percent in 2000. Outstanding credit to the private sector is projected to rise by 5.5 percent this year when adjusted for loan write-offs and mortgage debt relief, mainly due to strong growth of credit by private commercial banks, while credit by mortgage banks and public banks have continued to decline. Interest rates have declined since the beginning of the year, and the central bank reduced its interest rates on six occasions in 2001 in light of the continued favorable outlook for inflation, the economic slowdown, and declining international interest rates.

7. The recovery of the financial system has continued in 2001. After heavy losses in the previous two years, the system recorded moderate profits in the first half of 2001. The capital adequacy ratio of commercial banks (including public banks and mortgage banks) stood at 12.7 percent in August 2001, nearly unchanged from December 2000. At the same time, nonperforming loans fell to 10.9 percent of total loans, reflecting lower delinquencies for consumer and commercial credit. Mortgage portfolios, however, have deteriorated since May 2000, with nonperforming loans hovering around 20 percent of total loans during 2001. In an effort to strengthen the mortgage banks, FOGAFIN, the public deposit insurance agency, recently launched a recapitalization program for mortgage institutions. Under the new

program it will extend credit to the owners of these institutions, against appropriate guarantees, to finance the purchase of capitalization bonds issued by Fogafin and subject to a significant equity injection by the owners. The new line of credit for this purpose has already been set up and has been used to facilitate the restructuring of three mortgage banks. Although the government remains committed to the divestment of all public banks, except Banco Agrario, some legal and administrative steps remain that have delayed the sale or liquidation of some.

8. The foreign exchange market has remained orderly since the peso was floated in September 1999. The central bank's foreign exchange auction system is transparent and has been functioning well. After a depreciating trend in the first five months of this year, the peso has remained stable against the U.S. dollar, resulting in a depreciation of 3.6 percent from December 2000 to October 2001. The central bank continues to be committed to the flexible exchange rate regime and to the transparent procedures for foreign exchange interventions that are compatible with the bank's inflation targeting framework for monetary policy.

9. The reduction of oil exports, mainly due to sabotage of the pipelines in the first half of the year and the weakening of coffee prices are projected to cause the external trade surplus to fall to US$0.4 billion in 2001 from US$2.5 billion in 2000. Nontraditional exports would grow by 8 percent despite a weakening of external demand from around the middle of the year. Imports are projected to grow by 12 percent. Transfer receipts have been larger than envisaged (related to grants under the Plan Colombia and larger remittances from Colombians abroad). The foreign financing of the fiscal deficit and the somewhat higher-than-projected private capital inflows so far this year would help accumulate nearly US$800 million in net international reserves (NIR), with the level rising to about US$9,600 million, equivalent to more than 5.5 months of imports of goods and services.

10. As a result of the strong implementation to date of the government's three-year program, the external vulnerability of the Colombian economy is relatively low (the ratio of NIR to external debt-service payments falling due in 2002 exceeds 100 percent). Colombia has continued to enjoy access to external financing with falling bond spreads despite the turbulence in the international capital markets and the financial difficulties faced by some countries in the region, as noted above. The floating of the exchange rate and the fiscal consolidation since 1999 have strengthened the confidence in Colombia's economic management and given the authorities room to maneuver in case of external shocks.

II. The Outlook for 2001 and the Program for 2002

11. During the recent revision of the macroeconomic framework for 2001, the projection of real GDP growth has been reduced to around 2 percent, from the 3.8 percent projected at the beginning of the year; the forecast for consumer price inflation has been maintained at 8 percent, and the NIR accumulation is projected to exceed the program target. The real GDP growth projection for 2002 has been reduced to 3 percent from 4.5 percent, in line with the revisions that have been made for growth in the world economy.

12. In order to tackle the combined effects of the economic slowdown and the persistence of high unemployment, the authorities introduced a set of measures in the last half of 2001 to help stimulate economic growth and generate employment. In particular, the government announced an initiative to make the labor market more flexible. This initiative was taken up by congress, which will continue to discuss this issue in the March–June session of 2002. Other elements in the set of measures include debt relief and temporary price support for the coffee sector, which is suffering from record low prices on the world market; the use of resources in the petroleum stabilization fund to restructure territorial government debt; and new credit lines (funded by the sale of assets by a second-tier public bank) to benefit small- and medium-sized firms at below market-interest rates (the cost of which will be covered with budgetary transfers). The government has also taken steps to accelerate the low-cost housing construction program, and provide additional resources to fund the public health system. These measures to stimulate economic growth have been adopted in a framework of fiscal discipline, within the deficit target discussed below.

13. The combined public sector deficit in 2001 will be 3.3 percent of GDP, compared with 2.9 percent of GDP in the program. This widening reflects mainly the effect on revenue collections of the cyclical downturn and the impact of the sabotage against oil pipelines. The larger-than-programmed expenditures related to the peace process, the support for the coffee sector, and higher health and social security outlays, have been accommodated by spending compression in other areas, higher quasi-fiscal profits of the central bank, and lower costs of the bank restructuring program (mainly due to lower domestic interest rates).

14. On this basis, the NFPS' primary surplus will continue to improve in 2001, to 1.1 percent of GDP from 0.9 percent of GDP in 2000. At the same time, the primary fiscal balance, when the oil sector and the operations of the public health (ISS) and pension systems are excluded, improved by 3.3 percent of GDP in 2000 and will be strengthened by another 2 percent of GDP in 2001. This illustrates the fiscal consolidation effort to date under Colombia's three-year recovery program.

15. In order to prevent a crowding-out of the private sector from the domestic credit market and avoid upward pressure on interest rates, the public sector has kept its use of domestic credit resources to a minimum so far this year, and the combined public sector deficit is being financed mainly with external resources, (the net use of domestic credit will amount to 0.1 percent of GDP in 2001, compared with 1.3 percent of GDP last year). In June of this year the government swapped domestic debt amounting to Col$5.6 trillion (US$2.4 billion) falling due in 2001–05 with securities of longer maturities in order to smooth the amortization profile. This voluntary operation extended the average maturity of the domestic debt from 3.5 to 4.5 years and reduced amortization payments by 22 percent in 2001 and 34 percent in 2002 at a marginal increase in costs.

16. The combined public sector deficit is projected to be 2.3 percent of GDP in 2002, compared with the 1.9 percent indicated at the time of the second program review, with the increase reflecting the negative impact on revenue of two consecutive years of lower-than-projected economic growth. The target reflects a continuation of the adjustment effort and is

consistent with a strengthening of the primary balance by 1.3 percent of GDP. The improvement of this balance over the three years of the government's recovery program supported by the EFF would amount to 5.1 percent of GDP. The primary deficit excluding oil and social security accounts will improve by 1 percentage point of GDP in 2002 for a total adjustment of 6.3 percent of GDP between 1999 and 2002.

17. In addition, Colombia will need to spend some 0.3 percent of GDP in 2002 to further the ongoing peace process in the context of the implementation of the "Plan Colombia," which sets out the government's strategy for settling the internal conflict, curbing the production of and trafficking in illicit drugs, and dealing with the social consequences of these problems. The additional spending reflects the government's intensified efforts in these areas. The continuation of the peace process will strengthen the underlying economic position of the country in the medium term, but requires a temporary increase in spending in order to ensure its adequate implementation. The additional expenditures will be used for social investment in the conflict zones, strengthening the capability of the armed forces, and reinforcing narco-traffic control activities. Since the establishment of the three-year economic recovery program in 1999 the Colombian authorities have explained to the public and to the Fund that a need might arise to strengthen the peace process with targeted expenditure programs. After taking into account these expenditures, the combined public sector deficit will amount to 2.6 percent of GDP in 2002.

18. The government expects that this deficit will be financed mainly through medium- and long-term external resources from multilateral lenders and the private financial markets. As noted, the government has already made considerable progress in prefinancing its 2002 needs. The authorities will continue to make every effort to limit the access to domestic financial savings by the public sector in order to secure adequate domestic credit resources for the private sector to support the economic recovery. If during the first half of 2002 there is a shortfall in the programmed external financing, the government will postpone nonpriority expenditures and will use most of its available external portfolio resources to attend to payments before increasing its access to the domestic financial market. This policy response will be subject to special focus at the time of the subsequent program review, scheduled for September 15, 2002. If Colombia's access to external markets were to become difficult towards the middle of the year, the government will assess the need to cut postponed expenditures. If it is concluded that the difficulties to access international financial markets would remain for the rest of the year, the government would modify its expenditures plans as needed in the context of the review mentioned above. Also, if revenue were to fall short of projections in the first two quarters of 2002, the government will take expenditure measures in order to meet the corresponding fiscal deficit targets.

19. The monetary framework based on inflation targeting that was adopted by the central bank in 2000 has been functioning well. The framework is transparent and the central bank's quarterly inflation reports are made public to provide a clear signal of the central bank's determination to achieve the program's inflation objectives. Within the context of the program, the central bank has set targets for inflation and the authorities undertake to consult with the Fund (the Executive Board) on inflation control policies if inflation were to deviate

significantly from the projected quarterly path, as set out in the attached Technical Memorandum of Understanding (TMU). Information up to November provides assurances that the 8 percent inflation target established for 2001 will be achieved, and the central bank has reaffirmed its inflation target of 6 percent for 2002, thereby continuing the process of lowering inflation towards international levels. The current central bank assessment of inflation for 2002 indicates the possibility of a temporary increase in the prices of food items due to weather related disruptions of a temporary nature, which would not require corrective action on the part of the central bank.

III. STRUCTURAL REFORMS

20. The government's structural reform agenda includes ambitious measures to increase economic efficiency, stimulate economic growth, and foster social progress. To this end, a large number of reforms have been introduced so far under the three-year program, starting with the floating of the peso at its inception in 1999. Other important reforms have been introduced through the adoption of an inflation targeting framework for monetary policy; the restructuring of the financial sector; two revenue enhancing tax packages; the establishment of funds to support territorial government pensions; privatization/liquidation of public enterprises and banks; action to deepen domestic financial markets and develop longer-term financial instruments for the private sector; and elimination of the remaining capital account restrictions. Since the second program review in March this year, additional action has been taken to strengthen the control of public finances at all levels of government, mainly through a constitutional reform of the system of transfers (revenue sharing) to the territorial governments and the submission to congress of a proposal to increase territorial government revenue. The central government, in conjunction with the territorial governments, has also been implementing the territorial fiscal adjustment law (Law 617), which is expected to generate permanent fiscal savings, improve the debt profile of territorial entities while preventing the emergence of unfunded contingent liabilities, and reinforce the administrative capacity of local governments. The government also has submitted to congress a proposal to improve the control and allocation of the revenue sharing funds, particularly by strengthening the control of education and health expenditures (reform of Law 60). The proposal for a second-generation pension reform will be presented to congress in December, and a reform that will strengthen the finances of the health service of the Social Security Institute was initiated in July. Also since the last program review, steps have been taken to improve the instruments and procedures used to address and facilitate the restructuring needs of the mortgage banks; and a new legal framework for the capital market is being established.

21. Since early in its mandate and with technical advice from the World Bank, the government has been developing a pension reform that aims to reduce its long-term actuarial deficit and bolster the financial position of the public pension systems, which would otherwise require significant fiscal support over the next decade. The government's draft pension reform has been submitted for analysis and comments to a commission of representatives from the industrial associations, labor unions, congress, and the presidential candidates, before it is presented to congress. The main elements of the government's reform

proposal are: a) an increase of up to 2 percentage points in payroll contributions (1 point initially and 0.25 points yearly from 2005 to 2008); b) increased retirement ages (from 60 to 63 years for men and from 55 to 58 for women in 2014 and then to 65 and 60 years, respectively for men and women in 2020); c) an increase, beginning in 2014, in the minimum number of weeks of contributions required for a pension (from 1,000 at present to 1,250 by 2020, increasing by 35 weeks per year); d) making higher-income pensions subject to income taxes; e) establishing a cap for new pensions equivalent to 20 minimum wages; and f) requiring new public employees to enroll in the public pension system. The government expects that the final approval of the reform will take place in the first half of 2002. The fiscal savings of the pension reform amount to 2.2 percent of GDP during the period to 2010, and the net present value of the pension liabilities to 2050 will be reduced from 206 percent of GDP to 159 percent of GDP. In addition, a reform of the special (privileged) pension regimes will be developed by a group of experts that has been entrusted to present recommendations for their reform by March 2002, which would be added to the reform of the general pension system. The government expects that the reform of the special regimes will make the pension system more equitable and reduce the actuarial deficit further while adding to the medium-term fiscal savings.

22. Action has been taken to reverse the financial deterioration of the Social Security Institute's (ISS) health service. To this end, a wide-ranging restructuring plan has been adopted and is being implemented. The main elements of the plan include an unprecedented renegotiation of the collective bargaining agreement with the health workers completed in October 2001, which reduces wage and pension benefits; a set of measures to streamline the operations of the ISS; and the restructuring of the ISS's debt. It has been decided to reduce ISS costs further through a more equitable distribution of the financial burden related to high-cost illnesses among health insurance providers. Also, the superintendency of health recently lifted the sanction that prevented the ISS from increasing the number of its affiliates; this will allow the ISS to increase its income and contribute further to the reduction of its deficit. These reforms involve significant savings that will reduce the health system's cash deficit by 0.2 percent of GDP per year from 2002, and eliminate its operating deficit by 2005.

23. The reform of the system of revenue transfers to the territorial governments that was adopted through a constitutional amendment in June, will be complemented by the modification of Law 60. The proposed changes in this law, submitted to congress in September, will improve the efficiency in the use of revenue sharing funds and strengthen the control over the use of these resources. In the area of education, the proposed reform establishes clear definitions of the responsibilities between regional and municipal governments for providing education services; distributes resources based on the number of students rather than teachers; incorporates performance indicators for learning; and establishes limits on current spending. The government will set up a special regulatory commission to monitor the performance indicators and determine the technical parameters of the new system, such as the average cost per student, optimal student to teacher ratio, etc. In the area of health, the roles of each jurisdiction are being clarified; a number of intermediary institutions will be eliminated; and performance-based indicators also will be established.

While this law is not expected to generate fiscal savings, it will contribute to significant efficiency gains that will allow for a widening of coverage in the provision of these services.

24. The government has named a Public Revenue Commission to address the distortions and rigidities that hamper fiscal efficiency in Colombia. The commission, which includes three foreign experts, has been entrusted to study the Colombian tax system and propose comprehensive measures to deal with the distortions in the revenue system, and the problems stemming from the widespread earmarking of public resources at both the national and local level. The commission also has been asked to suggest further measures to ensure that medium-term sustainability of the public finances is achieved. The commission began its work last July and will issue its final recommendations by August 2002.

25. The territorial tax reform proposal, which was presented to congress in September, is intended to increase the fiscal autonomy at the territorial government level and strengthen tax administration by simplifying regulations and payment procedures. It would appear that this proposal will not be supported by congress in the forthcoming electoral period, and the government will ask the Public Revenue Commission to review the proposal with a view to including it among its recommendations to the next government.

26. To ensure the permanence of the reforms described above, the government will submit to congress in the first half of 2002 a proposal for a fiscal responsibility law. The main elements of the law will include fiscal rules to ensure that the annual fiscal deficits are consistent with the stabilization of the public debt and procedures for casting the budget within a multiannual financial plan will be established. The proposal will call for periodic reports to congress and evaluations of compliance with the objectives of the law. It also will provide for a further strengthening of the regulations that limit the access to credit of territorial governments.

27. While the financial sector is recovering from the crisis of the past few years, as noted above, the authorities are continuing their efforts to strengthen Colombia's financial system. In particular, in September the government proposed to congress a modification of the banking law to allow the implementation of closed-bank resolution procedures for problem banks and to modify the legal framework for the asset management company (CISA). The adoption of closed-bank resolution mechanisms will help minimize the use of public resources and strengthen the stability of the financial sector during times of stress. The proposed legal framework for CISA will facilitate the sale of the foreclosed assets acquired from the public banks. In addition, the efforts to privatize or liquidate all public banks, except Banco Agrario, have been advancing but recent market events, as well as legal and administrative issues, have delayed the plans. The process of taking Bancafé to the point of sale will be completed by end-2001 and it will be offered for sale when market conditions permit. Progress on the privatization or closure of Granahorrar is being made but its final resolution is subject to the coming into effect of the revisions of the banking law. In the case of Banestado, its commercial activities have been severely curtailed but the bank cannot be sold or liquidated until pending legal issues are resolved.

IV. The Medium Term and Other Issues

28. The authorities have reviewed the medium-term outlook for Colombia's public finances, external debt, and the balance of payments. The projections reflect a conservative scenario in which productivity gains, unemployment, the investment rate, and GDP growth return gradually to their historical levels. As a result of the extensive fiscal adjustment measures and the structural reforms that have been implemented so far, the growth of public sector debt is projected to moderate significantly from the rapid increases in the late 1990s, when the debt rose from 26.7 percent of GDP in 1997 to 42.6 percent of GDP in 2000. At the same time, the external current account deficit would be reduced from 5.4 percent of GDP on average during 1997–98, to 2.9 percent of GDP on average in the period to 2010. The authorities recognize that the fiscal adjustment and the structural reforms being pursued in 2001 and 2002 will not be sufficient to stabilize the public debt at 44–46 percent, as is desirable. To achieve this, it will be necessary to continue Colombia's fiscal consolidation efforts beyond the three years of the EFF-supported program and put in place a combination of measures that permanently reduce the fiscal deficit by around 1 percent of GDP relative to the current projection. It should also be noted that this medium-term scenario does not take into consideration the positive impact on the economy that additional progress in the peace process would bring about.

29. In the area of trade policy, the government has developed a plan to reduce the dispersion of tariffs in the context of harmonization of tariffs within the Andean Group, and to convert the export tax certificates (CERTs) into a simple duty drawback instrument. The export subsidy components of the Plan Vallejo (mainly a subsidy on imports of materials and capital goods used in export industries) and the free trade zones have been notified to the WTO and will be eliminated according to agreements with the WTO. In September and October, the 1.2 percent customs service charge and the implicit value-added tax on some imports were eliminated. Temporary safeguard measures in the form of tariffs and quantitative restrictions currently exist on three products, but they will be lifted by 2003.

30. The Colombian government gives special emphasis to transparency issues. As noted above, Colombia has subscribed to the Special Data Dissemination Standard (SDDS) and took part in the FSAP pilot project. The government has also decided to undertake the fiscal transparency module; it has advanced on the self-assessment and has requested a technical mission from the Fund to discuss the assessment and complete the module.

31. Colombia has strengthened legislation regarding control and prevention of money laundering since 1992 for all financial intermediaries subject to the vigilance of the Banking Superintendency and has adopted legislation consistent with the 40 recommendations suggested by the Financial Action Task Force. In particular, Colombia is presently strengthening the "know your client" obligations in line with the "Customer due diligence for banks" issued by the Bank for International Settlements early this year. Colombia is also reviewing the mechanisms for control and interdiction of funds transferred for the purpose of terrorist activities, particularly those resulting from drug related operations. An Information

and Financial Intelligence Unit was established in late 1990s as part of the country's integrated system to fight money laundering. Its main function is to detect funds originating from narcotics operations, arms trade, extortion, and corruption, among others.

32. The authorities have noted the Executive Board's decision on safeguards assessment and have explained to the Fund staff the legal framework that underpins the current audit system of the central bank. The present system has been working well and has served to safeguard the resources of the central bank. Nonetheless, the authorities commit to establishing an external audit mechanism according to International Standards on Auditing and to publish the audit opinion together with the central bank's annual financial statements beginning with the financial year 2002.

33. The authorities reiterate their commitment to accept the obligations of the Fund's Article VIII, Sections 2, 3, and 4, by the time of the review scheduled for September 2002, and to help achieve this the remaining multiple currency practices will be eliminated. Also, congress has accepted the proposed Fourth Amendment of the Fund's Articles of Agreement and only the final approval by the constitutional court is pending.

34. The Colombian authorities reaffirm their policy commitments under the program supported by the extended arrangement approved by the Fund in December 1999, and request completion of the third review thereunder. At the same time, the authorities request a waiver for the minor technical excess over the end-June 2001 ceiling on the deficit of the combined public sector. In light of the delay in concluding the discussions for the third program review, no performance criteria were set for September and December 2001; the authorities request that the amount of purchases corresponding to observance of the performance criteria for those dates be made available in 2002. In light of the delay in completing the third review of the program, the authorities also propose that the date for the fourth review be changed from February 15, 2002 to September 15, 2002.

Sincerely yours,

/s/	/s/
Juan Manuel Santos Minister of Finance and Public Credit	Miguel Urrutia General Manager Bank of the Republic

Attachment

COLOMBIA—TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This memorandum sets out the definition of concepts, specific performance criteria for March 31 and June 30, 2002, and the structural benchmarks for the remaining period of the program, as well as the assumptions that apply under the program supported by the extended arrangement.

I. FISCAL TARGETS

A. Performance Criterion on the Overall Deficit of the Combined Public Sector[1]

	Ceiling[2] (In billions of Colombian pesos)
Overall deficit of the combined public sector from January 1, 2001 to December 31, 2001 (indicative)	6,550
Overall deficit of the combined public sector from January 1, 2002 to:	
March 31, 2002 (performance criterion)	950
June 30, 2002 (performance criterion)	2,100
September 30, 2002 (indicative)[3]	2,700

[1] As measured by the net financing defined in the text below. The combined public sector is defined in the text below.
[2] Maximum cumulative deficit of the combined public sector. The ceilings for the quarters in 2002 are based on an annual deficit of Col$5,356 billion.
[3] To be specified as performance criterion at the time of the program review scheduled for September 15, 2002.

2. The overall balance of the **combined public sector** (PS) is defined as the sum of the overall balances of the nonfinancial public sector (NFPS), the operating cash result (quasi-fiscal balance) of the Banco de la República (BR), the overall balance of the Fondo de Garantías de Instituciones Financieras (FOGAFIN), and the net fiscal costs borne by the central administration and the rest of the NFPS related to financial sector restructuring. The **NFPS** consists of the general government and the public enterprises; the general government includes the central government, the territorial governments, and the social security system; the central government includes the central administration and the national decentralized agencies as indicated below. The net fiscal costs borne by the central administration and the rest of the NFPS related to financial sector restructuring (not part of the NFPS balance) are defined to include interest payments and amortization of the bonds used to compensate financial entities for the mortgage debt reductions approved by the congress in December 1999, the interest payments on the bonds used to recapitalize public banks, the costs of

closing Caja Agraria, and any additional fiscal charges (including interest costs) related to the recapitalization, restructuring, liquidation, and privatization of financial entities.

The Combined Public Sector

PS = NFPS[1] + FOGAFIN + quasi-fiscal BR + net fiscal costs borne by the NFPS related to bank restructuring
NFPS = general government (GG) + public enterprises (PE)
GG = central government (CG) + territorial governments (TG) + social security
CG = central administration + national decentralized agencies
TG = territorial government + territorial decentralized agencies

[1] Excludes net fiscal costs borne by NFPS related to bank restructuring.

3. For any given calendar quarter, the overall **PS balance** is measured, in Colombian pesos, as the sum of: (i) its net domestic financing; (ii) its net external financing; and (iii) privatization proceeds, as defined below. Items denominated in foreign currency will be converted into Colombian pesos at the actual exchange rate of each transaction.

4. The **PS net domestic financing** comprises (i) the change in its net credit from the financial system, excluding bonded debt; (ii) the change in its bonded debt (including domestic bonds denominated in or indexed to foreign currencies) excluding any valuation changes; (iii) the change in the budget carryover (*rezago presupuestario,* which includes *cuentas por pagar* and *reservas de apropiación*) of the central administration and changes in the floating debt (*cuentas por pagar)* of the social security system (*Instituto de Seguro Social, Cajanal, and Caprecom*) and main public enterprises: Ecopetrol, Telecom, the national electricity companies (ISA, ISAGEN, and the national electricity distributors), and the national coffee fund; (iv) the change in the amount of public funds administered by *Fiduciarias*; and (v) the operating cash result of the BR. Any capitalization of interest on new issues of government bonds after September 1, 1999 and the accrual of the inflationary component of indexed bonds will be included—on a quarterly basis—as interest expenditure for the purpose of measuring the PS deficit.

5. The **financial system** comprises the banking sector, mortgage banks, finance corporations *(corporaciones financieras)*, FEN, IFI, finance and leasing companies *(compañías de financiamiento comercial)*, Bancoldex, Finagro, and Findeter. The banking sector comprises the BR and the commercial banks.

6. The PS **net external financing** is defined as the sum of (i) disbursements of project and nonproject loans, including securitization (*titularización)* of export receipts; (ii) proceeds from bond issues abroad; (iii) the net changes in short-term external debt including pre-payment of exports; and (iv) any change in arrears on external interest payments; minus (v) net increase in the financial assets held abroad by the PS; (vi) cash payments of principal on current maturities for bonds and loans; (vii) cash payment to settle any external arrears;

(viii) any prepayment of external debt; and (ix) the value of any new leasing contracts entered into by the public sector during the program period, which is defined as the present value at the commercial interest reference rate (CIRR) (at the inception of the lease) of all lease payments expected to be made during the period of the lease contract excluding those that cover the operation, repair, or maintenance of the property. The local currency amounts of the net external financing transactions are calculated at the actual exchange rate of each transaction.

7. **Privatization** proceeds are defined as the cash payments received by the PS, converted to Colombian pesos at the actual market exchange rate of each transaction. Nonrecurrent fees (e.g., prepayments) received by the PS for concessions to operate public services, such as in the telecommunications sector, are treated as privatization proceeds. For purposes of the program, such fees will be accounted for over the concession period, distributed in equal quarterly amounts. Proceeds from the decapitalization of public enterprises will be considered as privatization. To the extent the purchasers of public enterprises assume their debts, the net financing used by these enterprises during the program period until their sale will be deducted from the net financing of the PS; if the PS assumes the debt, the net financing used by the enterprise during the program period before the sale will remain outstanding as part of the financing of the PS.

8. The **joint operation** between TELECOM and a resident firm, which is a subsidiary of a foreign company, will be registered in the fiscal accounts on an accrual basis. The operation involves the acquisition by TELECOM from a resident firm of fixed assets (represented by installed telephone lines) financed by a loan from the resident firm that will accrue interest. The breakdown of the debt service between amortization and interest payments, to be accrued in the fiscal accounts, will be determined by the internal rate of return corresponding to the cash payments to be made during the period of the joint agreement.

9. **Adjustment**

(i) The quarterly ceilings on the combined public sector deficit will be adjusted upward (larger deficit), and the ceiling on net disbursements of medium- and long-term external debt of the public sector (see below) will be adjusted upward by the full amount of any concessional loan disbursements in support of the "Plan Colombia." A loan will be considered concessional if it has at least a 35 percent grant element at the time of loan approval using the commercial interest reference rate (CIRR) as discount rate (Fund staff will provide data for the CIRR if required).

(ii) The cumulative quarterly ceilings on the combined public sector deficit will be adjusted downward by 130 percent of the revenue of the petroleum stabilization fund (FAEP), as currently defined in the law, in excess of the baseline set out in the attached Table.

II. MONETARY TARGETS

10. Reflecting the BR's inflation targeting approach to monetary policy, quarterly targets for 2002 have been established for the 12-month rate of consumer price inflation, measured by the *Indice de precios al consumidor* (IPC) compiled by the *Departamento Administrativo Nacional de Estadisticas* (DANE). The authorities will complete consultations with the Fund (Executive Board) on the proposed policy response before requesting purchases from the Fund in the exceptional event that the observed quarterly inflation were to deviate by 2 percentage points or more from the quarterly baseline set out in the table below.[1] In the event that the actual inflation deviates significantly from the programmed target (within the 2 percentage point margin) in any calendar quarter, the BR staff will report to the IMF staff on the reasons for the deviation and the policy response adopted, if any.

	Actual September 2001	Indicative Dec. 31 2001	Projected[1] Mar. 31 2002	June 30 2002	Sept. 30 2002
Inflation target	8.0	8.0	7.8	7.2	6.7

[1] The projected path for inflation is based on the central bank's annual inflation target of 6 percent for December 2002.

III. EXTERNAL TARGETS

A. Performance Criterion on NIR of the BR

	Target[1] (In millions of U.S. dollars)
Outstanding stock as of:	
September 30, 2001 (actual)	9,388
December 31, 2001 (indicative)	9,500
March 31, 2002 (performance criterion)	9,580
June 30, 2002 (performance criterion)	9,660
September 30, 2002 (indicative)[2]	9,740

[1] Minimum quarterly levels of NIR of the BR based on a projected annual accumulation for 2002 of US$323 million. NIR is defined in Paragraph 10.
[2] Performance criterion to be specified at the time of the program review scheduled for September 15, 2002.

[1] The BR also will provide Fund staff with monthly information and analysis of inflationary developments and forecasts, as agreed, and keep the staff informed of all policy actions taken to achieve the inflation objectives of the program.

11. The **NIR** of the BR (*reservas de caja*) are equal to the balance of payments concept of net international reserves excluding accrued, but unpaid, interest on reserve assets and liabilities (*causaciones*); and are the U.S. dollar value of gross foreign reserves of the BR minus gross reserve liabilities. The net reserves are accounted for at the U.S. dollar value at the time of acquisition.

12. **Gross foreign reserves** of the BR comprise (i) gold; (ii) holdings of SDRs; (iii) the reserve positions in the FLAR and the Fund; and (iv) all foreign currency-denominated claims of the BR. Gross foreign reserves exclude capital participation in international financial institutions (including Corporación Andina de Fomento (CAF), IDB, IBRD, IDA, and the Caribbean Development Bank), the holdings of nonconvertible currencies, and holdings of precious metals other than gold. The *pesos andinos* are considered to be part of Colombia's gross foreign reserves. **Gross reserve liabilities** of the BR are defined as the sum of (i) all foreign currency-denominated liabilities of the BR with an original maturity of one year or less; (ii) liabilities to the Fund, (iii) any net position on foreign exchange derivatives, including forward (futures) contracts, with both residents and nonresidents undertaken directly by the BR or by other financial institutions on behalf of the BR; (iv) any purchases from the Latin American Reserve Fund (FLAR); (v) any increase in medium- and long-term external debt of the BR over and above US$ 88.8 million, which is the level of the outstanding debt on August 31, 2001; and (vi) any foreign currency deposits in the BR by residents, including financial institutions. Options to sell foreign exchange to the central bank will be added to reserve assets in the net international reserves when they are exercised. The face value of outstanding options to buy foreign exchange from the central bank will be treated as a reserve liability and thus subtracted from the net international reserves.

13. **Adjustment**

(i) The quarterly NIR targets may be adjusted downward by up to US$1.5 billion (about US$650 million above the cumulative overperformance to September 2001 relative to the NIR targets since December 1999), as necessary, to help secure orderly foreign currency market conditions consistent with transparent rules of the central bank's foreign exchange interventions within its inflation targeting monetary framework.

B. Performance Criterion on the Net Disbursement of Medium- and Long-Term External Debt of the Public Sector[1 2]

	Ceiling (In millions of U.S. dollars)
Cumulative net disbursement of external debt by the public sector from January 1, 2001 to December 31, 2001 (indicative)	2,680[3]
Cumulative net disbursement of external debt by the public sector from January 1, 2002 to:	
March 31, 2002 (performance criterion)	1,100
June 30, 2002 (performance criterion)	1,800
September 30, 2002 (indicative target)[4]	2,400

[1] The public sector includes the PS as defined above and the financial public sector, including second-tier banks. In calculating compliance with the ceiling, the use/accumulation of the public sector's assets held abroad will raise/lower net disbursements. The quarterly targets for 2002 are based on a total net disbursement of medium- and long-term external debt (including the use of public sector external assets) of US$ 2,573 million during that year.

[2] Debt is defined in point 9 of the Guidelines on Performance Criteria with respect to foreign debt (Executive Board Decision No. 12274–00/85, August 24, 2000).

[3] It is expected that the first tranches of the fast-disbursing loans to be considered by the Board of the World Bank and the Inter-American Development Bank in late December 2001 (US$200 million and US$173 million, respectively) will be disbursed in early 2002. For purposes of the program, these loans will be accounted for in 2001.

[4] Performance criterion to be specified at the time of the program review scheduled for September 15, 2002.

14. This ceiling applies to the net disbursement (gross disbursement minus amortization/redemptions) of debt of the public sector (financial and nonfinancial) of nonconcessional external debt of maturity of over one year. The changes in the external debt will be valued in U.S. dollars at the exchange rate prevailing at the time of each transaction.

15. **Guarantees.** The government will maintain the policy of not guaranteeing private sector external debt.

C. Performance Criterion on Change in the Outstanding Stock of Short-Term External Debt of the Public Sector[1]

	Ceiling (In millions of U.S. dollars)
Cumulative net disbursement of short-term external debt of the public sector from January 1, 2001 to:	
September 30, 2001 (actual)	80
December 31, 2001 (indicative)	180
March 31, 2002 (performance criterion)	180
June 30, 2001 (performance criterion)	180
September 30, 2002 (indicative)[2]	80

[1] Short-term debt defined as all debt with an original maturity of one year or less, excluding normal trade financing. Public sector includes the PS as defined above and the financial public sector except transactions that affect the reserve liabilities of the BR.

[2] Performance criterion to be specified at the time of the program review scheduled for September 15, 2002.

IV. Structural Performance Criterion

16. The government will make public reform plans for the special pension regimes (exceptuados, not under collective bargaining agreements) that will reduce the actuarial deficit of these regimes taken as a whole in a proportion similar to that proposed by the government for the general regime, and raise additional cash savings.

V. Structural Benchmarks

17. **To be completed by December 31, 2001:**

- Present to congress a proposal for a second generation pension reform (modifying Law 100 of 1993).
- Final decision on the remaining elements in the plan to reduce the deficit of the ISS health system.
- Bring to the point of sale at least one public bank through a finding and a decision by the council of ministers that the bank is free of encumbrances and is ready to be offered for sale.

18. **To be completed by June 30, 2002:**

- Introduce reform of special pension regimes referred to above and consistent with the above requirements, if required by presenting legislation to congress.
- Invite bids for the sale of at least one public bank.

- Submit all legal issues to permit decisions by courts or tribunals with a view to liquidating or divesting all remaining public banks except Banco Agrario; and bring those that are to be divested to the point of sale.

- Introduce a draft fiscal responsibility law in congress.

19. **To be completed by Program Review Scheduled for September 15, 2002:**

- Final report of the Public Revenue commission to be made public.

- Complete the 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. Colombia: Baseline Assumptions for Oil Stabilization Fund Revenue (FAEP)

	Dec. 2001[1]	Proj. 2002[2]		
		Mar.	Jun.	Sep.
(In millions of U.S. dollars)				
Revenue of FAEP	287	50	50	50

[1] Cumulative since January 1, 2001.
[2] Cumulative since January 1, 2002.

Statement by the IMF Staff Representative
January 25, 2002

Since the Staff Report (EBS/02/5) was prepared, the staff has received the following information. The new information does not alter the thrust of the staff appraisal.

Following a breakdown in the **peace talks** earlier this month, a last-minute understanding was reached this past weekend on a timetable for working out a ceasefire agreement. Consequently, the government extended the timeframe for the demilitarized zone (sanctuary for the FARC guerillas) until April 10. Meanwhile, hostilities have continued in other parts of the country.

Recent information on **growth** in the third quarter of 2001 would suggest that real GDP growth in 2001 was lower than estimated earlier (probably about 1.5 percent). **Inflation** was 7.7 percent in 2001, compared with a target of 8 percent. The **net international reserves** of the central bank rose by nearly US$1.2 billion in 2001, considerably more than projected in the staff report. The excess reportedly reflected market expectations towards the end of the year that the peso would strengthen in late 2001 and early 2002. The **exchange rate** stood at C$2,291 per U.S. dollar at the end of 2001, a depreciation of about 3 percent from a year earlier (from mid-May 2001 until January 18, 2002, the peso appreciated by about 5 percent). On January 18, the central bank reduced its **repo rate** by 50 basis points to 8 percent, following a reduction of 350 basis points during 2001.

The central bank has reaffirmed its **inflation target** of 6 percent for 2002 and announced a range of 4–6 percent for 2003; the point-target for 2003 would be announced in November this year. At the same time, the target for the medium term was lowered from 4 to 3 percent.

The central bank modified the **rules for its foreign exchange auctions** in late December 2001. To allow for the earlier intervention in response to significant exchange rate swings, the threshold that triggers auctions of options to buy or sell foreign exchange was reduced from 5 to 4 percent above the moving average peso/U.S. dollar rate of the previous 20 days. In addition, the central bank introduced the possibility of auctioning preannounced options to sell foreign exchange that could be exercised during the following month if the value of the peso falls below the moving average of the previous 20 working days.

In December the government decided **not to complete the process of bringing Bancafe to the point of sale by the end of 2001** because of a lack of market interest. The authorities are currently considering other options, including the capitalization of Bancafe by private investors, as a means to proceed with its policy of divesting or liquidating all public banks except Banco Agrario.

INTERNATIONAL MONETARY FUND

NEWS BRIEF

FOR IMMEDIATE RELEASE

News Brief No. 02/5
FOR IMMEDIATE RELEASE
January 25, 2002

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

IMF Completes Third Review of Colombia's Extended Arrangement

The Executive Board of the International Monetary Fund (IMF) completed today the third review of Colombia's performance under the Extended Fund Facility (EFF)[1] arrangement approved on December 20, 1999 (see Press Release No. 99/63) for SDR 1.96 billion (about US$2.44 billion). The completion of the review allows Colombia to draw, if needed, up to SDR 1.2 billion (about US$1.5 billion) from the IMF. To date, the country has not made any purchases under this arrangement.

Following the Executive Board's discussion on Colombia, Eduardo Aninat, Deputy Managing Director, said:

"Colombia has achieved considerable macroeconomic stabilization since 1999 when it adopted the present stabilization program. Inflation has been reduced significantly, fiscal consolidation has advanced, and significant structural reforms have been introduced. With full implementation of the program for 2002, the authorities will have come a long way toward achieving the objectives of their program, despite the difficult domestic security situation and the recent worsening of the global economic environment.

[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 4½-year grace period, and the interest rate, adjusted weekly, is currently about 3.8% a year.

"The Colombian authorities recognize that the reform effort and the fiscal consolidation process need to be continued beyond 2002 to strengthen further the control over the public debt dynamics and to consolidate the gains in macroeconomic stabilization. They agree that it is important that the pension reform be broad based, the fiscal policy recommendations to be made by the Public Revenue Commission be acted upon, and that the finances of the territorial governments be strengthened further.

"The banking system has been strengthened since the serious difficulties of 1998/99. The authorities are commended for their actions to raise prudential norms and for their recent efforts to improve further the performance of the system by taking important steps to strengthen the mortgage banks. As regards the remaining public banks (except Banco Agrario), the authorities are encouraged to pursue their preparation for privatization or liquidation.

"While Colombia's external competitiveness has improved considerably, helped by a real depreciation of the peso since the late 1990s, the country faces challenges related to a near-term decline in oil production and weakness in the international coffee market. These challenges underscore the need to continue the structural reform effort in order to enhance the productivity of the Colombian economy. Progress in the reform initiative to enhance labor market flexibility will be important," Mr. Aninat said.

Statement by Murilo Portugal, Executive Director and Roberto Junguito, Alternate Executive Director for Colombia
January 25, 2002

Introduction

The Colombian economy was significantly affected by external shocks and domestic non-economic factors in 2001. On the external front, the adverse factors included the world economic slowdown, unprecedentedly low coffee prices, lower oil prices, some spillover from the Argentine situation, and the aftermath of the September 11 events. On the domestic front, uncertainty about the peace process continued to be an obstacle to private investment, while insecurity was the direct cause of the drop in oil production and exports due to sabotage.

Notwithstanding, economic performance was positive. Economic growth is estimated to have reached around 1.8 percent in 2001. Though less than in 2000, GDP growth was above the average for Latin America and appears to have prevented a decline in per capita income. Inflation was below the targeted 8 percent. The external position remained strong and the fiscal deficit declined. Unemployment eased somewhat but remains high. As noted by staff, most quarterly performance criteria under the program up to June were met, and the assessment of the authorities indicates that, in September, all indicative targets were also reached. What is also important to highlight is that, despite the turbulent international environment, authorities managed to continue accessing international capital markets. They were in a position to reduce interest rates within the inflation-targeting framework, given the positive inflationary outlook and the stability in the nominal exchange rate. Advances were also made on the structural front.

Fiscal Policy

The combined public sector deficit is projected to have declined modestly to 3.3 percent of GDP from 3.5 percent in 2000. The combined deficit in 2001 was broadly in line with the indicative target, after adjusting for revenue collections. Though revenues increased above their 2000 level as a result of the tax reform, they were below the expected levels owing mainly to the impact of the world slowdown on economic growth. Public spending increased more than envisaged due to required purchases of security equipment, rising costs of the public health system, and the support to the coffee sector, but both wage costs and interest payments were lower than expected. In this regard, it is important to note that the constitutional court reversed, in part, an earlier decision that required backward indexation of public wages. As noted below, the government has also advanced in the fields of health and pension reforms that have been major sources of expenditure pressures.

As programmed, the authorities opted for financing government needs mainly from external sources, while leaving the domestic market to satisfy private sector demand, thus preventing crowding out and upward pressures on interest rates. A key element of the external financing strategy was the approval and the use of a World Bank guarantee, which helped to place around US$1 billion in the international capital markets. Remaining market placements were made without guarantees. Access to international markets allowed the pre-financing of a significant proportion of 2002 needs. This was a preventive strategy adopted in light of the decrease in market access that could come about as a result of the world economic slowdown and the spillover of the Argentine situation. The pre-financed resources were maintained outside the country so as not to place untimely pressures on the foreign exchange market. In June, the government successfully swapped domestic debt falling due 2001-05 with longer maturity instruments.

For 2002, the projected combined fiscal deficit is 2.6 percent of GDP. Current and capital expenditures relative to GDP must both be reduced in order to achieve the fiscal goal. Fiscal adjustment has been significant. Over the three years of the program, the primary balance will have improved by 5.1 percentage points of GDP. We would like to emphasize that in case of adverse developments in fiscal revenues or lack of international financing, which cannot be covered through the domestic market without major pressures, the authorities would further adjust spending to achieve the quarterly fiscal targets of the program, as is highlighted in the Letter of Intent (LOI). Notwithstanding, the ongoing peace negotiations may require a temporary increase in expenditures to ensure adequate implementation. In such an event, the Fund will be given prior notice.

Monetary and Financial Sector Issues

The quarterly inflation targets were met during 2001. Annual inflation amounted to 7.6 percent, below the 8.0 percent annual ceiling. As indicated, in view of the favorable outlook for inflation, the central bank lowered its rates by more than 350 basis points. The inflation-targeting framework has been performing very well and will be maintained. The authorities have set an inflation target of 6 percent for 2002 and are confident that it will be achieved. The central bank also established a medium-term inflationary goal of 3 percent to be reached by 2005.

The flexible exchange-rate regime adopted in September 1999 has continued to work well and, despite the world economic turbulence, the exchange rate showed low volatility. No interventions in the market were required, except for the exercise of the options mechanism, which allowed for the strengthening of international reserves.

The financial sector has continued to recover and achieved moderate profits in 2001. Prudential indicators also improved. In an effort to deal with the remaining problems, which are concentrated in the housing sector, the economic authorities launched a capitalization program oriented to strengthen the mortgage banks' capital base. For 2002, the major actions envisaged encompass putting in place a restructuring program for the mortgage banks and completing the effort to bring prudential standards to international levels. Also, the Colombian authorities will continue to take steps to facilitate the privatization of remaining public banks, except Banco Agrario. Legal and administrative obstacles delayed privatization actions. Recently, as a result of the world economic slowdown and the economic situation in Argentina, authorities have been informed by their advisors of the current lack of market interest for a traditional privatization of public banks. As a result, upon the recommendation of their external advisors, the authorities opted in the case of Banco Cafetero to extend a mandate for the placement of new equity shares in the international markets.

External Sector Developments and Outlook

The current account deteriorated in 2001 to a deficit of 2.5 percent of GDP from near balance in 2000, as a result of the weakening of international coffee prices and lesser oil exports resulting from a drop in oil prices and export volumes. Despite the world economic slowdown, non-commodity exports continued to increase. The deterioration in the current account was also caused by increased capital goods imports, mainly transport equipment. For 2002, the authorities project an increase of the current deficit to a still manageable level of around 3.2 percent of GDP, stemming from the reduction in the international oil price. On the capital account, net capital inflows increased sharply in 2001 not only due to the public sector external financing plan, but also because private sector financing showed a high rollover rate for medium- and long-term debt and there was some recovery in foreign direct investment.

Net international reserves increased by US$1.2 billion in 2001 and amounted to around US$10 billion, equivalent to near six months of imports of goods and services. For 2002, net international reserves are projected to increase by US$320 million, which can be achieved through interest earnings on reserves.

Colombia's total external debt is estimated to have reached 46.4 percent of GDP in 2001 and is projected to decline slightly in 2002. Most external debt is of a medium- and long-term nature, with outstanding short-term debt representing only around 10 percent of total external debt. Measured as a percentage of exports of goods and services, debt service amounted to around 54 percent, while the ratio of reserves to short-term external debt by remaining maturity has been maintained at around 100 percent. Moreover, international reserves cover 40 percent of broad money. Thus, indicators of external vulnerability continue to be comfortable.

The Structural Reform Program

Since the last review at end-March 2001, positive advances have been made on the structural reform front. Congress approved in June 2001 the constitutional reform of the system of transfers to territorial governments (revenue sharing), which partially delinks transfers from current income of the central government. As a complementary action, the government introduced a bill to Congress to improve the control and allocation of the revenue sharing funds for education and health expenditures, which was approved at end-December.

On public finances, the government named a commission, which includes three distinguished foreign experts, to propose measures to deal with the remaining distortions and rigidities that dampen fiscal efficiency in Colombia, and to suggest measures to facilitate the achievement of medium-term sustainability of public finances. The commission will issue its recommendations in August 2002 by the time of the hand-over of the government to the incoming administration.

Secondly, in order to complement the tax reform approved in 2000, the government submitted to Congress a territorial tax reform intended to increase fiscal autonomy at the territorial level and strengthen tax administration. As noted in the LOI, if the proposal is not discussed and passed through Congress, the government shall ask the Revenue Commission to include it on its agenda for discussion with the incoming administration.

Thirdly, the government will submit to Congress, by mid-year, a proposal to establish a fiscal responsibility law intended to design fiscal rules to enhance fiscal discipline. Important advances in fiscal responsibility legislation had already been achieved at the territorial level in 2000 (through the approval of Law 617, which has led to a down-sizing of the territorial governments), and initial discussions on the contents of the draft proposal have been held with Fund experts.

The reform of the Social Security Institute (ISS)'s health services, a notable source of expenditure over-runs, has also been implemented. As indicated by staff, the collective bargaining agreement with health workers, one of the strongest labor unions in the country, was renegotiated; the restructuring of ISS debt with health service providers was completed, and, as a result, the Institute was allowed to continue receiving new affiliates for its health services.

More importantly, after extremely difficult negotiations within the government and consensus building with social and other interested groups, the authorities submitted to Congress in late December a proposal for a second-generation reform of the general pension system. The last major reform had been adopted in 1993 through Law 100. As discussed by staff (Appendix VI), the proposed reform is designed to reduce significantly the system's actuarial deficit and to improve the medium-term cash flow. The authorities recognize that, given the circumstances and the time under which it was framed, in many respects the proposed reform does not incorporate all desirable technical elements. Nevertheless, given the circumstances, it is a substantive and politically viable proposal. Authorities have also made a commitment to address the issue of two special pension regimes (teachers and security forces). The passage of tax and pension legislation, however, will be particularly difficult and challenging in the first semester given that presidential elections will take place in May.

Medium-Term Outlook

With respect to the medium-term outlook, the discussions focused, as noted by staff, on two key issues: the public sector debt profile and its sustainability to 2010. As indicated in the report, under a reasonable and achievable set of assumptions regarding GDP growth, inflation, interest rate, oil production, and medium-term approval and implementation of the pension reform, it was found that the annual public sector deficit would be reduced to the range of 2-2.5 percent of GDP. This would allow the stabilization of public debt at around 45 percent of GDP. The authorities recognize that, in order to stabilize public debt, fiscal consolidation must continue beyond the present administration's economic program. This condition is likely to be met given the good track record of Congress in legislating on fiscal affairs, and the tradition in Colombia to discuss and put into effect the recommendations of independent high-level fiscal missions as the experience with the past Musgrave, Taylor and Bird missions so clearly attest.

Performance Criteria, Reviews, and Other Program Issues

As mentioned above, most performance criteria were met by June. The only missed target and request for waiver refer to very small slippages of an accounting nature in the fiscal target. Given the delay in the review, no performance criteria were explicitly set for September and December. Notwithstanding, the September indicative targets were also met by wide margins, particularly the fiscal targets. Available information indicates that the inflation and NIR indicative targets were also met at end-December. (Information on the year-end fiscal outcome and medium-term external financing is not yet available).

The present program establishes explicit performance criteria only for March and June of 2002, given that the next review will take place in mid-September. In addition to the traditional quarterly targets, a new structural performance criterion was introduced. It refers to making public a proposal for the reform of the exempted pension regimes before April 15. Though the timing is inappropriate given elections, the authorities accepted the structural performance criteria. The government had already expressed, in its pension reform proposal to Congress, its commitment is to reform such pension regimes.

As pointed out in the LOI, the authorities have taken note of the Executive Board's decision on safeguard assessments. Though the central bank has a highly professional internal auditing system that has served it well, it has agreed to engage an external auditing firm to establish an audit mechanism according to international standards, and publish the audit opinion together with the central bank's annual financial statements beginning with financial year 2002.

We would like to highlight Colombia's commitment to transparency. Colombia has been publishing, since the start of the program, the staff report and communicated to the Fund its acceptance to publish the present report before it was circulated. Colombia participates in the SDDS, undertook the FSAP at the pilot phase, and has strengthened and supports the anti-money laundering principles of the FATF. In the coming months, Colombia will undertake the fiscal transparency module.

We would like to close by thanking staff and Management for their support and advice on the Colombian program.