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Colombia: Second Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria—Staff Report; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Colombia

In the context of the second review under the Stand-By Arrangement and request for waiver of performance criteria, the following documents have been released and are included in this package:

- the staff report for the second review under the Stand-By Arrangement and request for waiver of performance criteria, prepared by a staff team of the IMF, following discussions that ended on **November 14, 2003**, 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 December 24, 2003.** 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 Press Release summarizing the views of the Executive Board as expressed during its January 12, 2004 discussion of the staff report that completed the request and 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*
Memorandum of Economic and Financial Policies by the authorities of Colombia*
Technical Memorandum of Understanding*

*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

Second Review Under the Stand-By Arrangement and Request for Waiver of Performance Criteria

Prepared by the Western Hemisphere Department

(In consultation with other departments)

Approved by Jorge Márquez-Ruarte and Michael T. Hadjimichael

December 24, 2003

Economic program. The authorities' program for 2003-04 seeks to reduce the economy's vulnerability and promote faster economic growth. Key policies include raising the public sector's primary surplus to reduce the public debt, which reached 58 percent of GDP at end-2002, and structural reforms focused on strengthening medium-term fiscal sustainability and improving financial supervision, thereby creating conditions for sustained growth.

Stand-By Arrangement. A two-year arrangement was approved on January 15, 2003 in the amount of SDR 1,548 million (100 percent of quota on an annual basis). The first review was completed in June 2003. Colombia has no outstanding credit from the Fund (Appendix I).

Performance under the program has been strong. All quantitative performance criteria and all structural reforms through September were met. The submission of the revised budget code (a structural performance criterion for end-October) has been delayed until end-2003. The public expenditure freeze and pension reform proposed in the national referendum have not been approved, and the authorities have developed alternative fiscal measures.

Discussions. A staff team visited Bogotá during November 4–14, 2003 and held many meetings, including with Mr. Alberto Carrasquilla (minister of finance), Mr. Miguel Urrutia (the general manager of the Banco de la República), the Board of Directors of the Banco de la República, and Mr. Santiago Montenegro (director of the national planning department). The staff team comprised R. Rennhack (Head), B. Fritz-Krockow, A. Espejo, H. Hirschhofer (all WHD) and J. Wiegand (PDR). R. Steiner (OED) attended all meetings.

Letter of Intent. In the attached letter, the authorities are requesting: (i) the completion of the second review, on the basis of the policies proposed; (ii) a waiver for the nonobservance of the structural performance criterion; and (iii) a waiver of the applicability of the performance criteria for end-December 2003. The staff supports the authorities' requests. Upon completion of this review, Colombia could draw a total SDR 774 million, although the authorities will continue to treat the arrangement as precautionary.

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EXECUTIVE SUMMARY

Economic performance in 2003 is likely to be favorable. Real economic growth is expected to reach almost 3 percent, while inflation is likely to fall to 6.2 percent, virtually in line with the program target of 5.9 percent. The external current account deficit is projected to reach 2.2 percent of GDP, somewhat less than anticipated in the program.

Economic policies for the year are broadly on track. Fiscal policy through September was in line with the program and, in late October, President Uribe announced measures to keep fiscal policy under control following the unfavorable outcome of the national referendum, which included an expenditure freeze and pension reform. The central bank took steps to contain inflationary pressures early in the year. All but one of the structural reforms has proceeded as scheduled. However, the submission of the revised budget code to Congress (a structural performance criterion for end-October) was delayed to December 16, 2003.

The authorities remain fully committed to preserving the program's macroeconomic framework. The program anticipates a continued improvement in economic performance, with a pick up in growth and a continued decline in inflation. The external current account deficit is projected to rise moderately, and net international reserves will hold steady.

The program proposes a slight increase in the fiscal deficit targets to 2.8 percent of GDP in 2003 and 2.5 percent of GDP in 2004. These targets are designed to keep fiscal policy on a sustainable path, as the primary surplus of the nonfinancial public sector would improve significantly from 0.4 percent of GDP in 2002 to 2.4 percent of GDP in 2004.

Monetary policy will target a decline in inflation to 5½ percent in 2004. The financial program provides room to prepay a limited amount of the government's external debt.

The planned structural reforms will proceed as envisaged. In addition, the program incorporates a new timetable for reforming the budget code as well as a new initiative to begin to strengthen the system of fiscal decentralization and additional steps on pension reform.

Risks to the program remain significant. President Uribe now faces a different political landscape and will need to devote significant effort to maintain a political consensus for the program. The constitutional court may play a more activist role in economic policy. The security situation remains fragile. The external environment poses some risk as international interest rates might rise in the near future.

The staff supports the authorities' request to complete the second review. It also supports their requests for a waiver of the nonobservance of the structural performance criterion and of the applicability of the performance criteria for end-December 2003.

I. DEVELOPMENTS IN 2003

1. **The economic outturn for the year is likely to be very favorable**:

- In the first three quarters, real GDP grew by about 3¼ percent year-on-year led by strong growth in construction, manufacturing and financial services (Figure 1). Real investment rose significantly, while real private consumption expanded slowly. Urban unemployment declined to 15.4 percent in October (16.1 percent a year earlier). Based on this outturn, the authorities raised their official growth projection for 2003 to 2.8 percent, from 2 percent in the program (Table 1).

- Inflation is expected to decline to 6.2 percent during 2003, slightly above the program target of 5.9 percent (Table 2). Monthly inflation has fallen sharply since April, because of falling food prices in recent months and a broadly stable currency since early this year.

- The external current account deficit is projected to reach 2.2 percent of GDP in 2003, slightly below the program target of 2.3 percent of GDP (Table 3). Exports are expected to increase by 7 percent—in spite of the collapse of exports to Venezuela—on the strength of higher oil and coal prices and the significant real effective exchange rate depreciation since mid-2002. Imports are projected to grow by 8-9 percent, reflecting strong growth in capital goods imports. Net international reserves are projected to decline by US$100 million during 2003, a somewhat better performance than the adjusted program target.[1]

2. **Economic policies for the year are broadly on track:**

- The combined public sector (CPS) deficit through September amounted to 1.4 percent of annual GDP, compared with the program target of 1.5 percent of GDP (Tables 4 and 5). On October 25, the vote on the national referendum took place, and none of the proposed reforms, including the expenditure freeze and pension reform, has been

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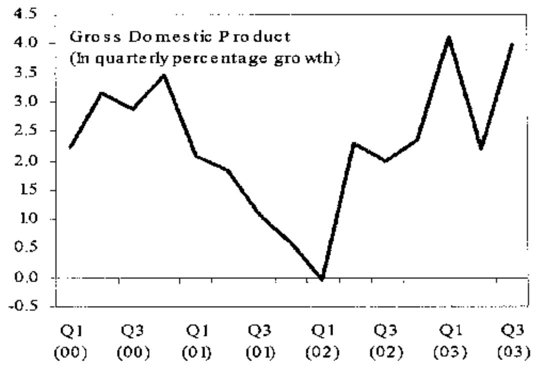
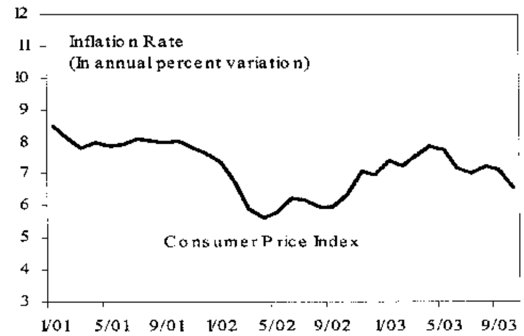
[1] In March–July 2003, the Banco de la República sold US$338 million through the options mechanisms established in 1999. The net international reserve target is to be adjusted downward by up to US$2 billion of foreign exchange sold through these mechanisms.

Figure 1. Colombia: Selected Indicators

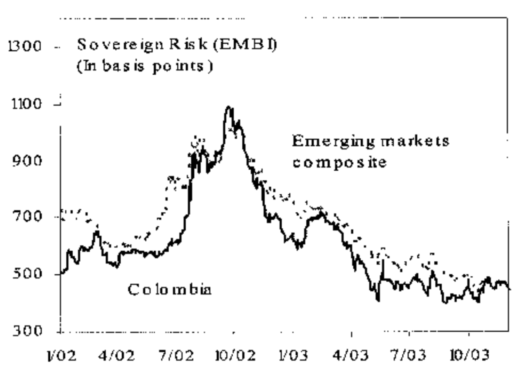
The economy is recovering...



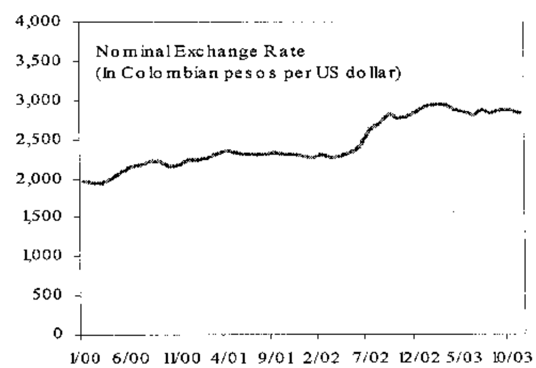
... and inflation is declining.



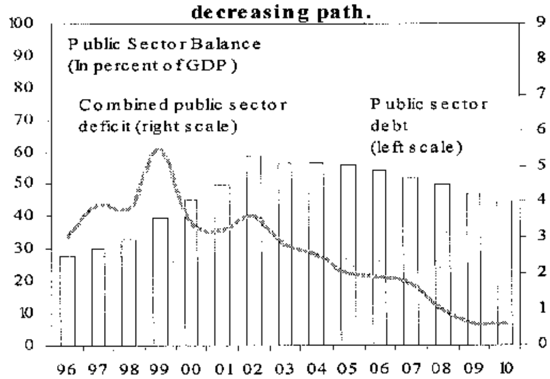
Colombian spread is declining, ...



... the exchange rate remains stable, ...



... and the fiscal deficit is declining, while the public debt should be on a decreasing path.



Colombia: Social Indicators

GDP (2002) (billions of US$)	80.8
Population (2002) (millions)	43.4
Share of income of:	
Richest 20 percent of the population (%)	60.9
Poorest 20 percent of the population (%)	3.0
Pop. below the poverty line (%), 1987-2000	17.7
Pop. with access to safe water (%), 2000	91
Under-5 mortality rate (per 1,000 live births), 2001	23

Sources: Central Bank of Colombia; National Department of Statistics (DANE); JP Morgan; and UNDP Human Development Indicators 2003.

approved, because of an insufficient voter turnout.[2] At end-October, President Uribe announced alternative measures to keep fiscal policy under control.

- The Banco de la República raised its main refinancing interest rate by a total of 200 basis points in January and April to 7.25 percent, and—within the parameters of the program—intervened in the foreign exchange market in March–July to contain the expected currency depreciation, which was threatening to spillover into inflation expectations. Since midyear, the central bank has left its policy interest rate unchanged, in view of the slowdown in monthly inflation, the continued high unemployment as well as the calm market reaction following the referendum. On December 9, the central bank purchased US$100 million (about ½ of the daily volume in the foreign exchange market) in the foreign exchange market, citing concerns about the recent currency appreciation.

- Almost all structural reforms have proceeded as scheduled (Memorandum of Economic Policies, Table 2). The Fiscal Responsibility Law was approved by Congress in June, the decree on military pensions was issued in July, and the reform of the public health system is underway. Moreover, the government restructured the state petroleum and telecommunications companies—positive steps beyond the reforms planned in the program. However, the submission of the reform of the budget code (a structural performance criterion for October 2003) was delayed until mid-December 2003.

- The authorities continue to strengthen financial supervision, while banking system profitability and capital adequacy have improved further (Tables 6 and 7). However, mortgages still account for much of the weak loan portfolio of the banking system, and the weak banks are still under restructuring plans monitored by the bank superintendency (Figure 2).

3. **Markets have remained calm**. Asset prices had shown increasing volatility in the runup to the referendum vote. However, since late October, the currency has appreciated moderately, while the country risk premium has remained in the range of 430 to 470 basis points.

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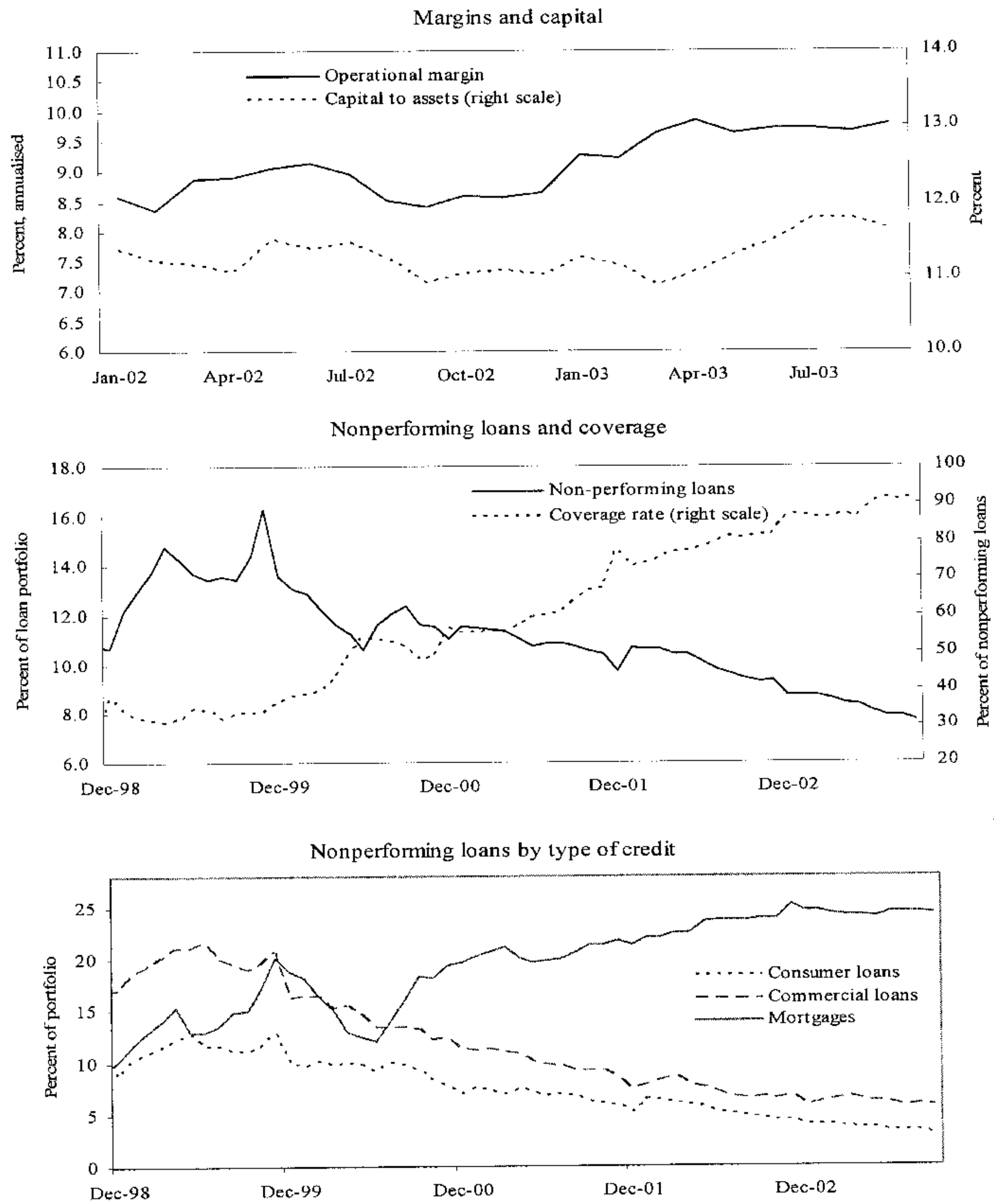
[2] Approval of each measure required a minimum of almost 6.3 total votes (25 percent of the electorate) and a simple majority of the votes cast. All reforms received at least 80 percent of the votes cast, but none received the minimum number of votes. Final results have been delayed to resolve disputes over votes, but it is expected that at best only a few of the reforms will be approved.

Figure 2. Colombia: Banking System Indicators



Source: Superintendency of Financial Institutions; Fedesarrollo.

II. POLICY DISCUSSIONS

4. **The authorities remain committed to preserving the program's macroeconomic framework.** The program for 2004 anticipates a continued improvement in economic performance, with real GDP rising by over 3 percent, inflation falling to 5½ percent, and net international reserves holding steady. The external current account deficit is projected to rise to 2.5 percent of GDP in 2004, which is expected to be fully financed with capital inflows.

Macroeconomic Framework: Main Elements 2002-04

		2003		2004	
	2002	Prog.	Rev.	Prog.	Rev.
	(Annual percentage change)				
Real GDP	1.7	2.0	2.8	3.3	3.3
CPI (end of period)	7.0	5.9	6.2	5.0	5.5
	(In percent of GDP)				
External current account deficit (-)	-2.0	-2.3	-2.2	-2.4	-2.5
NFPS primary balance	0.4	2.7	1.9	2.7	2.4
Combined public sector deficit (-)	-3.6	-2.5	-2.8	-2.1	-2.5
Total public debt	58.4	54.9	55.6	53.5	56.2
	(In billions of U.S. dollars)				
Net international reserves	10.5	10.5	10.4	10.8	10.4

A. Fiscal Policy

5. **The program proposes a slight increase in program targets for the CPS deficit to 2.8 percent of GDP in 2003 and 2.5 percent of GDP in 2004.** These targets would still keep fiscal policy on a sustainable path, as the primary surplus of the nonfinancial public sector would improve from 0.4 percent of GDP in 2002 to 2.4 percent of GDP in 2004. Moreover, in line with the recently approved Fiscal Responsibility Law, the government intends to announce by June 2004 that the primary surplus would rise to 3 percent of GDP in 2005, which is consistent with reducing public debt to 40–45 percent of GDP by 2010.

6. **For 2003, the authorities will reach the proposed fiscal target by controlling expenditure.** The rejection of the expenditure freeze proposed in the referendum would have raised the CPS deficit to 3.2 percent of GDP in the absence of corrective measures.[3] After the referendum vote, the authorities scaled back planned increases in spending on many investment projects, yielding expenditure savings of 0.4 percent of GDP. The authorities had a contingency plan to issue a decree to freeze government wages above a certain threshold (about US$450 a month), which would have lowered the wage bill by 0.3 percent of GDP. However, in early November the constitutional court ruled that public wages had to rise by at least half the rate of inflation, making it impossible to carry out this contingency measure, and it was not possible to keep the CPS deficit in line with the original program target.

Fiscal Adjustment in 2003 (In percent of GDP)	
CPS deficit w/o measures	3.2
Program target	2.5
Effect of referendum	0.7
Expenditure cuts	0.4
Revised target	2.8

7. **For 2004, the authorities intend to reduce the CPS deficit further through both revenue and expenditure measures.**

- Without corrective measures, the CPS deficit would have reached 3.7 percent of GDP in 2004. The approved 2004 budget included additional military spending and costs of restructuring two public enterprises and the public health service. Also, the outcome of the referendum would have raised current spending further.

Fiscal adjustment in 2004 (In percent of GDP)	
CPS deficit w/o measures	3.7
Original program target	2.1
Structural reform costs, higher military spending	0.4
Effect of referendum	1.2
Tax package	0.5
Expenditure	0.7
Revised program target	2.5

- In December 2003, Congress approved a tax package designed to raise revenues by 0.5 percent of GDP in 2004. The government had proposed to increase tax revenues by 0.7 percent of GDP by raising VAT and income tax revenues, which were intended to encourage savings and investment. However, congress wanted a more progressive tax package and rejected any increase in the VAT. After a lengthy debate, a compromise was approved that is expected to yield 0.5 percent of GDP of additional revenues. The measures include:

[3] The 2003 budget included a temporary expenditure freeze on most current primary spending. Following the referendum result, this temporary freeze was lifted retroactively to the beginning of 2003.

- Keeping the top income tax rate at 38.5 percent,[4] with a credit for 30 percent of reinvested profits.
- Maintaining a tax of 0.3 percent on individual net worth above a certain threshold.[5]
- Increasing the financial transactions tax rate from 0.3 percent to 0.4 percent.
- Avoiding any change in the tax rates or base of VAT revenues. However, congress accepted the government's proposal to introduce a rebate of 2 percentage points for credit and debit card transactions and to lower withholding of these tax payments, which will slightly lower VAT collections.
- Improving tax administration by enhancing the government's power to settle disputes and raising penalties for tax evasion.[6]
- The staff encouraged the authorities to limit the loopholes (the credit for reinvested profits and the VAT rebate), as these would erode revenues over time.

- The authorities announced that they will trim expenditure by 0.7 percent of GDP by curtailing public investment (0.4 percent of GDP) and redirecting some the transfers to territorial entities to build up their pension funds (0.3 percent of GDP).

8. **With these fiscal targets, public debt is expected to decline to 56 percent of GDP by end-2004**. The authorities are planning to secure net external financing of 1.6 percent of GDP in 2004, reflecting disbursements of US$1.2 billion from multilateral lenders as well as US$1.2 billion of international bond issues. In 2004 the authorities want to rely on external funding to limit the possibility for crowding out, especially in the first half of the year. However, over the medium term they intend to increase the share of domestic debt to 60 percent of total debt by 2010 to reduce the effect of exchange rate and international interest rate risks on the value of public debt.

B. Monetary and Exchange Rate Policy

9. **Monetary policy will continue to be conducted within the inflation targeting framework**. The Banco de la República's inflation target for 2004 of 5 ½ percent takes into

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[4] The 2002 tax reform raised the top income tax rate to this level for one year.

[5] In August 2002, Congress approved a one-time net worth tax for 2003.

[6] The 2004 budget approved by Congress in October includes estimated revenues of 0.4 percent of GDP arising from a one-time tax amnesty. The program projections exclude these potential revenues and their related spending.

account the effect of the elimination of gasoline subsidies and higher prices for public services. The Bank also announced that it would lower inflation to a range of 3½ to 5½ percent in 2005. The authorities reiterated their commitment to take the necessary policy actions to reach the inflation target, and noted that—with the decline in inflation in recent months—the Banco de la República's main refinancing rate has become positive in real terms. They agreed that price pressures might become more prominent over the next year or two, as the gap between actual and potential output is expected to narrow considerably.[7]

10. **The staff noted that the public discussion of inflation focused largely on recent economic trends, making it more difficult to take policy decisions based on the outlook for inflation.** The staff suggested that the central bank consider sharing more information about its own inflation model with the public, which could help shift the discussions towards the outlook for inflationary pressures.

11. **The program holds net international reserves steady in 2004.** The authorities proposed a limited use of reserves to prepay some of the government's external debt, in order to lower the government's net interest costs. As a result, it was agreed that the interest accumulated on international reserves (about US$300 million a year) could be available for this purpose. With this revised target, net international reserves would remain at 110–120 percent of short-term debt on a remaining maturity basis. The mission cautioned that more significant declines in net international reserves would most likely drive up the country risk premium and offset any potential benefits of prepaying external debt.

12. **The staff raised concerns about political pressures on the Banco de la República**. The government had publicly urged the central bank to take several actions, including most recently the proposal to use international reserves. The mission noted that, while the current legal framework provided for central bank independence, this pressure limited the central bank's scope to make decisions independently. The authorities observed that the current legal framework allowed the government and the central bank to maintain a close coordination, which had helped to implement a monetary policy under which the country reduced inflation while growth recovered.

C. Financial Sector

13. **The authorities are continuing to strengthen financial supervision**. The draft budget code submitted to Congress in December contains a provision to give full budgetary autonomy to the financial superintendency. The implementation of the risk classification and loan provisioning in line with the Basle II accord is proceeding gradually. Banks are currently submitting their internal risk control systems for assessment to the superintendency,

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[7] In its June 2003 inflation report, the Banco de la República projected that the output gap would fall to 1 percent in 2004.

and in 2004, the new models and regulatory provisions will be applied on a test basis. Beginning 2005, selected banks will be allowed to use the new approach.

14. **The government's ownership stake in two intervened banks—Bancafé and Granahorrar—is being scaled back.** Private investors are currently bidding for 55 percent of the capital of Bancafé, and the sale is most likely to be completed in early January 2004. The government plans to sell its remaining ownership stake in Bancafé to employees and other investors during 2004. The financial restructuring agency is reviewing the options for restructuring Granahorrar, with a view to bringing it to the point of sale by September 2004, as envisaged in the program.

15. **Several mortgage banks continue to experience difficulties.** The authorities continue to monitor the weak institutions through restructuring plans. An FSAP follow-up mission is scheduled to visit Bogotá in 2004, and will review the adequacy of this approach.

D. External Sector Outlook

16. **In 2004, the external current account deficit is projected to widen, as the trade balance moves into a small deficit.** Exports are projected to rise moderately, as strong growth in nontraditional exports more than compensates for the effect of falling petroleum exports. Imports are projected to grow by broadly in line with the economy. With regard to capital inflows, net public sector borrowing is expected to reach about 1¾ percent of GDP, while net inflows to the private sector would amount to about ¾ percent of GDP. Total external debt is projected to remain slightly below 50 percent of GDP.

17. **The outlook for growth and sustainability over the medium term remains favorable (Table 8).** In the baseline scenario, real growth is expected to rise moderately, while annual inflation declines to 3 percent. Interest rates are assumed to average about 6 percent in real terms, in line with international interest rates adjusted for currency depreciation and a country risk premium of about 450–500 basis points. The primary surplus of the nonfinancial public sector would need to range from 3 to 3½ percent of GDP to reduce public debt to less than 45 percent of GDP by 2010. With this fiscal policy stance, the external current account deficit would rise to over 3 percent of GDP in 2006–07, as oil exports decline, and then improve to less than 2 percent of GDP, as new oil exports come on stream. Total external debt would decline from about 50 percent of GDP in 2004 to around 40 percent of GDP by 2010.

18. **This medium-term debt profile remains sensitive to the effect of different assumptions.** Currency fluctuations have a significant impact on both public and external debt. A hypothetical 30 percent real exchange rate depreciation would raise public debt to 62 percent of GDP and external debt to 52 percent of GDP by 2010 (Tables 9 and 10). If interest rates were to rise by 300–400 basis points in 2003–04 compared to the baseline, public debt would rise to 57 percent of GDP.

19. **Colombia would be able to repay the Fund, if all the purchases were made under the arrangement**. Fund credit would peak at only 3 percent of GDP in 2004. Debt service would peak at 5.5 percent of exports of goods and nonfactor services in 2007 (Table 11).

20. **The authorities are proposing to accept the obligations of Article VIII.** [8] A bilateral payments agreements with China was phased out in mid-2003 and the tax on inward remittances was eliminated in December 2003. Consistently with Colombia's obligations under the WTO, the subsidies under the export rebate system have been eliminated, although the enabling legislation remains in place. The government intends to remove the tax on outward remittances by 2005. It is undertaking conversations with Fund staff to identify whether the foreign exchange regime for hydrocarbons exporters gives rise to an exchange restriction.

E. Structural Issues

21. **The planned structural reforms—other than reforming the budget code—will proceed as envisaged, in order to lay the basis for sustained economic growth**. In particular, efforts will continue to strengthen the financial position of the public health system and to modernize the public sector.

22. **The program incorporates a new timetable for reforming the budget code, which was to be approved by Congress by end-2003**. The revised code will scale back provisions for revenue earmarking, limit the government's ability to approve budgetary commitments for future years, and restrict spending from commitments made in previous years. The authorities have agreed to secure congressional approval of the revised budget code during 2004 as a condition for completing the fourth review under the program. The 2005 budget will include a presentation of spending according to a standard international classification system—which is one element of the budget code reform designed to improve the evaluation of expenditure. This measure will be a structural performance criterion for July 2004.

23. **The program includes steps to develop a plan to strengthen Colombia's system of fiscal decentralization**. Currently, the central government shares revenues with territorial entities but the allocation of responsibility for expenditures is unclear, leading to a duplication of spending in several areas. With an input from FAD technical assistance, an interagency committee (CONPES) will develop a strategy by September 2004 for improving the current system.

24. **The authorities also intend to take additional steps on pension reform**. By March 2004, they plan to propose a constitutional reform to congress that will scale back the generous benefits of the special pension regimes.[9] They also intend to recover in 2004

[8] A separate paper will be circulated to the Board for approval on a lapse-of-time basis of the authorities' request to accept the obligations of Article VIII.

[9] The referendum included a measure to eliminate all special pension regimes by 2008.

pension contributions that some workers had transferred to private pension funds before they were permitted under the law.

25. **The program also includes a plan to prepare monthly data on the position of the nonfinancial public sector**. Currently this information is available only quarterly and with a long delay, which hampers the government's ability to monitor the stance of fiscal policy.

III. Program Monitoring

26. All performance criteria and structural benchmarks through end-September 2003 have been observed. Access under the arrangement remains appropriate (Table 12). Upon completion of this review, an amount of SDR 96.7 million will be made available, and the authorities would be eligible for a cumulative purchase of SDR 774 million under the arrangement (Table 13).

27. **Program conditionality is being amended at this review as follows**:

- The target for the CPS deficit in 2003 is being raised to 2.8 percent of GDP, from 2.5 percent of GDP.
- The indicative targets for December 2003 for inflation, net international reserves, net disbursements of short-term external debt and of medium- and long-term external debt by the public sector are being converted into performance criteria.
- Performance criteria for March 2004 and June 2004 and indicative targets for September and December 2004 are being established for the CPS deficit, inflation, net international reserves, and net disbursements of short-term external debt and of medium- and long-term external debt of the public sector.
- The third review under the arrangement is to be completed by May 2004. This review will ensure that policies remain consistent with achieving the program's objectives and will set performance criteria for September and December 2004. The timing of the review will also allow for a discussion of the fiscal outlook for 2005.
- The fourth review under the arrangement is to be completed by November 2004. Congressional approval of the revised budget code is a condition for the completion of this review.
- The authorities are requesting a waiver of the nonobservance of structural performance criterion for the submission of the revised budget code to Congress, which was to be completed by end-October 2003 and was submitted to Congress on December 16, 2003.
- The authorities are also requesting a waiver of the applicability of the performance criteria for end-December 2003, because the information for this test date will not be available at the time of the Board discussion.

- The amounts of purchases and the availability dates for the remaining purchases under the SBA are proposed to stay the same, with a slight modification of the condition for purchase related to the performance criteria for June 2004.

28. **Risks to the program remain significant**. President Uribe continues to enjoy approval ratings of 70–80 percent, even after the vote on the referendum. Since late October, however, the major political parties have presented more challenges to the government's legislative proposals, and President Uribe will probably have to show more flexibility to gain political support for his initiatives, especially with regard to fiscal policy. Also, based on recent experience, the constitutional court could reverse some of the government's economic policies. The security situation is perceived to be improving, but remains fragile. A further deterioration in Venezuela would probably have little additional economic effects on Colombia, as most of the effects have already occurred. The external environment poses some risk, as monetary policy in the United States could tighten or Colombia's risk premium could widen if fiscal policy weakens.

IV. Staff Appraisal

29. **In 2003, the authorities' program made good progress towards creating the conditions for faster sustained growth over the medium term.** The implementation of strong economic policies helped strengthen confidence and restore access to international capital markets. In turn, this contributed to a pick up in real economic growth, a decline in inflation, and a stronger external position.

30. **Economic policies for 2004 aim to preserve the program's macroeconomic framework**. Real economic growth is expected to rise further, inflation is targeted to remain on a downward trend, and the external position is projected to remain comfortable. The calm market reaction since late October reflects in part confidence in the authorities' commitment to strong economic policies.

31. **Fiscal policy is expected to stay on a sustainable path.** The revised fiscal target for 2004, as well as the authorities' intentions for 2005, show that fiscal policy is being directed towards reducing public debt significantly by 2010. The fiscal target for 2004 is to be achieved through expenditure restraint, as well as the revenue strengthening approved by Congress in December 2003. Nonetheless, there are some concerns about the tax package approved by congress. It is particularly unfortunate that the package resorts to an increase in the financial transactions tax, which is a distortion that can limit the development of financial markets. Moreover, the credit for a share of reinvested profits and the VAT rebate will complicate tax administration and could erode the revenue base over time. Having said this, the revenue effort is a welcome step towards improving the country's fiscal position. In the coming year, the staff urges that the authorities consider measures that broaden and simplify many of the existing taxes, with a view to achieving a more durable strengthening of revenue, and the staff will be prepared to extend further technical assistance toward this end.

32. **The central bank has been successful in achieving its inflation target**. It is committed to taking the actions necessary to meet its targets for further declines in inflation in 2004 and beyond. However, looking ahead, it is likely to face challenges in reaching these targets, as demand pressures may become more prominent. The central bank's foreign exchange intervention during 2003 helped preserve stability without resisting market trends, and as a result, export competitiveness benefited from the sizable real depreciation since mid-2002. Continued exchange rate flexibility is essential to allow the economy to adjust to shifts in world markets.

33. **The proposed target for net international reserves will maintain an adequate reserve cushion.** It will also facilitate the prepayment of some of the government's external debt. Nonetheless, it will be important to resist pressures for larger debt prepayments financed with reserves. The best way to limit the public sector's net interest payments is to maintain strong fiscal and monetary policies, which keep interest rates and public debt low.

34. **The health of the financial system continues to improve**. Granting budgetary autonomy to the financial superintendency is an important step forward. The adoption of new risk classification and loan provisioning standards in line with Basle II may prove advantageous, but a cautious transition to the new system is warranted. It will be important to complete the process of selling the government's ownership in the two intervened banks and to closely monitor the mortgage bank still experiencing difficulties.

35. **The prospects for sustained growth over the medium term remain favorable, provided the authorities maintain a strong fiscal policy and advance structural reforms.** In particular, three reforms—the revision of the budget code, rationalizing the system of fiscal decentralization, and strengthening the pension system—are essential to moderate the growth of public expenditure and achieve fiscal sustainability. A new budget code will allow for a more transparent and effective management of expenditure, and it will be important to approve this reform during 2004. A better system of fiscal decentralization can remove unnecessary revenue transfers and avoid duplication in spending by different levels of government. Further pension reform will keep net pension costs under control. With a strong fiscal policy, the external position will remain comfortable, with manageable current account deficits and continued access to international capital markets. If economic policies weaken, confidence can reverse quickly, harming the country's growth prospects.

36. **The staff welcomes the authorities' proposal to accept the obligations of Article VIII**. During 2003, they have eliminated two exchange restrictions, and the export rebate system has been consistent with Article VIII and Colombia's obligations to the WTO. The authorities plan to remove the tax on outward remittances in the next few years and are discussing with Fund staff whether the regime for hydrocarbons exporters gives rise to an exchange restriction.

37. **The staff supports the authorities' request for the completion of the second review**. While the risks to the program remain significant, the authorities have reiterated their firm commitment to achieving the objectives of the program in 2004. In particular, the CPS

deficit will continue to decline in relation to GDP, even following the outcome of the referendum. The staff supports the authorities' request for a waiver of the nonobservance of the structural performance criterion, which was completed with a brief delay, and their request for a waiver of the applicability of the performance criteria for end-December 2003.

Table 1. Colombia: Selected Economic and Financial Indicators

	1999	2000	2001	2002	2003 Prog.	2003 Proj.	2004 Prog.	2004 Proj.
(Percentage changes, unless otherwise indicated)								
National income and prices								
Real GDP	-4.2	2.9	1.4	1.7	2.0	2.8	3.3	3.3
GDP deflator	12.6	12.1	6.0	6.3	7.4	7.6	5.0	5.7
Consumer prices (average)	10.9	9.2	8.0	6.3	6.9	7.0	5.3	5.7
Consumer prices (end of period)	9.2	8.7	7.6	7.0	5.9	6.2	5.0	5.5
External sector (on the basis of U.S. dollars)								
Exports (f.o.b.)	4.9	13.2	-6.1	-3.8	-1.4	6.8	4.9	3.9
Imports (f.o.b.)	-26.3	8.1	10.6	-1.6	-0.9	8.4	4.7	7.1
Export volume	1.4	1.2	1.4	-5.4	-5.6	-2.1	8.0	4.9
Import volume	-22.4	7.7	12.4	-1.6	-5.9	1.2	-1.3	2.6
Terms of trade (deterioration -)	8.8	11.5	-6.0	1.8	-0.9	1.9	-8.4	-5.2
Real effective exchange rate (depreciation -)	-6.4	1.4	2.4	-15.9	...	...	...	...
Central administration								
Revenue	8.1	25.7	20.8	10.1	14.8	12.8	4.1	9.5
Expenditure 1/	20.0	11.9	16.7	12.6	3.4	9.5	2.0	7.9
Money and credit 2/								
Broad money	8.4	1.2	5.8	5.2	7.4	9.3	7.0	10.2
Credit to the private sector 3/	-2.0	-7.6	2.0	4.8	8.1	11.0	9.7	10.8
Interest rate (90-day time deposits; percent per year)								
Nominal	15.8	13.4	11.5	7.7	...	...	...	...
Real	6.0	4.2	3.6	0.7	...	...	...	...
(In percent of GDP)								
Central administration balance 1/	-7.4	-5.7	-5.7	-6.3	-4.4	-5.2	-3.9	-4.8
Nonfinancial public sector balance 1/	-6.4	-3.5	-3.5	-4.2	-2.5	-3.1	-2.2	-2.6
Public sector savings 1/	3.2	4.5	5.0	4.0	4.6	4.8	5.0	4.8
Public sector balance 1/	-5.5	-3.4	-3.2	-3.6	-2.5	-2.8	-2.1	-2.5
Foreign financing	1.1	1.6	2.3	0.6	2.1	1.9	0.9	1.6
Domestic financing 4/	3.7	1.2	0.9	3.1	0.5	1.0	1.3	1.0
Privatization	0.7	0.5	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Public debt 5/6/	39.8	45.1	49.6	58.4	54.9	56.3	53.5	56.4
Gross domestic investment	12.9	13.7	15.1	15.2	15.0	16.3	15.2	16.7
Gross national savings	13.7	14.5	13.6	13.2	12.7	14.1	12.8	14.2
Current account (deficit -)	0.8	0.8	-1.5	-2.0	-2.3	-2.2	-2.4	-2.5
External debt 7/	45.4	46.1	47.6	52.8	52.0	48.2	49.9	47.9
Of which: public sector 7/	25.0	26.3	28.6	32.2	32.6	30.2	31.6	31.0
Total short-term external debt to reserves	107.0	87.6	98.0	90.7	75.1	...	76.5	...
(In percent of exports of goods, services, and income)								
External debt service 7/	50.6	50.1	50.1	64.0	60.3	60.6	47.8	46.3
Of which: public sector	22.5	21.7	28.2	37.1	34.7	33.0	26.3	23.6
Interest payments 7/	16.8	15.9	16.2	16.9	17.2	16.3	16.9	15.9
Of which: public sector	8.5	8.9	10.4	11.3	12.2	11.4	11.9	11.2
(In millions of U.S. dollars)								
Overall balance of payments	-315	870	1,217	138	-2	-289	295	0
Gross official reserves 6/	8,103	9,006	10,245	10,838	10,787	10,527	11,082	10,527
Net official reserves (in months of imports of goods and services)	6.7	6.8	8.0	7.9	8.1	7.2	8.3	7.1

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

1/ Includes floating debt defined as unpaid bills plus outstanding budgetary commitments.
2/ All annual changes in foreign currency stocks valued at constant exchange rate.
3/ The figures for 1999-2002 have been adjusted for loan write-offs resulting from the mortgage debt reduction and bank rrestructuring programs.
4/ Includes the quasi-fiscal balance of Banco de la Republica, sales of assets, phone licenses, and statistical discrepancy.
5/ Includes bonds issued to recapitalize financial institutions.
6/ Assuming no purchases under the current SBA arrangement.
7/ Includes short-term debt.

Table 2. Colombia: Performance Criteria 1/

	Performance Criteria	2003 Performance Criteria			
	Dec. 31, 2002	March 31	June 30	Sept. 30	Dec. 31
	Cumulative Flows from Beginning of Calendar Year (In billions of Colombian pesos)				
Overall balance of the combined public sector					
Floor	-8,350	-1,590	-3,240	-3,315	-6,375
Outturn	-7,371	-1,209	-1,900	-3,245	...
Margin (+) or shortfall (-)	979	381	1,340	70	...
	Inflation Rate 2/ (12-month inflation rate)				
Inflation - Consultation band					
Upper limit	8.0	8.1	8.3	8.1	7.9
Target	6.0	6.1	6.3	6.1	5.9
Lower limit	4.0	4.1	4.3	4.1	3.9
Outturn	7.0	7.6	7.2	7.1	...
	(In millions of U.S. dollars)				
Net international reserves of the Banco de la Republica					
Floor	10,300	10,215 3/	10,075 4/	10,074 5/	10,540
Outturn	10,507	10,316	10,211	10,331	...
Margin (+) or shortfall (-)	207	101	136	257	...
	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	1,100	650	1,250	1,850	1,850
Outturn	274	298	266	820	...
Margin (+) or shortfall (-)	826	352	984	1,030	...
Change in the outstanding stock of short-term external debt of the public sector					
Ceiling	375	300	200	200	100
Outturn	108	-226	-207	-133	...
Margin (+) or shortfall (-)	267	526	407	333	...

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

1/ Definitions of concepts and adjustments to the performance criteria are explained in the technical memorandum of understanding attached to the staff report for Colombia's request for a Stand-by Arrangement (EBS/02/210).

2/ Deviations from the quarterly path for inflation will trigger consultations with the Fund, as set out in the technical memorandum of understanding.

3/ The target for March has been adjusted by US$145 million to account for the effect of foreign exchange intervention.

4/ The target for June has been adjusted by US$345 million to account for the effect of foreign exchange intervention.

5/ The target for September has been adjusted by US$338 million to account for the effect of foreign exchange intervention.

Table 3. Colombia: Summary Balance of Payments, 1999-2004

	1999	2000	2001	2002	2003 Prog.	2003 Proj.	2004 Prog.	2004 Rev.
			(In millions of U.S. dollars)					
Current account balance	**671**	**626**	**-1,251**	**-1,639**	**-1,753**	**-1,677**	**-1,832**	**-2,017**
Trade balance	1,775	2,531	503	225	159	44	190	-382
Exports, f.o.b.	12,037	13,620	12,772	12,302	12,129	13,139	12,719	13,649
Coffee	1,324	1,069	764	772	777	847	881	942
Petroleum products	3,757	4,569	3,285	3,275	3,265	3,635	2,502	3,001
Non-traditional	5,279	6,200	6,613	6,287	6,133	6,250	7,037	6,953
Other	1,678	1,782	2,110	1,968	1,953	2,408	2,299	2,754
Imports, f.o.b.	10,262	11,090	12,269	12,077	11,971	13,095	12,529	14,031
Services (net)	-1,204	-1,276	-1,424	-1,458	-1,451	-1,474	-1,493	-1,517
Exports	1,940	2,044	2,180	1,857	...	1,913	...	1,965
Imports	3,144	3,320	3,604	3,315	...	3,387	...	3,483
Income (net)	-1,355	-2,298	-2,593	-2,812	-2,777	-3,019	-2,778	-2,933
Interest (net)	-1,661	-1,663	-1,738	-1,905	-1,960	-2,094	-1,918	-2,014
Of which								
Public sector	-759	-889	-1,087	-1,262	-1,380	-1,445	-1,456	-1,428
Other Income (net)	306	-634	-855	-908	-816	-925	-860	-919
Current transfers (net)	1,455	1,669	2,263	2,406	2,316	2,773	2,248	2,815
Financial account balance	**-555**	**-16**	**2,390**	**1,295**	**1,751**	**1,175**	**2,128**	**2,017**
Public sector (net)	901	458	1,441	361	1,316	1,041	723	1,356
Nonfinancial public sector	1,235	1,258	1,911	485	1,543	1,394	736	1,710
Medium- and long-term (net)	1,995	1,663	3,464	-1,098	884	1,055	500	1,399
Disbursements	3,719	3,238	5,743	2,462	3,953	4,212	2,618	3,346
Amortization	1,724	1,575	2,280	3,560	3,069	3,157	2,118	1,947
Other long-term flows	-23	-40	-35	-30	0	-26	0	-26
Short term 1/	-737	-365	-1,517	1,613	659	365	236	337
Of which								
Change in public assets	-612	-259	-1,539	1,563	659	460	236	337
Financial public sector	-333	-800	-470	-124	-227	-353	-13	-355
Private sector (net)	-1,457	-474	949	934	435	134	1,404	661
Nonfinancial private sector (net)	-71	-68	1,006	1,336	526	118	1,262	405
Direct investment	1,392	1,973	2,493	1,171	1,474	991	1,519	1,182
Of which : Privatization	0	465	0	0	0	0	0	0
Leasing finance	208	-109	-211	-153	-142	-404	-88	-315
Long-term loans	-193	-479	126	-970	-636	-796	0	-322
Short term 2/	-1,479	-1,453	-1,401	1,288	-169	328	-169	-141
Financial private sector (net)	-1,385	-406	-57	-402	-91	17	142	256
Net errors and omissions	**-430**	**260**	**78**	**482**	**0**	**213**	**0**	**0**
Changes in GIR	**-315**	**870**	**1,217**	**138**	**-2**	**-289**	**295**	**0**
Changes in NIR, program def. 3/	**...**	**687**	**1,182**	**525**	**-2**	**-83**	**295**	**0**
			(In percent of GDP)					
Current account balance	0.8	0.7	-1.5	-2.0	-2.3	-2.2	-2.4	-2.5
			(In months of imports of goods and services)					
Gross international reserves 4/	6.7	6.8	8.0	7.9	8.1	7.2	8.3	7.1

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

1/ Includes movements of short-term assets owned by the public sector abroad.

2/ Includes net portfolio investment.

3/ In contrast to the traditional concept, foreign currency liabilities of the central bank to residents are excluded (among other things). A complete definition is given in the Technical Memorandum of Understanding.

4/ Not including Fund purchases under the standby arrangement.

Table 4. Colombia: Operations of the Combined Public Sector

(In percent of GDP)

	1999	2000	2001	2002	2003 Prog. 1/	2003 Rev.	2004 Prog. 1/	2004 Rev.
Total revenue	**27.4**	**28.0**	**29.6**	**29.6**	**30.3**	**30.3**	**29.3**	**30.1**
Current revenue	**27.4**	**28.0**	**29.6**	**29.6**	**30.3**	**30.3**	**29.3**	**30.1**
Tax revenue 2/	16.9	17.3	19.2	19.2	20.8	19.9	20.6	20.1
Nontax revenue	10.5	10.7	10.4	10.4	9.4	10.4	8.8	10.0
Property income	1.0	1.0	1.3	0.9	0.9	1.2	0.8	0.9
Operating surplus of public enterprises	4.0	4.2	4.2	4.0	4.4	4.7	3.7	4.4
Of which : Ecopetrol	2.4	3.0	2.5	2.3	2.5	3.0	1.8	2.7
Other	5.5	5.5	4.8	5.4	4.1	4.5	4.3	4.7
Total expenditure and net lending 2/	**33.3**	**31.5**	**33.3**	**33.7**	**32.8**	**33.4**	**31.5**	**32.7**
Current expenditure	**24.5**	**23.6**	**24.9**	**25.5**	**25.6**	**25.4**	**24.4**	**25.3**
Wages and salaries	7.7	7.2	7.5	7.5	7.1	7.4	6.4	7.4
Goods and services 3/	3.7	3.3	3.5	3.4	3.2	3.6	3.1	3.4
Interest	3.8	4.4	5.0	4.5	5.2	5.1	4.9	5.0
External	1.4	1.6	2.3	2.1	2.4	2.3	2.3	2.2
Domestic	2.3	2.8	2.8	2.4	2.8	2.8	2.6	2.8
Transfers to private sector	9.2	9.0	9.8	9.7	10.2	10.3	10.0	10.5
Of which: from social security	5.5	5.5	6.5	6.7	7.0	6.9	7.0	7.2
Other 4/	0.2	-0.3	-0.9	0.2	-0.1	-1.0	0.0	-1.0
Capital expenditure	**8.7**	**7.9**	**8.3**	**8.1**	**7.1**	**7.9**	**7.1**	**7.4**
Fixed capital formation 4/	8.6	7.8	8.2	7.9	7.1	7.8	7.0	7.3
Transfers	0.1	0.1	0.1	0.2	0.0	0.1	0.1	0.1
Net lending	0.1	0.0	0.1	0.1	0.1	0.1	0.0	0.0
Statistical discrepancy	-0.5	0.0	0.2	-0.1	0.0	-0.1	0.0	0.0
Nonfinancial public sector balance	**-6.4**	**-3.5**	**-3.5**	**-4.2**	**-2.5**	**-3.1**	**-2.2**	**-2.6**
Quasi-fiscal balance (BR cash profits)	0.4	0.5	0.7	0.8	0.4	0.6	0.3	0.3
Fogafin balance	0.5	0.0	0.2	0.3	0.1	0.2	0.3	0.2
Net cost of financial restructuring 5/	0.0	-0.4	-0.7	-0.6	-0.5	-0.4	-0.6	-0.4
Overall balance	**-5.5**	**-3.4**	**-3.2**	**-3.6**	**-2.5**	**-2.8**	**-2.1**	**-2.5**
Overall financing	**5.5**	3.4	**3.2**	**3.6**	**2.5**	**2.8**	**2.1**	**2.5**
Foreign, net	1.1	1.6	2.3	0.6	2.1	1.9	0.9	1.6
Of which								
Changes in assets held abroad (-increase)	-1.0	-0.1	-1.9	1.9	0.9	0.6	0.3	0.3
Domestic, net	3.7	1.2	0.9	3.1	0.5	1.0	1.2	0.9
Financial system 6/	2.2	-0.5	-1.1	-1.4	-1.4	-0.6	0.0	-1.0
Bonds 7/	0.9	2.3	2.8	3.9	1.9	2.6	1.2	1.7
Change in floating debt and accrual adjustments	0.6	-0.6	-0.7	0.7	-0.1	-1.0	0.0	0.2
Privatization (including concessions) 8/	0.7	0.5	0.0	-0.1	-0.1	-0.1	-0.1	-0.1
Memorandum items								
NFPS savings	2.9	4.4	4.7	4.1	4.6	4.8	5.0	4.8
NFPS primary balance	-2.6	0.9	1.5	0.4	2.7	1.9	2.7	2.4
Oil stabilization fund (deposits in FAEP)	0.4	0.9	0.2	-0.2	-0.2	-0.2	-0.3	-0.3
Military expenditure	3.2	3.2	3.3	3.6	4.2	4.5	4.2	4.8

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

1/ SBA fiscal figures at the completion of the first review in June 2003.

2/ Expenditure reported on commitments basis.

3/ From year 2000 includes the unpaid bills of the Social Security Institute (ISS).

4/ Includes adjustments to put spending on commitment basis and the change in unpaid bills of selected nonfinancial public enterprises.

5/ Interest payments on public banks restructuring bonds and mortgage debt relief related costs.

6/ Includes changes in public sector loans and deposits in the financial system.

7/ Includes changes in holdings of public securities by banks and nonbanks.

8/ Includes nonrecurrent fees from telecommunications licensing.

Table 5. Colombia: Operations of the Central Administration

(In percent of GDP)

	1999	2000	2001	2002	2003 Prog. 1/	2003 Rev.	2004 Prog. 1/	2004 Rev.
Total revenue	**12.0**	**13.0**	**14.7**	**15.0**	**15.7**	**15.5**	**15.1**	**15.7**
Current revenue	**12.0**	**13.0**	**14.7**	**15.0**	**15.7**	**15.5**	**15.1**	**15.7**
Tax revenue	10.0	11.2	13.2	13.4	14.4	14.0	13.8	14.2
Net income tax and profits	4.2	4.3	5.3	5.9	6.1	5.8	5.7	5.9
Goods and services	4.9	5.3	5.9	5.7	6.5	6.5	6.3	6.4
Value-added tax	4.4	4.8	5.3	5.3	6.0	6.0	5.8	5.9
Gasoline tax	0.5	0.5	0.6	0.5	0.5	0.5	0.5	0.5
International trade	0.9	1.0	1.1	1.0	1.0	1.0	1.1	1.0
Financial transaction tax	0.0	0.6	0.8	0.7	0.7	0.7	0.7	0.9
Stamp and other taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Nontax revenue and transfers	1.9	1.8	1.5	1.6	1.4	1.5	1.3	1.5
Property income	0.3	0.5	0.3	0.3	0.2	0.4	0.3	0.3
Other	1.6	1.3	1.2	1.3	1.1	1.1	1.0	1.2
Total expenditure and net lending	**19.4**	**18.8**	**20.4**	**21.4**	**20.2**	**20.6**	**19.0**	**20.5**
Current expenditure	**15.0**	**15.3**	**15.8**	**17.6**	**16.9**	**17.3**	**16.0**	**17.9**
Wages and salaries	2.9	2.9	3.0	3.0	2.7	2.9	2.2	3.0
Goods and services	1.3	1.3	1.5	1.6	1.4	1.9	1.4	2.1
Interest	2.1	3.0	3.5	3.5	4.1	4.1	4.2	4.3
External	1.0	1.2	1.6	1.7	2.0	1.9	2.0	2.0
Domestic	1.1	1.8	1.9	1.7	2.1	2.2	2.2	2.4
Other expenditure 2/	0.2	-0.1	-0.9	0.6	-0.1	-1.0	0.0	-1.0
Current transfers 3/	8.5	8.2	8.6	8.9	8.7	9.4	8.3	9.5
Capital expenditure	**3.8**	**3.0**	**3.8**	**3.1**	**2.7**	**2.8**	**2.6**	**2.3**
Fixed capital formation 2/	1.6	1.0	1.3	1.3	0.9	0.9	0.9	0.4
Capital transfers	2.3	2.1	2.5	1.8	1.8	1.9	1.7	1.9
Net lending	**0.5**	**0.5**	**0.8**	**0.6**	**0.6**	**0.5**	**0.4**	**0.3**
Overall balance	**-7.4**	**-5.7**	**-5.7**	**-6.3**	**-4.4**	**-5.2**	**-3.9**	**-4.8**
Memorandum items								
Primary Balance	-5.3	-2.7	-2.2	-2.9	-0.3	-1.1	0.3	-0.5
Transfers to local governments	5.0	4.6	5.4	5.1	5.2	5.2	5.2	5.3

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

1/ SBA fiscal figures at the completion of the first review in June 2003.
2/ Includes adjustments to put spending on commitment basis.
3/ Includes interest payment to the rest of the nonfinancial public sector.

Table 6. Colombia: Monetary Indicators

	1999	2000	2001	2002	2003 Prog. 1/	2003 Rev.	2004 Prog.	2004 Rev.
(Billions of Colombian pesos, unless otherwise stated)								
Central bank								
Net international reserves 2/	14,941	19,470	23,320	30,301	32,404	30,545	34,201	32,342
billions of US$	8.1	9.0	10.2	10.504	10.5	10.5	10.8	10.5
Net domestic assets	-5,202	-8,760	-11,672	-16,194	-17,493	-14,167	-18,098	-14,988
Net credit to public sector	2,013	2,790	1,641	2,403	1,548	2,704	1,368	2,424
Net credit to financial system	3,661	2,695	2,006	3,230	901	5,351	1,264	5,031
Other	-10,876	-14,245	-15,319	-21,826	-19,941	-22,222	-20,730	-22,443
Monetary base	9,740	10,710	11,648	14,107	14,912	16,378	16,104	17,354
Of which: currency in circulation	6,037	7,276	8,349	9,993	10,563	11,546	11,408	12,728
Banking system								
Net foreign assets 2/	7,597	13,455	18,303	24,649	25,684	27,809	27,108	29,601
billions of US$	4.1	6.0	8.0	8.6	8.3	9.6	8.5	9.6
Net domestic assets	46,754	41,532	40,550	37,352	37,959	39,958	40,983	45,105
Net credit to public sector	8,249	8,031	8,006	10,641	16,674	11,066	18,385	10,827
Credit to private sector	49,515	45,261	46,049	48,379	54.987	53,725	60,329	59,554
Other net	-11,010	-11,761	-13,505	-21,669	-33,703	-24,833	-37,731	-25,276
Broad money 3/	54,351	54,987	58,853	62,001	63,643	67,767	68,092	74,706
(Annual percentage change)								
Credit to public sector, net	62.6	-2.6	-0.3	32.9	5.2	4.0	10.3	-2.2
Credit to private sector	-3.1	-8.6	1.7	5.1	8.1	11.0	9.7	10.8
Currency	31.1	20.5	14.8	19.7	5.7	15.5	8.0	10.2
Monetary base	40.7	10.0	8.8	21.1	5.7	16.1	8.0	6.0
Broad money 3/	8.4	1.2	7.0	5.3	7.4	9.3	7.0	10.2
(Percent of GDP)								
Credit to public sector, net	5.4	4.6	4.3	5.3	7.5	4.9	7.7	4.4
Credit to private sector	32.7	25.9	24.5	23.9	24.8	24.0	25.1	24.3
Currency	4.0	4.2	4.4	4.9	4.8	5.1	4.7	5.2
Monetary base	6.4	6.1	6.2	7.0	6.7	7.3	6.7	7.1
Broad money 3/	35.9	31.4	31.3	30.6	28.7	30.2	28.3	30.5
(Annual percentage change)								
Central bank inflation target 4/	15.0	10.0	8.0	6.0	5.9	5.9	...	5.5
Consumer price index	9.2	8.8	7.6	7.0	5.9	6.2	...	...
Exchange rate	21.5	19.0	2.8	25.0	...	1.2	...	7.2
(In billions of Colombian pesos, unless otherwise stated)								
Financial system 5/								
Net assets in foreign currency 6/	-387	-445	373	650	...	...	...	...
billions of US$	-0.2	-0.2	0.2	0.2	...		...	
percent of GDP	-0.3	-0.3	0.2	0.3	...	...	...	...
Foreign currency assets to total assets (percent) 6/	10.9	8.9	8.2	8.7	...	...	...	...
Foreign currency credit to total credit (percent) 6/	15.2	13.1	11.0	11.6	...	...	...	...
Foreign currency deposits to total deposits (percent) 6/	0.5	0.4	0.5	0.4	...	...	...	...
Memorandum item								
Broad money/net international reserves	3.6	2.8	2.5	2.0	2.5	2.2	2.5	2.3

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

1/ Historic data series were revised during 2003.
2/ Assets on and liabilities to nonresident entities. Net international reserves include liabilities in foreign currency to resident entities. Exclude valuation effect.
3/ Currency in circulation plus deposit liabilities of the private sector.
4/ 2003 target was revised upward by 0.4 percentage points in account of the first round effect of the VAT reform.
5/ Banking system excluding the central bank.
6/ Regulation limits net foreign liabilities to 5 percent and net foreign assets to 20 percent of regulatory capital.

Table 7. Colombia: Banking System Indicators

	1999	2000	2001	2002	2003 1/
(In millions of Colombian pesos, unless otherwise stated)					
Total system 2/					
Assets	80,046	80,390	84,244	89,185	93,063
Investment portfolio	12,066	17,165	22,163	25,070	26,471
Loan portfolio	48,469	44,301	44,098	46,436	48,723
of which non-performing loans	6,919	5,211	4,640	4,386	4,047
Capital	8,823	9,101	9,417	9,824	10,812
Operational margin 3/	-1,366	-174	1,558	2,393	2,571
Net results	-2,599	-1,574	506	1,349	1,820
(Annual percent change)					
Assets	0.8	0.4	4.8	5.9	7.2
Loan portfolio	7.7	2.5	9.0	5.3	8.3
Of which: nonperforming loans	21.6	-24.7	-11.0	-5.5	-12.7
(Percent)					
Financial ratios					
Total system 2/					
Net interest margin to assets	3.0	3.5	3.0	3.3	3.9
Gross interest margin to assets	7.9	8.3	8.4	8.7	9.8
Operational margin to assets 3/	-1.7	-0.2	1.8	2.7	3.7
Return on equity	-29.5	-17.3	5.4	13.7	22.4
Cash to assets	7.2	6.7	6.2	6.3	6.0
Investment portfolio to total assets	15.1	21.4	26.3	28.1	28.4
Nonperforming loans to total loans 4/	13.6	11.0	9.7	8.7	7.7
Loan-loss provisions to nonperforming loans	36.8	56.6	77.5	86.5	91.4
Capital to assets 5/	11.0	11.3	11.2	11.0	11.6
Mortgage banks					
Net interest margin to assets	3.6	5.5	3.7	4.4	5.3
Return on equity	-28.0	-1.3	-0.4	8.8	20.3
Cash to assets	5.0	5.3	5.7	6.4	4.8
Investment portfolio to total assets	8.5	17.1	20.8	24.3	26.8
Nonperforming loans to total loans 4/	22.1	22.0	23.8	24.1	21.9
Loan-loss provisions to nonperforming loans	16.0	27.4	44.9	50.5	55.6
Capital to assets 5/	7.0	8.3	8.6	8.8	9.5
(In percent of private sector investment portfolio, unless otherwise indicated)					
Memorandum items					
Capital adequacy banks excl. mortgage banks	11.1	12.2	12.4	12.0	12.6
Capital adequacy mortgage banks	8.2	13.1	12.3	12.1	13.7
Private sector investment portfolio (percent of GDP)	19.0	23.0	28.4	37.7	...
Banks	41.8	42.6	41.5	32.8	...
Insurance companies	9.0	6.5	6.8	5.6	...
Mutual funds	3.5	3.0	19.1	31.0	...
Pension funds	27.6	28.6	29.4	28.1	...
Investment funds	18.1	19.4	3.1	2.6	...

Source: Superintendencia Bancaria.

1/ Data to September 2003.
2/ Excluding credit unions and public sector special institutions (IOE).
3/ Gross interest margin plus net provisions and administrative cost before depreciation and amortization.
4/ Nonperforming based on past-due period (30 days).
5/ Not risk weighted.

Table 8. Colombia: External Debt Sustainability Framework - Baseline Scenario

	2002	2003	2004	2005	2006	2007	2008	2009	2010
I. Output and Prices									
(Annual percentage changes)									
Real GDP	1.6	2.8	3.3	3.7	3.9	4.0	4.0	4.0	4.0
Consumer prices									
End of period	7.0	6.2	5.5	4.5	3.5	3.0	3.0	3.0	3.0
Period average	6.3	7.0	5.7	5.0	3.7	3.3	3.0	3.0	3.0
(In percent of GDP, unless indicated otherwise)									
II. Saving and Investment									
Gross national saving	**12.7**	**14.1**	**14.2**	**14.0**	**14.0**	**14.0**	**14.5**	**15.3**	**16.1**
Private sector	8.7	9.1	9.3	9.0	8.2	8.3	8.2	8.2	8.8
Public sector	4.0	5.1	4.9	5.0	5.7	5.7	6.3	7.1	7.2
Gross domestic investment	**14.7**	**16.3**	**16.7**	**16.7**	**16.9**	**17.2**	**17.4**	**17.7**	**17.9**
Private sector	7.1	8.4	9.3	9.7	9.7	9.8	9.8	9.9	9.9
Public sector capital expenditure	7.6	7.9	7.4	7.0	7.2	7.4	7.6	7.8	8.0
External current account balance	**-2.0**	**-2.2**	**-2.5**	**-2.7**	**-2.9**	**-3.2**	**-2.9**	**-2.4**	**-1.8**
Private sector	1.6	0.7	0.0	-0.7	-1.4	-1.5	-1.6	-1.7	-1.0
Public sector	-3.6	-2.8	-2.5	-2.0	-1.5	-1.7	-1.3	-0.7	-0.8
III. Nonfinancial and Consolidated Public Sector									
Nonfinancial public sector									
Revenue	29.6	30.2	30.2	30.0	29.7	29.4	29.5	29.9	29.8
Expenditure	33.7	33.3	32.9	32.1	31.3	31.1	30.9	30.6	30.6
Current expenditure	26.0	25.3	25.5	25.1	24.1	23.7	23.3	22.8	22.6
Capital expenditure	7.6	7.9	7.4	7.0	7.2	7.4	7.6	7.8	8.0
Primary balance	0.5	1.9	2.4	3.0	3.5	3.3	3.3	3.1	2.9
Overall balance	-4.2	-3.1	-2.6	-2.0	-1.6	-1.7	-1.4	-0.7	-0.8
Combined public sector balance	-3.6	-2.8	-2.5	-2.0	-1.5	-1.7	-1.3	-0.7	-0.8
External financing	0.6	1.9	1.6	1.5	0.6	0.6	-0.2	-0.5	-0.5
Domestic financing	3.1	1.0	1.0	0.4	0.9	1.1	1.5	1.2	1.3
Privatization	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
IV. Financial System									
Velocity (GDP / broad money)	3.3	3.3	3.3	3.2	3.4	3.4	3.4	3.4	3.4
Real growth in private sector credit	-1.2	3.8	4.9	4.0	-2.5	6.9	6.7	5.8	5.7
V. Balance of Payments									
External current account balance	-2.0	-2.2	-2.5	-2.7	-2.9	-3.2	-2.9	-2.4	-1.8
Of which: trade balance	0.3	0.1	-0.5	-0.8	-0.4	0.2	0.9	1.4	2.1
Exports	15.2	16.9	16.7	16.7	16.6	16.7	17.3	17.6	18.4
Imports	14.9	16.9	17.2	17.5	17.0	16.5	16.3	16.2	16.3
Capital and financial account balance	1.6	1.5	2.5	2.7	3.5	3.5	3.1	2.7	2.1
Public sector	0.4	1.3	1.7	1.1	0.6	0.6	-0.2	-0.5	-0.5
Private sector	1.2	0.2	0.8	1.5	2.9	2.9	3.2	3.1	2.6
Overall balance	0.2	-0.4	0.0	0.0	0.6	0.4	0.1	0.3	0.3
VI. Debt									
Total external debt	52.8	48.2	47.9	47.5	46.7	45.8	44.5	43.0	41.0
Public debt	32.2	30.2	31.0	31.4	30.2	28.9	27.1	25.0	23.0
Private debt	20.6	17.9	16.9	16.0	16.5	16.8	17.5	18.0	18.0
Total public debt	58.6	55.6	56.2	55.7	53.4	51.5	49.5	46.9	44.6
Domestic debt	26.4	25.4	25.2	24.2	23.2	22.6	22.4	21.9	21.6
External debt	32.2	30.2	31.0	31.4	30.2	28.9	27.1	25.0	23.0

Sources: Colombian authorities; and Fund staff estimates.

Table 9. Colombia: External Debt Sustainability Framework, 2002-2010

(In percent of GDP, unless otherwise indicated)

		Prel.	Projections						
	2002	2003	2004	2005	2006	2007	2008	2009	2010
I. Baseline Medium-Term Projections									
External debt	**52.8**	**48.2**	**47.9**	**47.5**	**46.7**	**45.8**	**44.5**	**43.0**	**41.0**
Change in external debt	5.2	-4.6	-0.3	-0.4	-0.8	-0.9	-1.2	-1.6	-2.0
Identified external debt-creating flows	3.4	-3.9	-1.8	-1.6	-1.7	-1.4	-1.5	-2.0	-2.5
Current account deficit, excluding interest payments	-1.2	-1.1	-0.8	-0.9	-0.9	-0.8	-1.0	-1.1	-1.6
Net nondebt creating capital inflows (negative)	-1.7	-1.3	-1.5	-1.5	-1.5	-1.6	-1.6	-1.6	-1.6
Automatic debt dynamics 1/	6.2	-1.5	0.4	0.8	0.7	1.0	1.1	0.7	0.7
Residual, including change in gross foreign assets	1.8	-0.7	1.2	1.5	1.0	0.6	0.3	0.5	0.5
Key macroeconomic and external assumptions									
Real GDP growth (in percent)	1.6	2.8	3.3	3.7	3.9	4.0	4.0	4.0	4.0
Nominal exchange rate appreciation									
(US$ value of local currency, change in percent)	-20.0	-1.1	-5.6	-5.4	-1.4	-0.9	-0.9	-0.9	-0.9
GDP deflator in US$ (change in percent)	-15.2	6.4	-0.2	-0.6	2.2	2.4	2.1	2.1	2.1
Nominal external interest rate (in percent) 2/	6.4	6.8	7.0	7.7	8.6	9.2	9.2	8.4	8.4
Growth of exports (US$ terms, in percent)	-5.3	6.3	3.7	1.5	3.4	5.4	7.6	6.7	10.7
Growth of imports (US$ terms, in percent)	1.1	10.8	8.7	4.3	3.1	3.1	5.0	5.0	7.1
II. Stress Tests for External Debt Ratio									
Real GDP growth, nominal interest rate, dollar deflator, noninterest current account, and nondebt inflows are at historical average in 2003-10	52.8	48.2	46.8	45.1	44.1	42.9	41.3	40.0	38.6
Nominal interest rate is at historical average plus two standard deviations in 2003 and 2004	52.8	48.2	48.6	48.7	47.9	47.0	45.8	44.3	42.3
Real GDP growth is at historical average minus two standard deviations in 2003 and 2004	52.8	48.2	51.2	54.6	53.9	53.2	52.1	50.7	48.8
Noninterest current account is at historical average minus two standard deviations in 2003 and 2004	52.8	48.2	55.5	62.8	62.2	61.7	60.8	59.5	57.8
Combination of 2-4 using one standard deviation shocks	52.8	48.2	54.4	60.9	60.3	59.7	58.8	57.5	55.7
One time 30 percent nominal depreciation in 2003	52.8	48.2	56.5	56.2	55.6	54.8	53.8	52.4	50.6
Statistics for key variables		Average 1991-2001		Standard Deviation			Average 2002-10		Standard Deviation
Current account deficit, excluding interest payments		0.0		3.0			-1.0		0.3
Net non-debt creating capital inflows		2.3		1.1			1.6		0.1
Nominal external interest rate (in percent)		7.4		0.6			8.3		0.8
Real GDP growth (in percent)		2.6		2.7			3.8		0.3

Source: Fund staff projections.

1/ Depends on external interest rates, domestic GDP deflator, real GDP growth, exchange rate changes, and the share of domestic-currency denominated debt in total external debt.

2/ Nominal effective interest rate on all external debt.

Table 10. Colombia: Public Sector Debt Sustainability Framework, 2002-2010

(In percent of GDP, unless otherwise indicated)

	2002	Prel. 2003	Projections 2004	2005	2006	2007	2008	2009	2010
I. Baseline Medium-Term Projections									
Public sector debt 1/	**58.6**	**55.6**	**56.2**	**55.7**	**53.4**	**51.5**	**49.5**	**46.9**	**44.6**
Of which : foreign-currency denominated	32.2	30.2	31.0	31.4	30.2	28.9	27.1	25.0	23.0
Change in public sector debt	8.9	-2.9	0.2	-0.5	-2.3	-1.9	-2.0	-2.6	-2.3
Identified debt-creating flows (4+7+12)	7.5	-2.2	-0.4	-0.8	-1.9	-1.7	-1.8	-2.3	-2.0
Primary deficit	-0.5	-1.9	-2.4	-3.0	-3.5	-3.3	-3.3	-3.1	-2.9
Revenue and grants	29.6	30.2	30.2	30.0	29.7	29.4	29.5	29.9	29.8
Primary (noninterest) expenditure	29.2	28.2	27.9	27.1	26.2	26.1	26.2	26.7	26.9
Automatic debt dynamics 2/	8.1	-0.2	2.1	2.1	1.5	1.6	1.6	0.9	0.8
Contribution from interest rate/growth differential 3/	0.9	-0.6	0.3	0.4	1.1	1.3	1.3	0.6	0.6
Of which contribution from real interest rate	1.7	0.9	2.0	2.3	3.1	3.3	3.2	2.5	2.3
Of which contribution from real GDP growth	-0.8	-1.5	-1.7	-1.9	-2.0	-2.0	-1.9	-1.8	-1.7
Contribution from exchange rate depreciation 4/	7.2	0.4	1.8	1.7	0.5	0.3	0.3	0.2	0.2
Other identified debt-creating flows	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual, including asset changes (2-3)	1.4	-0.7	0.5	0.3	-0.3	-0.3	-0.3	-0.3	-0.3
Public sector debt-to-revenue ratio 1/	197.7	184.3	184.4	184.0	178.5	174.0	166.2	155.5	148.2
Key Macroeconomic and Fiscal Assumptions									
Real GDP growth (in percent)	1.6	2.8	3.3	3.7	3.9	4.0	4.0	4.0	4.0
Average nominal interest rate on public debt (in percent) 6/	9.8	9.6	9.8	9.7	9.8	10.1	9.9	8.5	8.5
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	3.7	1.9	4.1	4.7	6.1	6.8	6.9	5.5	5.5
Nominal appreciation (increase in US dollar value of local currency, in percent)	-20.0	-1.1	-5.6	-5.4	-1.4	-0.9	-0.9	-0.9	-0.9
Inflation rate (GDP deflator, in percent)	6.1	7.6	5.7	5.0	3.7	3.3	3.0	3.0	3.0
Growth of real primary spending (deflated by GDP deflator, in percent)	4.8	-0.4	2.1	0.7	0.6	3.5	4.3	6.2	4.8
II. Stress Tests for Public Debt Ratio									
1. Historical average real growth, real interest rate, and primary balance	58.6	55.6	**56.8**	**57.9**	**57.1**	**56.2**	**55.2**	**54.3**	**53.3**
2. Real interest rate shock (two standard deviation)	58.6	55.6	**61.1**	**66.3**	**64.4**	**62.7**	**60.6**	**58.2**	**55.8**
3. Real GDP growth shock (two standard deviation)	58.6	55.6	**56.7**	**60.1**	**59.1**	**57.4**	**54.9**	**52.4**	**49.9**
4. Primary balance shock (two standard deviation)	58.6	55.6	**58.2**	**63.2**	**62.2**	**60.5**	**58.1**	**55.6**	**53.2**
5. Combination of 2-4 using one standard deviation shocks	58.6	55.6	**63.1**	**70.6**	**69.2**	**67.7**	**65.7**	**63.3**	**61.0**
6. One time 30 percent real depreciation in 2003 7/	58.6	55.6	**70.6**	**70.6**	**69.2**	**67.7**	**65.7**	**63.3**	**61.0**

Statistics for Key Variables (past 10 years)	Historical Average	Standard Deviation	Average 2003-10
Primary deficit	-0.7	1.8	-2.9
Real GDP growth (in percent)	2.7	3.0	3.7
Nominal interest rate (in percent) 6/	18.6	4.8	9.5
Real interest rate (in percent)	1.8	6.2	5.2
Inflation rate (GDP deflator, in percent)	16.8	5.6	4.3
Revenue to GDP ratio	26.9	1.4	29.8

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate;
a = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi (1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

6/ Derived as nominal interest expenditure divided by previous period debt stock.

7/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 11. Colombia: Indicators of Capacity to Repay the Fund, 2004-09 1/

	2004	2005	2006	2007	2008	2009
Fund repurchases and charges						
In millions of SDRs	27	33	34	467	792	342
In millions of U.S. dollars	37	46	46	644	1092	472
In percent of exports of goods and NFS	0.2	0.3	0.3	3.7	5.9	2.4
In percent of GDP	0.0	0.1	0.1	0.7	1.1	0.4
In percent of quota	3.5	4.3	4.3	60.3	102.3	44.2
In percent of overall debt service	0.3	0.4	0.3	4.4	6.8	2.9
In percent of gross foreign reserves	0.4	0.4	0.4	5.8	9.6	4.0
Fund credit outstanding						
In millions of SDRs	1,548	1,548	1,548	1,113	339	0
In millions of U.S. dollars	2,132	2,134	2,136	1,535	467	0
In percent of exports of goods and NFS	13.7	13.5	13.0	8.9	2.5	0.0
In percent of GDP	2.6	2.6	2.4	1.6	0.5	0.0
In percent of quota	200.0	200.0	200.0	143.7	43.7	0.0
In percent of overall debt service	18.0	17.5	15.9	10.5	2.9	0.0
In percent of gross foreign reserves	20.2	19.9	19.5	13.7	4.1	0.0
(In millions of U.S. dollars; unless otherwise stated)						
Memorandum items						
Exports of goods and NFS	15,615	15,851	16,391	17,268	18,581	19,827
Quota (millions of SDRs)	774	774	774	774	774	774
GDP	81,316	82,803	87,683	93,096	98,823	104,914
U.S. dollar per SDR (WEO projection)	1.377	1.379	1.380	1.379	1.379	1.379
Public sector external debt	25,088	26,191	26,663	27,149	26,937	26,382
Overall external debt service	11,877	12,197	13,434	14,555	15,947	16,368
Overall external debt	39,042	40,196	41,854	43,618	44,989	46,043
Gross foreign reserves	10,546	10,723	10,956	11,188	11,412	11,691

Source: Fund staff estimates.

1/ Projections assume all upcoming scheduled purchases under the Stand-By Arrangement are made.

Table 12. Colombia: External Financing Requirements and Sources, 1999-2004

	1999	2000	2001	2002	Proj. 2003	2004
	(In millions of U.S. dollars)					
1. Gross financing requirements	8,028	8,911	10,361	11,849	11,801	10,795
External current account deficit	-671	-626	1,251	1,639	1,677	2,017
Debt amortization	9,014	8,667	7,893	10,072	10,413	8,778
Medium and long term debt	5,036	5,727	5,379	7,022	6,921	4,966
Public sector	2,093	2,127	2,823	3,820	3,384	2,034
Private sector	2,943	3,601	2,556	3,202	3,537	2,931
Short-term debt 1/	3,978	2,940	2,514	3,050	3,492	3,812
Public sector	976	672	199	320	429	172
Private sector	3,002	2,267	2,315	2,730	3,063	3,641
Gross reserves accumulation	-315	870	1,217	138	-289	0
2. Available financing	8,028	8,911	10,361	11,849	11,801	10,795
Foreign direct investment (net)	1,392	1,973	2,493	1,171	991	1,182
Medium and long-term debt disbursements	5,698	5,645	7,884	4,183	6,218	5,324
Public sector	3,719	3,238	5,743	2,462	4,212	3,346
of which : multilaterals	...	...	...	856	2404	1,160
Private sector	1,980	2,407	2,141	1,720	2,007	1,978
Public sector use of external assets	-612	-259	-1,539	1,563	460	337
Short-term debt 2/	2,940	2,514	3,050	3,492	3,812	4,079
Public sector	672	199	320	429	172	172
Private sector	2,267	2,315	2,730	3,063	3,641	3,907
Other capital flows (net) 3/	-1,390	-963	-1,527	1,440	320	-128
Exceptional financing and arrears	0	0	0	0	0	0
of which: IMF 4/	0	0	0	0	0	0
3. Financing gap	0	0	0	0	0	0
	(In stocks)					
Memorandum items						
Gross international reserves	8,103	9,006	10,245	10,844	10,527	10,527
Net international reserves (traditional concept) 5/	8,102	9,004	10,192	10,841	10,522	10,522
Net international reserves (program definition) 6/	8,113	8,800	9,982	10,507	10,424	10,424

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

1/ Original maturity of less than 1 year. Stock at the end of the previous period.
2/ Original maturity of less than 1 year. Stock at the end of the current period.
3/ Includes all other net financial flows, and errors and omissions.
4/ Assumes no purchases under the Stand-by Arrangement.
5/ The traditional balance of payments concept of net international reserves, which excludes central bank short term foreign liabilities and liabilities to the Fund.
6/ In contrast to the traditional concept, foreign currency liabilities of the central bank to residents are excluded (among other things). A complete definition is given in the Technical Memorandum of Understanding.

Table 13. Colombia: Schedule of Purchases Under the SBA, 2002-2004

Date	Amount (In millions of SDR)	Amount (In percent of quota)	Conditions
	193.50	25.0	Board approval.
February 15, 2003	193.50	25.0	Completion of first review and observance of end-December 2002 performance criteria.
May 15, 2003	193.50	25.0	Observance of end-March 2003 performance criteria.
July 31, 2003	96.80	12.5	Observance of end-June 2003 performance criteria.
November 15, 2003	96.70	12.5	Observance of end-September 2003 performance criteria and completion of second review.
February 15, 2004	193.50	25.0	Observance of end-December 2003 performance criteria.
May 15, 2004	193.50	25.0	Observance of end-March 2004 performance criteria and completion of third review.
August 15, 2004	193.50	25.0	Observance of end-June 2004 performance criteria and end-July 2004 structural performance criterion.
November 15, 2004	193.50	25.0	Observance of end-September 2004 performance criteria and completion of fourth review.
Total	**1,548.00**	**200.0**	

Source: Fund staff estimates.

COLOMBIA: FUND RELATIONS

(As of October 31, 2003)

I. Membership Status:
Joined: December 27, 1945
Status: Article XIV

II. General Resources Account:	**SDR Million**	**% Quota**
Quota	774.00	100.00
Fund holdings of currency	488.20	63.08
Reserve position in Fund	285.80	36.93

III. SDR Department:	**SDR Million**	**% Allocation**
Net cumulative allocation	114.27	100.00
Holdings	114.28	100.01

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
SBA	Jan. 15, 2003	Jan. 14, 2005	1,548.00	0.00
EFF	Dec. 20, 1999	Dec. 19, 2002	1,957.00	0.00

VI. Projected Obligations to Fund: None

VII. Safeguards Assessments:

Under the safeguards policy, Colombia is subject to a safeguards assessment with respect to its current Stand-By Arrangement with the Fund. Staff concluded a safeguards assessment mission on April 10, 2003 and the final report was approved by management on May 14. The assessment noted no significant vulnerabilities. The Banco de la República already has strong financial control environment and complies with most of the International Accounting Standards (IAS). The BRC intends to fully adopt IAS to the extent that these do not conflict with established accounting regulations and the law. The Banco de la República has adopted as a more permanent feature the requirement for an annual external audit conducted by an external audit firm, with international experience and exposure.

VIII. Exchange Rate Arrangement:

In September 1999 the Banco de la República eliminated the exchange rate band, and floated the peso. Multiple currency practices still exist arising from taxes on profit remittances from direct investment in Colombia and on foreign exchange earnings from personal services and transfers, but the government submitted legislation to Congress to eliminate the tax on inward remittances.

IX. Last Article IV consultation:

The 2002 Article IV consultation was concluded by the Executive Board on January 15, 2003. A two-year Stand-By Arrangement with Colombia was approved by the Executive Board on January 15, 2003.

X. FSAP participation:

The Executive Board discussed the Financial Sector Stability Assessment (FOSSE) (FO/DIS/99/172) when it approved the Extended Fund Facility (December 20, 1999).

XI. Recent Technical Assistance:

Dept.	**Purpose**	**Time of Delivery**
FAD	ROCS Assessment	March 2002
MAE/LEG	Assessment of exchange restrictions	July 2002
MAE	Assessment of the banking system	September 2002
SAT	Follow-up on government finance statistics	November 2002
FAD	Advice on the reform of the budget code	March 2003
FAD	Expenditure Management Assessment	March 2003

XII. Resident Representative: None.

XIII. Fourth Amendment: Colombia has accepted the Amendment to the Articles of Agreement in May 2002.

COLOMBIA: WORLD BANK RELATIONS[1]

The World Bank and Colombia's Development Strategy

Colombia's National Development Plan is built on four pillars: (i) provide security to all Colombians; (ii) foster sustainable economic growth and employment generation under macroeconomic and price stability; (iii) build a more equitable society; and (iv) increase the transparency and efficiency of the State. The World Bank Group's (Wag's) strategy seeks to support Colombia's quest for development and peace. The Country Assistance Strategy (CASS) envisages a maximum lending program for BIRD of about US$1.8 billion for the remainder of FY 2004 to FY 2006. Between 50–60 percent of the lending program would consist of fast-disbursing operations.

The World Bank Program for FY 2004–06

In 2004, the BIRD will continue the preparation of a series of adjustment loans to support fiscal adjustment, financial sector adjustment, the labor and social sector reform and environmental management. It will have an investment operation to support the peace and development efforts. The WAG will also support an anticorruption program and a broad program of initiatives in the infrastructure sector, covering water supply, wastewater and sanitation management, national urban transportation and an urban upgrading strategy. IRC's focus will be on supporting new forms of public-private partnership. MEGA will focus on the provision of political risk guarantees for private sector investments; hands-on technical assistance for investment promotion intermediaries; and the dissemination of information on investment opportunities in Colombia.

The BIRD would also provide support for the government's strategy to enhance equity in coverage, quality and efficiency in the education sector. In the health sector, the BIRD will have in 2004 a health investment operation to support hospital restructuring. In rural development, the World Bank will support the development of an institutional platform to enable the transition to a more competitive sector, as well as enhancing the knowledge and innovation system for competitiveness.

Bank-Fund Collaboration in Specific Areas

The WAG is helping Colombia implement its reform agenda in the following areas of Bank-Fund collaboration:

- Fiscal adjustment, notably reforming the tax system, strengthening tax administration, implementing a fiscal responsibility law, and reforming the public sector.
- Reform of the pension and social security systems.
- Foster financial sector and capital market developments.
- Broaden and deepen the scope of Colombia's anticorruption program.
- Combat money laundering.

[1] Prepared by World Bank staff. Questions may be addressed to Ms. Keta Ruiz, Senior Country Officer, at (202) 473-0137 or kruiz@worldbank.org.

Operations Portfolio (BIRD/IDA and grants)
As of December 4, 2003
(In millions on U.S. dollars)

Closed Projects	**153**
Active Projects	**22**
IBRD/IDA *	
Total Disbursed (Active)	416.1
of which has been repaid	36.6
Total Disbursed (Closed)	9,286.3
of which has been repaid	8,103.7
Total Disbursed (Active + Closed)	9,702.4
of which has been repaid	8,140 3
Total Undisbursed (Active)	649.4
Total Undisbursed (Closed)	0.1
Total Undisbursed (Active + Closed)	649.5

Loan Information (IBRD)
As of September 30, 2003
(In millions of U.S. dollars)

Fiscal Year*	2001	2002	2003	2004
Total Disbursements	264	369	948	248
Repayment Amount	225	243	223	77
Net Disbursements	39	126	725	170

* Fiscal Year: July 1–June 30.

IFC Operations
(as of September 30, 2003)
(In millions of U.S. dollars)

	Loans	Equity (+Quasi)	Participation	Total
Total commitments	170.7	172.6	166.6	509.9
Total undisbursed	49.9	8.3	7.1	65.3

COLOMBIA: RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK[1]

(As of December 8, 2003)

I. Background and Objectives

In September 2003, the IADB Board of Directors approved the Bank's strategy for Colombia for the period 2003–2006. The strategy identifies three overarching objectives that constitute the frame of reference for Bank activities: (i) lay the foundations for economic revival and jump-starting growth; (ii) foster social progress and make sure society's most vulnerable are protected; and (iii) strengthen governance and further modernization of the State.

To help **reinvigorate the economy** the Bank will: (i) foster competitiveness and (ii) support agricultural development and natural resources management. **To foster social progress and ensure that society's most vulnerable are protected**, Bank's actions will improve: (i) social protection systems, to leave low-income groups less vulnerable, and (ii) the coverage, quality, and efficiency of essential social services, including employment avenues. In the **governance and modernization of the State** sphere the Bank will support: (i) national public sector reform, (ii) local management capacity building, (iii) initiatives to foster transparency and combat corruption, and (iv) judicial branch reform.

From the Bank's standpoint, two constraints for the strategy's viability are the country's fiscal deficit and the escalating armed conflict. Both constraints have implications for the size of the lending program, the mix of lending and nonlending products, and prospects for achieving the strategy objectives.

II. LENDING

As of November 30, 2003 the country's portfolio consists of 29 loans an amount equivalent to US$2.6 billion. These resources are distributed among 27 investment loans (US$990.0 million), a policy-based loan (US$400,0 million) and an emergency loan (US$1,25 billion). In addition, the country portfolio with Colombia includes 31 non-reimbursable technical cooperation (US$24,4 million) and four small projects (US$1.5 million). Through the Multilateral Investment Fund (MIF), which finances private sector investment projects, Colombia has 21 non-reimbursable operations (US$18.6 million).

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[1] Prepared by IADB staff. Questions may be addressed to Mr. Javier León, Country Officer, at (202) 623-1769 or javierl@iadb.org.

In 2003 five loans for US$1,886.03 million will be approved. These operations include a social emergency program (US$ 1.25 billion). According with the last Programming Mission Report on November 2003, the Bank would approve in 2004 six investment loans by US$ 343.3 million and a policy-based loan, whose amount is not already defined. The lending program for 2004 will support the government strategy in areas such as rural household, vaccination, transport, public services, environmental investment, privatization, and national public sector reform.

COLOMBIA: FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK
(As of November 30, 2003)

I. IDB OPERATIONS
(In millions of U.S. dollars)

	Commitments	Disbursements	Undisbursed amounts
Agricultural and rural development	125.1	90.7	34.3
Public sector management	359.5	166.3	193.2
Social Investment	2,019.2	1,156.7	862.5
Water supply and sewerage and infrastructure	49.4	25.0	24.4
Natural resource management	36.9	26.9	10.0
Urban development	50.2	30.0	20.0
Grand total	**2,640.3**	**1,495.6**	**1,144.7**

II. IDB LOAN TRANSACTIONS
(In millions of U.S. dollars)

	1996	1997	1998	1999	2000	2001	2002	2003(*)
Gross disbursement	262.7	271.6	412.9	952.4	241.2	785.3	151.8	1,518.2
Amortization, interest and contributions	467.2	579.2	369.1	445.8	473.2	408.2	819.4	960.7
Net cash flow	-204.5	-307.6	43.8	506.6	232.0	377.1	-667.6	557.5

(*) Projections.

Source: IADB.

Bogotá, Colombia
December 24, 2003

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

Dear Mr. Köhler:

The government remains fully committed to promoting faster sustainable and equitable economic growth through the implementation of its economic program for 2003–04, which is being supported by the two-year Stand-By Arrangement (SBA) approved by the Fund in January 2003.

We are requesting the completion of the second review under the program. We are adopting policies that will achieve the program's objectives for the remainder of 2003 and 2004, and are proposing quantitative performance criteria for end-December 2003, end-March and end-June 2004 (with indicative targets for the remainder of 2004) and structural reforms for 2004. These policies are explained in detail in the attached Memorandum of Economic Policies (MEP) and Technical Memorandum of Understanding (TMU). All quantitative performance criteria through September 2003 have been observed, and all but one of the structural reforms have been implemented on schedule. In the area of budget reform, we had planned to submit the bill to reform the Budget Code by end-October 2003, which is a structural performance criterion. However, we have needed more time to ensure that the proposed reform is as strong as possible. We submitted this bill to Congress on December 16, 2003, and on this basis, we are requesting a waiver for the nonobservance of this structural performance criterion. We are also requesting a waiver of the applicability of the performance criteria for end-December 2003.

We are proposing to have two additional reviews under the program, the third to be completed by May 2004 and the fourth by November 2004. In the third review, we will reach understandings on quantitative performance criteria for September and December 2004, while in the fourth review, we will ensure that the program policies remain on track. The government will continue to treat the SBA as precautionary and will maintain a close policy dialogue with the Fund.

Sincerely yours,

/s/

Alberto Carrasquilla
Minister of Finance
and Public Credit

/s/

Miguel Urrutia
General Manager
Bank of the Republic

Memorandum of Economic Policies

I. Introduction

1. The government of President Alvaro Uribe took office in August 2002 in the midst of a deteriorating fiscal position, domestic security concerns, and difficulties in accessing international capital markets. The government's program sought to support an increase in real economic growth to 2 percent in 2003 and to over 3 percent in 2004, while continuing to reduce inflation gradually. Net international reserves were expected to rise by about US$300 million a year. The combined public sector (CPS) deficit was targeted to decline to 2½ percent of GDP in 2003 and 2.1 percent of GDP in 2004 in order to arrest the increase in public debt, which reached 58.4 percent of GDP by end-2002[12], and set public debt in relation to GDP on a downward path. Our policy initiatives also included structural reforms to resolve institutional issues that undermine the sustainability of the fiscal position, to improve the quality of social programs, and to continue to strengthen the financial system.

2. All quantitative performance criteria through end-September 2003 were observed, and all structural reforms, except for the submission of the revised budget code, have proceeded on schedule (Tables 1 and 2). Moreover, the economic outlook is favorable:

- Real GDP is projected to increase by 2.8 percent, faster than expected, led by increased output in construction, manufacturing, and financial services on the supply side and durable goods consumption and private investment on the demand side.
- Inflation is likely to decline to close to 6 percent by end year, in line with the program target of 5.9 percent, reflecting in large part the decisions by the Banco de la República to raise its policy interest rate and to conduct foreign exchange intervention. As a result, net international reserves are expected to decline by US$290 million, in line with the adjusted program target.
- The external current account deficit is projected to reach 2.2 percent of GDP, somewhat less than expected. Exports have performed well, in spite of the difficulties with Venezuela, because of the real effective exchange rate depreciation since mid-2002 and higher oil and coal exports.

II. Policies for the Remainder of 2003 and 2004

3. In the national referendum, the government had included a temporary expenditure freeze and additional pension reforms to help place fiscal policy on a sustainable path. In the October 25 vote on the referendum, these two proposals, as well as all other proposals,

[12] Includes debt of the financial public sector, in line with the program definitions.

received 5½ to 6 million votes, an overwhelming majority of the votes cast. Nonetheless, the preliminary results suggest that many of the proposals may not have received the required minimum number of votes. The negative outturn for the expenditure freeze means that—without corrective measures—the CPS deficit would have risen to 3½ percent of GDP in 2003 and to 3.7 percent of GDP in 2004.

4. The government is fully committed to keeping fiscal policy on a sustainable path. Because of this commitment, our program continues to aim at a further pick up in real economic growth to 3.3 percent in 2004, while targeting a further decline in inflation. With more rapid economic growth and the secular decline in oil exports, the external current account deficit is projected to rise to 2.5 percent of GDP, which is expected to be fully financed by net capital inflows.

5. The government intends to limit the CPS deficit to 2.8 percent of GDP in 2003 and to 2.5 percent of GDP in 2004, targets only slightly higher than those envisaged in the original program (Table 1). With these fiscal targets, the primary surplus of the nonfinancial public sector is projected to increase from 0.4 percent of GDP in 2002 to about 2½ percent of GDP in 2004, while public debt is projected to decline to about 56 percent of GDP by end-2004. To compensate for the rejection of the expenditure freeze that had been proposed in the referendum, the government moved quickly to develop a fiscal plan that paid close attention to the need to have all sectors contribute to this effort. This plan includes measures to trim expenditure in 2003 and 2004 and to secure congressional approval of a tax package for 2004 and beyond. The package proposes to:

- Keep the top income tax rate at 38.5 percent, with a credit for a certain percentage of reinvested profits.
- Establish a tax of 0.3 percent on individuals' net worth above a certain threshold;
- Increase the financial transactions tax rate from 0.3 percent to 0.4 percent.
- Strengthen tax administration by enhancing the authorities' powers to negotiate and settle disputed tax arrears and penalties and increase some penalties for tax evasion.
- There is no change in the structure of the VAT. However, there will be a rebate of 2 percentage points for credit and debit card transactions, which is intended to improve tax administration.

In 2004, the growth in expenditure will be restrained by redirecting territorial transfers to fund the territorial pension fund (FONPET) and by controlling spending on goods and services and investment.

6. In 2004, the CPS deficit will be financed largely from external sources to ensure that the private sector has sufficient financial resources. The government may seek additional

commercial external financing for liability management purposes or to pre-finance 2005 financing requirements. The public sector's external borrowing will remain in line with the performance criteria and indicative targets presented in the TMU. Over the next few years, the government intends to increase its reliance on domestic financing to reduce the sensitivity of public debt to external factors.

7. Looking beyond 2004, we intend to continue to strengthen the fiscal position through the term of this government. In line with the recently approved Fiscal Responsibility Law, the government intends to announce by June 2004 that the primary surplus for the nonfinancial public sector will reach 3 percent of GDP for 2005, which will place fiscal policy on a path to reduce public debt to 40–45 percent of GDP by 2010.

8. The Banco de la República will continue to conduct monetary policy within a framework of inflation targeting and a floating exchange rate. Since its inception, this approach has succeeded in reducing inflation, and has benefited from the current institutional arrangement for central bank independence. Looking forward, the Banco de la República has set an inflation target for 2004 of 5.5 percent and it will take the actions necessary to achieve this target. The quarterly path of inflation in 2004 is identified in Table 1. It intends to reduce inflation further to 3.5 to 5.5 percent in 2005, in line with its medium-term objective of lowering inflation to 3 percent. Consistent with the floating exchange rate system, the Banco de la República is targeting no change in its net international reserves.

9. The implementation of the structural reforms will continue to proceed as envisaged in the December 2002 MEP (Table 2), with the following changes:

- *Reform of the Budget Code.* The revised budget code is designed to strengthen the institutional framework for managing public spending. The government intends to secure congressional approval of the revised code during 2004 and agrees that it will not request completion of the fourth review until the key elements of this reform have been approved. As a first step towards strengthening budgeting procedures, the 2005 budget that is submitted to congress in July 2004 will include a presentation of expenditure according to a more transparent classification framework, as well as a presentation of expenditure according to the existing classification system and this action will be a structural performance criterion.

- *Pension reform.* In November 2003, the government submitted legislation to address the concerns raised by the constitutional court with regard to the pension reform approved in December 2002. By March 2004, the government will submit to congress constitutional reform to deal with the issues raised in the referendum in relation with special pension regimes. The government will evaluate the situation of people registered as contributors to both the public and private regimes (*multiafiliados*), and the contributions to private funds of those that were not yet eligible to transfer away from the public system will be returned to ISS.

- *Strengthening fiscal decentralization.* The government has requested technical assistance from the Fund's Fiscal Affairs Department to prepare a report on the system of fiscal decentralization, with a view to developing options for reform. CONPES will prepare a report by September 2004 that presents a strategy for increasing the effectiveness of the current system.

- *Statistical data on public sector financing.* The government will publish a document by June 2004 to recommend a statistical reporting system of the public sector financing with the objective of obtaining monthly estimates of the below–the-line fiscal deficit with a minimum reasonable delay.

- *Improving transparency of inflation targeting framework.* The Banco de la República will continue to improve the communication of its inflation targeting framework, with a view to helping markets develop a medium-term focus on inflation.

10. The government is prepared to accept the obligations under Article VIII of the Fund's Articles of Agreement. The bilateral payments arrangement with China was eliminated in June 2003, and the rate on the CERTs (the system of export subsidies) has been set at zero for several years, in line with Colombia's obligations to the WTO. The tax on inward remittances has been removed in the context of the tax legislation approved in December 2003. The government intends to eliminate the taxes on outward remittances by 2005. The central bank is undertaking conversations with Fund staff in order to identify whether the foreign exchange regime for hydrocarbons exporters gives rise to an exchange restriction.

11. The Banco de la República now requires its annual external audit to be conducted by an auditing firm with international experience and exposure, as recommended by the safeguards assessment.

Table 1. Colombia: Performance Criteria 1/

	Performance Criteria	2004			
		Performance Criteria		Indicative Targets	
	Dec. 31, 2003	Mar. 31	Jun. 30	Sept. 30	Dec. 31
	Cumulative flows from beginning of calendar year (In billions of Colombian pesos)				
Overall balance of the combined public sector					
Floor	-6,375	-1,200	-1,650	-1,850	-6,100
Outturn					
Margin (+) or shortfall (-)					
	Inflation rate 2/ (12-month inflation rate)				
Inflation - Consultation band					
Upper limit	7.9	8.0	8.0	7.7	7.5
Target	5.9	6.0	6.0	5.7	5.5
Lower limit	3.9	4.0	4.0	3.7	3.5
Outturn					
	(In millions of U.S. dollars)				
Net international reserves of the Banco de la Republica					
Floor	10,540	10,240	10,300	10,400	10,540
Outturn					
Margin (+) or shortfall (-)					
	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	1,850	800	1,300	1,750	1,800
Outturn					
Margin (+) or shortfall (-)					
Change in the outstanding stock of short-term external debt of the public sector					
Ceiling	100	200	200	200	200
Outturn					
Margin (+) or shortfall (-)					

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

1/ Definitions of concepts and adjustments to the performance criteria are explained in the technical memorandum of understanding attached to the staff report for Colombia's request for a Stand-by Arrangement (EBS/02/210).

2/ Deviations from the quarterly path for inflation will trigger consultations with the Fund, as set out in the technical memorandum of understanding.

Table 2. Colombia: Structural Performance Criteria and Benchmarks Under the SBA[1]

	Structural Performance Criteria	
October 31, 2003 ***July 31, 2004***	Submitting to congress a revision of the Budget Code (Ley Orgánica del Presupuesto). This revision will give the Ministry of Finance greater control over the expenditure level and budget execution with the purpose of achieving more transparency and higher budgetary flexibility. Specific measures will include (a) the adoption of budget classification according to int-ernational standards that fits into the context of Colombia's legal framework; (b) a requirement to include in the annual budget law information on tax expenditures, quasifiscal activities, subsidies, contingent fiscal liabilities, medium-term fiscal projections, and a fiscal sustainability analysis; (c) the establishment of a mid-year budget report to congress. *The 2005 budget submitted to congress will include a presentation of expenditure according to a standard international classification system.*	Was structural performance criterion for end-October 2003. *Done Dec.16, 2003. Waiver requested.*
Prior to completion of fourth review	*Congressional approval of the changes to the Budget Code. The revision will* (a) *adopt a budget classification according to international standards that fits into the context of Colombia's legal framework; (b) require that the annual budget law include information on tax expenditures, quasifiscal activities, subsidies, contingent fiscal liabilities, medium-term fiscal projections, and a fiscal sustainability analysis; (c) establish a mid-year budget report to congress;* (d) *gradually phase out most revenue earmarking not mandated by the constitution by subjecting these earmarking provisions to explicit sunset provisions; (e), limit the budget carry over by eliminating the "reserva presupuestal"; and (f) limit the power of the government to make spending commitments for future years on projects not authorized under the Development Plan.*	Was structural benchmark to be completed by end-2003.
	Structural Benchmarks	
December 31, 2002	Issuance of a decree to eliminate existing vacancies in the public service with immediate effect, and also to close vacancies created by retiring staff.	Done October 2002
March 31, 2003	Approval by CONPES (Consejo Nacional de Política Económica y Social) of the Social Security Institute's financial sustainability plan for its health service. The plan will clearly identify the fiscal effect of each of its elements and be consistent with eliminating the deficit of the ISS health system by 2007.	Done March 2003
June 30, 2003	Congressional approval of the Fiscal Responsibility Law. Presentation to congress of a revision of Law 80 to improve management of government contracts. The objective is to curb corruption in government procurement, improve transparency in public contracting, promote e-procurement, and design and implement a standard methodology specifying bidding terms and conditions for typical contracts. Implementation of a reform of the special pension regime for teachers that reduces the actuarial deficit of the regime for teachers at least in a proportion similar to that proposed by the government for the special regime.	Done June 2003 Done July 2002 Congress approved law in May 2003.
July 31, 2003	Implement reform of special pension regime for the military that will make the regime more equitable.	Done July 2003
December 31, 2003	CONPES to finalize a plan to streamline the management of government property under which an asset management unit will be set up to define and implement a management plan based on consolidated inventories and develop a program for inventory assessment.	Done October 2003

	Congressional approval of the modifications of Law 80 to improve management of government contracts. Bring Bancafé to point of sale.	
March 31, 2004	Completion of a CONPES document to strengthen the government's legal defense service to take effect by 2005.	*Done November 2003.*
	Structural Benchmarks	
June 30, 2004	*The government will issue a plan to improve the statistical reporting system for the financing of the nonfinancial public sector deficit.* *A financial evaluation of ISS health will be undertaken, in order to determine whether additional actions beyond those established in Decree 1750 of June 2003 are required.*	
September 30, 2004	Full implementation of CONPES plan to eliminate the deficit of the ISS health system by 2007. Implementation of the plan to strengthen the governments' legal defense services. Restructure and bring Granahorrar to the point of sale. *CONPES will approve a strategy for strengthening the current system of fiscal decentralization.*	

[1] New or revised measures or dates are presented in italics.

COLOMBIA—TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)

1. This memorandum sets out specific performance criteria for December 31, 2003 and March 31, 2004, and the structural performance criteria and structural benchmarks for the remaining period of the program. This TMU supplements the TMU of December 2, 2002, which presents all the definitions of the variables used to monitor performance under the program.

I. FISCAL TARGETS

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

	Ceiling (In billions of Colombian pesos)
Overall deficit of the combined public sector from January 1, 2003 to December 31, 2003 (performance criterion)	-6,375
Overall deficit of the combined public sector from January 1, 2004 to:	
March 31, 2004 (performance criterion)	-1,200
June 30, 2004 (performance criterion)	-1,650
September 30, 2004 (indicative target)	-1,850
December 31, 2004 (indicative target)	-6,100

2. The overall balance of the **combined public sector** (CPS) will remain as defined in the TMU of December 2, 2002 with the following change. With regard to Caja Agraria, the CPS deficit will include the severance payments and interest costs of closing Caja Agraria.

3. **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 beyond what is currently envisaged under the program, up to a maximum of 0.5 percent of GDP or US$400 million for 2004 as a whole, in support of the government's domestic security program "Seguridad Democrática." 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.

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

B. Baseline Assumption for Oil Stabilization Fund Revenue (FAEP)

	Revenue (In millions of U.S. dollars)
From January 1, 2004 to March 31, 2004	0
From January 1, 2004 to June 30, 2004	0
From January 1, 2004 to September 30, 2004	0
From January 1, 2004 to December 31, 2004	0

II. Monetary Targets

4. Reflecting the BR's inflation targeting framework for monetary policy, quarterly targets for 2003 and 2004 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 event that the observed quarterly inflation were to deviate from the programmed quarterly baseline target by 2 percentage points or more, as set out in the table below. In the event that the actual inflation deviates significantly from the programmed target within the 2 percentage points 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. The BR will provide Fund staff with monthly information and analysis of inflationary developments and forecasts, and keep the staff informed of all policy actions taken to achieve the inflation objectives of the program.

A. Performance Criterion on Inflation[1]

	Inflation (12-Month Percentage Change)
December 31, 2003 (performance criterion)	5.9
March 31, 2004 (performance criterion)	6.0
June 30, 2004 (performance criterion))	6.0
September 30, 2004 (indicative target)	5.7
December 31, 2004 (indicative target)	5.5

[1] These performance criteria trigger consultations with the Fund, as noted above.

III. External Targets

A. Performance Criterion on NIR of the BR[1]

	Target (In millions of U.S. dollars)
Outstanding stock as of:	
December 31, 2003 (performance criterion)	10,540
March 31, 2003 (performance criterion)	10,240
June 30, 2003 (performance criterion)	10,300
September 30, 2003 (indicative target)	10,400
December 31, 2003 (indicative target)	10,540

[1] These performance criteria and indicative targets are explained in the Annex to the TMU.

5. **Adjustment.** The quarterly NIR targets may be adjusted downward by up to a cumulative amount of US$2.0 billion in 2003 and 2004 of foreign exchange sales to help secure orderly foreign currency market conditions in the event of exogenous disturbances in the foreign currency market and consistent with transparent rules used by the central bank for foreign exchange intervention. In the event that NIR declines by US$1.0 billion during any 30-day period, the authorities will complete consultations with the Fund (Executive Board) on the proposed policy response before requesting purchases from the Fund.

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

	Ceiling (In millions of U.S. dollars)
Cumulative net disbursement of external debt by the public sector from January 1, 2003 to December 31, 2003 (performance criterion)	1,850
Cumulative net disbursement of external debt by the public sector from January 1, 2004 to:	
March 31, 2004 (performance criterion)	800
June 30, 2004 (performance criterion)	1,300
September 30, 2004 (indicative target)	1,750
December 31, 2004 (indicative target)	1,800

[1] These performance criteria and indicative targets are explained in the Annex to the TMU.

C. Performance Criterion on Net Disbursement 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, 2003 to December 31, 2003 (performance criterion)	100
Cumulative net disbursement of short-term external debt of the public sector from January 1, 2004 to:	
March 31, 2004 (performance criterion)	200
June 30, 2004 (performance criterion)	200
September 30, 2004 (indicative target)	200
December 31, 2004 (indicative target)	200

[1]These performance criteria and indicative targets are explained in the Annex to the TMU.

IV. Structural Performance Criteria

6. These are described in the Table 2 of the Memorandum of Economic Policies.

Colombia: External Program Targets

(In millions of U.S. dollars, cumulative from the beginning of the year)

	2004			
	March	June	Sept.	Dec.
1. Net accumulation of long-term external debt 1/				
Target	***800***	***1,300***	***1,600***	***1,600***
Projection	**433**	**840**	**1,408**	**1,381**
Margin	**367**	**460**	**192**	**219**
Net long-term financing	606	1,217	1,522	1,363
Nonfinancial public sector	593	1,210	1,537	1,399
Disbursements	1,366	2,307	2,977	3,346
Central government	1,250	2,156	2,588	2,869
Decentralized entities	116	151	389	477
Amortization	773	1,097	1,440	1,947
Central government	636	844	1,077	1,377
Decentralized entities	137	253	363	570
Financial public sector	13	7	-15	-36
Disbursements	34	49	49	51
Amortization	21	42	64	87
Net change in foreign currency assets	-173	-376	-114	18
Nonfinancial public sector	146	-57	205	337
Central government	82	-185	13	82
Decentralized entities	64	128	192	255
Financial public sector	-319	-319	-319	-319
Memorandum items				
Net accumumulation of long-term external debt by				
Central government	696	1,127	1,524	1,574
Decentralized entities	43	25	217	162
Financial public sector	-306	-312	-334	-355
2. Net accumulation of short-term external debt 1/				
Target	***200***	***200***	***200***	***200***
Projection	**0**	**0**	**0**	**0**
Margin	**200**	**200**	**200**	**200**
Net short-term financing	0			
Nonfinancial public sector (net)	0	0	0	0
Central government	0	0	0	0
Decentralized entities	0	0	0	0
Financial public sector (net)	0	0	0	0
Net change in dollar assets held by foreigners	0	0	0	0
3. Stock of net reserves (IMF defitition) 2/				
Target 3/	***10,250***	***10,300***	***10,400***	***10,540***
Projection	**10,172**	**10,257**	**10,341**	**10,424**
Change in reserves due to forex intervention in 2003	**-238**	**-238**	**-238**	**-238**
Margin	**160**	**195**	**179**	**122**
Gross reserves	10,275	10,359	10,443	10,527
Short-term liabilities (traditional definition)	5	5	5	5
Short-term liabilities (IMF definition)	102	102	102	103

1/ Ceiling.

2/ Floor.

Statement by Roberto Steiner, Alternate Executive Director for Colombia
January 12, 2004

On behalf of my authorities, I would like to thank Management and staff for their continued support of the efforts that the Colombian government has been undertaking since it took office in August, 2002. Recent developments have been positive, the program is on track, and there are reasons to believe that the economy will strengthen further in 2004, although staff highlights some important downside risks.

Macroeconomic indicators evolved favorably in 2003. Growth, which was originally expected to reach 2 percent, is now believed to surpass 3 percent. As a result, the rate of unemployment declined to 13.3 percent in November. CPI inflation was 6.5 percent, the lowest in 40 years and only slightly higher than the central bank's target. The debt to GDP ratio, although still high, declined 3 percentage points, while net international reserves surpassed seven months of imports of goods and services and 100 percent of short-term external debt.

All end-September quantitative performance criteria have been met, and we anticipate this will also be the case when end-December information becomes available. Targets for the fiscal deficit have been revised upward slightly to compensate for the fact that the expenditure freeze contemplated in a national referendum did not receive sufficient support and for higher than anticipated military expenditure. The revised targets are consistent with a further reduction in the debt burden. While progress has also been achieved on the structural front, a waiver is being requested for a two-month delay in the submission to Congress of legislation to reform the budget code.

1. Fiscal policy and debt sustainability

Since 1999, Colombia has focused on reducing its fiscal deficit and debt burden. Several elements are involved in these efforts, including increasing tax revenue, improving tax administration, debt management operations, reforming state institutions, overhauling the pension system, enacting a fiscal responsibility law, and improving the budgetary procedure.

The fiscal program for 2003 had two basic pillars, an increase in revenue emanating from a 2002 tax reform and savings of 0.8 percent of GDP from the expenditure freeze in the referendum. For 2004, the expenditure freeze would deliver savings of 1.4 percent of GDP. The referendum, voted on October 25, was not favorable to the government. Although all provisions were supported by over 80 percent of voters, in all but one question the total number of votes fell just short of the required threshold.

A. Compensating for the referendum

The government moved swiftly to ensure that fiscal sustainability would not be jeopardized by the failure to approve the referendum. For 2003, a reduction in investment was the main compensatory measure. For 2004 and beyond, the government proposed a combination of expenditure control and increased taxes. It submitted to Congress a tax bill centered on enhancing savings, promoting investment, and improving resource allocation. Its centerpiece was an increase in the VAT rate from 16 to 17 percent, a broadening of the VAT base, and an increase in the highest marginal tax rate on income to 38.5 percent. Unfortunately, the reform approved in December does not alter the VAT. Instead, it increases the financial transaction tax to 0.4 percent and establishes a 0.3 percent temporary tax on wealth.

The staff is critical of certain elements of the reform. Shortly, and after consulting with key economic and political actors, my authorities will decide whether to present to Congress a proposal aimed primarily at improving the quality of the tax code. At this stage, the government has stated that the shortfall in revenue in the recent reform--0.3 percent of GDP-- will be compensated with reductions in expenditure. The approved tax reform and expenditure restraint make the 2004 fiscal target attainable. With GDP expected to increase 3.3 percent, the debt burden should remain at around 56 percent of GDP in 2004, and decline gradually thereafter. In the context of the fiscal responsibility law, the government intends to announce that the 2005 budget will be consistent with an overall primary surplus of 3 percent of GDP. This target, if sustained, should deliver a debt ratio of 44 percent of GDP by 2010.

B. Debt management

Colombia not only managed to observe a reduction in its debt burden in 2003, it also made good use of ample liquidity in international and local markets and undertook important liability management operations. These operations lengthened the maturity of debt, reduced the rate of interest, and substituted debt indexed to the exchange rate for debt in pesos. Operations undertaken since 2002 have re-profiled $1.6 billion of external amortizations due in 2003-05. Now only 6.2 percent of external public debt is due in 2004. Domestic debt represents 47 percent of total public debt. Most of it is issued in pesos, with a small proportion indexed to inflation and a negligible part to the exchange rate.

The government is merging two directorates at the Ministry of Finance, Treasury and Public Credit. The former has been in charge of issuing securities with maturities under one year, the latter securities at longer maturities. Deficient coordination has resulted in a fragmented yield curve. In addition, since the market maker scheme has concentrated on the long-end of the yield curve, liquidity for short-term bonds is scant. Furthermore, there will now be much better coordination between cash flows and spending needs.

C. Structural reforms in the fiscal front

Colombia has put in place an important reform of the pension system, a labor reform, a fiscal responsibility law, and various measures streamlining state institutions. Draft legislation submitted to Congress makes the budget more transparent and flexible, and limits the use of revenue ear-marking, budget carry-over, and future spending commitments. Following a reform of the general pension regime in 2002, the government proposed the elimination, through the referendum, of all remaining privileged public pension systems. It will now study options to achieve the same purpose through ordinary legislation. In order to ensure a better use of resources, the government will identify options to reform the decentralization regime.

2. Inflation, monetary and exchange rate policy

In 2003, inflation was 6.5 percent, slightly above target. Two hikes in interest rates during the first semester and a stable exchange rate played a key role in delivering this outcome. Annual inflation was running below 6.2 percent in November, but a strike in the transport sector brought about a 1.25 percent hike in food prices in December alone. For 2004, the central bank has established an inflation range of 5 - 6 percent, and for 2005 has announced a 3 ½ - 5 ½ percent range. This year two issues could have an effect on monetary policy. First, if the output gap is narrowing, there would be less scope for further declines in inflation. However, there is uncertainty about the size of the narrowing of the gap, as the high rate of investment observed in 2003 should have a positive impact on potential GDP. Second, if investor confidence were to deteriorate, a weakening of the peso could ensue. My authorities are committed to adopting the required policy actions to meet the inflation target in the context of a floating exchange rate regime with pre-determined rules of intervention.

Concerns regarding the inflation targeting framework or political pressures on the central bank have to be assessed in the context of a relatively successful experience with inflation targeting. Since the inception of inflation targeting in the mid 1990s, the target has been missed only twice, and in both cases by less than one percentage point. Staff points out that key actors do not appear to use sophisticated models to forecast inflation. Expectation surveys do in fact suggest that most agents seem to form their expectations in a static manner, with the latest data on annual inflation the preferred choice for expectations one year ahead. With shocks that temporarily increase inflation, this expectations formation mechanism can make matters unnecessarily complicated for the central bank. My authorities agree with staff that it would be appropriate to share with the public more information regarding the central bank's inflation model. However, they believe their model requires refinements, and for that purpose are requesting, through staff, technical assistance from the central bank of the Czech Republic as a follow-up to very valuable advice received in 2003.

Colombia's 1991 Constitution granted independence to the central bank, to be exercised while maintaining close coordination with the government. To that effect, the Minister of Finance is a member of the board of the bank. This arrangement has worked well, and coordination has not prevented the bank from choosing the required instruments to achieve its mandate of a low rate of inflation. Since the bank became independent, the government has never requested central bank credit. Recently, there has been a tendency for the peso to strengthen. In no way impinging on the prerogatives of the central bank, the government has voiced its concern that a strong currency could slow down the economy. On the issue of reserves, the Ministry of Finance requested the central bank to undertake a study to determine whether the level of NIR was excessive or not. The result of the study is that there is no clear evidence of excess NIR. This means that in 2004 reserves could remain at their 2003 level and the return on reserves, projected at $320 million, could eventually be used to retire debt.

3. The financial sector

The financial sector has improved consistently following a well-contained crisis that erupted in 1999. In 2003, and for the first time in five years, credit to the private sector increased in real terms. In the process, NPLs continued to decline, provisions increased and profitability returned to close to pre-crisis levels. Still, problems remain in two mortgage banks. Tight regulation and supervision, in addition to the on-going recovery of the housing market, should alleviate those problems in the coming months.

The government has decided to privatize two banks, Bancafé and Granahorrar. In the first case, the process has advanced swiftly, with several potential buyers well-advanced in their due-diligence processes. The government expects to receive bids before the end of the month. With regard to Granahorrar, it should be brought to the point of sale before the end of September. It is worth noting that the draft legislation to review the budget code grants budgetary independence to the bank supervisory agency.

4. Upside risks

There are upside risks to the program, which could mitigate the negative ones identified by staff. On the one hand, Colombia and the United States are starting negotiations that should soon lead to a free trade agreement. The importance of the US market for Colombia is surpassed in Latin America only by the cases of Mexico and Venezuela. The recent solid performance of the US economy has allowed Colombian exports to grow, in spite of the contraction in Venezuela, Colombia's second export market. Colombia has made good use of preferential treatment granted by the United States under the Andean Trade Preference Act, and a bilateral agreement would make most of those benefits permanent.

Another upside risk is improved security. Under President Uribe's democratic security program kidnappings and terrorist attacks are down, traffic in national roads has accelerated, and hotel occupancy rates have been impressive. Recently, a high-ranking member of the FARC guerrilla movement was apprehended in Ecuador, boosting the moral of the military and suggesting that the government seems to have the upper-hand in its fight against terror. Furthermore, the fact that for the first time ever a candidate from the left was elected major of Bogotá, home to one in seven Colombians, shows that parties in the left can gain power through the democratic process, without resorting to the use of violence. This should also enhance support for the President's security strategy, even if it might somewhat complicate his relationship with Congress.

More trade and investment associated with a free-trade agreement with the United States, enhanced security, a supportive international environment, and continued commitment to macroeconomic stability, are all positive elements that should foster growth and generate employment, thereby mitigating the adverse risks to the program raised in the staff report.

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January 12, 2004

International Monetary Fund
Washington, D.C. 20431 USA

IMF Completes Second Review of Colombia's Stand-By Arrangement, Approves US$145 Million Disbursement and Grants Waivers

The Executive Board of the International Monetary Fund (IMF) today completed the second review of Colombia's performance under a two-year SDR 1.5 billion (about US$2.2 billion) Stand-By Arrangement that was approved in January 13, 2003 (see Press Release No. 03/04). This decision entitles Colombia to the release of a further SDR 96.7 million (about US$145 million), which brings the total amount disbursed under the program to SDR 774 million (about US$1.2 billion). The Colombian authorities have treated the arrangement as precautionary and not made any drawings.

In completing the review, the Executive Board approved Colombia's request to waive the nonobservance of the structural performance criterion on the submission to congress of a revised budget code before the end of October 2003. Draft legislation on reforming the budget code was subsequently submitted to congress before the end of December 2003. The Executive Board also approved Colombia's request to waive the applicability of the performance criteria for the end of December 2003 due to the unavailability of the information at the time of the Board's discussion.

Following the Executive Board's discussion on Colombia, Anne Krueger, First Deputy Managing Director and Acting Chair, said:

"The government of Colombia has made commendable progress in carrying out a strong economic reform program aimed at faster economic growth and improved social equity. This program has begun to deliver encouraging results, with strong growth in investment and economic activity and a significant decline in unemployment.

"Economic policies in 2003 were broadly on track. The overall public sector deficit is expected to have declined, reflecting both revenue measures and firm control over expenditures. The monetary policy conducted by the Banco de la Republica has contributed to lower inflation. All quantitative performance criteria for end-September 2003 were observed, and it is expected that the performance criteria for end-December will also have been observed. Structural reforms proceeded largely as scheduled.

"Economic policies for 2004 aim to support a further pick up in economic growth and a continued decline in inflation. The government and congress have put in place revenue and expenditure measures designed to lower the overall public sector deficit to two and one half percent of GDP in 2004. Moreover, the authorities intend to announce a further strengthening of the primary surplus for 2005, with a view to achieving a significant reduction in public debt as a share of GDP by 2010. Monetary policy will continue to be conducted in the context of the inflation targeting framework, together with a flexible exchange rate.

"Colombia's economic reform program and the government's firm intention to maintain the pace of structural reform have helped reduce the risks to the economic outlook. Firm implementation of the program will, nevertheless, remain necessary to lay the basis for sustained growth and improved equity. In particular, the adoption of the revised budget code, the rationalization of Colombia's system of fiscal decentralization and further strengthening of the pension system will be critical to moderate the growth of public expenditure and preserve fiscal sustainability. In addition, steps to broaden the revenue base and simplify many of the existing taxes would contribute to achieving a durable strengthening of public revenues."