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Colombia: 2005 Article IV Consultation and Fourth Review Under the Stand-By Arrangement, Requests for Waiver of Nonobservance of Performance Criteria and the Completion of the Fourth Review, and Request for Stand-By Arrangement—Staff Reports; Public Information Notice and Press Release on the Executive Board Discussion; and Statement by the Executive Director for Colombia

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of a combined discussion of the 2005 Article IV consultation with Colombia and the fourth review under the Stand-By Arrangement, and requests for a new Stand-By Arrangement, the following documents have been released and are included in this package:

- the staff reports for 2005 Article IV Consultation and the fourth review under the Stand-By Arrangement, requests for waiver of nonobservance of performance criteria and the completion of the fourth review, and request for Stand-By Arrangement, prepared by a staff team of the IMF, following discussions that ended on February 17, 2005, with the officials of Colombia on economic developments and policies. Based on information available at the time of these discussions, the staff reports were completed on April 14, 2005. 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 Public Information Notice (PIN) and Press Release, summarizing the views of the Executive Board as expressed during its April 29, 2005, discussion of the staff report on issues related to the Article IV consultation and the IMF arrangement, respectively.

- 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*
Selected Issues Paper
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.

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INTERNATIONAL MONETARY FUND

COLOMBIA

Staff Report for the 2005 Article IV Consultation

Prepared by the Staff Representatives for the 2005
Consultation with Colombia

Approved by José Fajgenbaum and Carlo Cottarelli

April 14, 2005

Two staff reports. The policy discussions covered a broad assessment of policies and objectives from a medium-term perspective as well as issues related to the Fund-supported programs. This report presents the discussions for the Article IV consultation. It is a complement to the paper that reviews performance under the current SBA and presents the authorities' request for a new SBA.

Financial sector assessment. An FSAP update mission visited Bogotá in October 2004 and prepared an FSSA for consideration by the Executive Board.

2002 Article IV Consultation. At the conclusion of the last Article IV discussion, Directors urged strict implementation of policies aimed at fiscal consolidation and debt reduction. They emphasized the importance of streamlining the tax system and of reducing the size of the public sector; and encouraged steps to increase labor market flexibility for raising growth in a sustained way. Directors also commended the central bank for its skillful management of the inflation targeting regime, and welcomed progress achieved in strengthening the banking system.

Exchange system. The exchange rate regime is a managed float. In 2004, Colombia accepted the obligations of Article VIII, Sections 2, 3, and 4. The authorities have not indicated a timetable to remove the special foreign exchange regime for hydrocarbons exporters and the tax on remittances abroad of nonresident income. Staff does not recommend the approval of these restrictions.

Statistical issues. Colombia's statistical base is adequate for effective program monitoring and surveillance. However, the timeliness and comprehensiveness of fiscal data need to be improved.

Discussions. A staff team held discussions in Bogotá during December 1–10, 2004 and during February 3–17, 2005. The team met with the Minister of Finance, the General Manager and the Board of Directors of the Banco de la República, the Director of the National Planning Department, other senior government officials, and representatives of the private sector and labor unions. The staff team comprised R. Rennhack (Head), R. Garcia-Saltos, O. Hendrick (all WHD), I. Adenauer (FAD), and J. Wiegand (PDR). C. Schnure (WHD), J. Cayazzo (MFD), and J. Acevedo (MFD-consultant) joined the first stage. Li Lian Ong (ICM) joined the second stage. J. Fajgenbaum (WHD) participated in the February policy discussions. Mr. Steiner, Alternate Executive Director for Colombia, participated in all policy discussions.

Contents Page

Executive Summary

Since 1999, Colombia has been pursuing a medium-term strategy based on fiscal consolidation, lowering inflation, and strengthening the financial system. By 2003–04, substantial progress had been achieved in these areas, and economic performance improved significantly.

Nonetheless, there are still important challenges to continue to strengthen economic performance. These include the need to translate steady economic growth into continued declines in unemployment and poverty, sustain the pace of fiscal consolidation; and continue to strengthen financial supervision and deepen domestic capital markets.

Overall, it was agreed that the policy strategy had worked well and was well suited to meet these challenges. Policies would continue to seek to sustain real growth of 4 percent a year, while gradually lowering inflation to 2–4 percent a year. Fiscal policy will keep public debt on a sustainable path. The central bank would continue to target inflation, while maintaining the flexible exchange rate regime to help the external sector adapt to possible shifts in conditions.

Public debt would decline to close to 40 percent of GDP by 2010. The authorities estimate that a primary surplus of 2.7 percent of GDP is consistent with this path, but they stand ready to adjust the primary surplus as needed to achieve this objective. It was agreed that the agenda for fiscal structural reforms over the medium term includes tax policy, pensions, domestic pricing of gasoline and diesel, social spending, revenue sharing, and public investment.

Monetary policy would continue to be conducted in the context of the inflation targeting framework, together with the flexible exchange rate regime. The staff supported the authorities' goal of reducing inflation by ½ percent point a year until annual inflation reaches the range of 2–4 percent.

The staff judged that external competitiveness seemed broadly adequate. In 2004, export growth was broad based and the external current account deficit was low. To prevent a recurrence of past episodes of large real appreciations followed by economic difficulties, the central bank had been purchasing foreign exchange since late 2003. However, they emphasized that the Banco de la República would always give top priority to achieving its inflation target. The staff urged the authorities to guard against excessive foreign exchange intervention, which could raise inflation or create quasi-fiscal costs from sterilization.

The authorities agreed with the main conclusions of the FSSA update. The Superintendency of Financial Institutions intends to continue strengthening the legal and regulatory framework, especially by improving the measurement of market and other risks and of the value of foreclosed assets. The government is seeking congressional approval of a securities market law designed to deepen domestic capital markets.

I. FROM CRISIS TO RECOVERY

1. **Since 1999, economic policies have sought to strengthen the economy, in the aftermath of the country's worst economic crisis in 30 years (Box 1)**. [1] The strategy focused on fiscal consolidation, lowering inflation, and strengthening the financial system. In mid-1999 the government of President Pastrana designed an economic emergency program to re-establish a credible policy framework. The authorities aimed at cutting the public sector deficit from 5½ to 1½ percent of GDP within three years to return public debt to a sustainable path. This effort was supported by structural fiscal reforms to strengthen the finances of subnational governments, which had accumulated high debt levels in previous years, and to improve the tax and pension systems. In September 1999, the Banco de la República switched to a flexible exchange rate regime, and adopted an inflation targeting framework to anchor inflationary expectations. The crawling exchange rate band—which Colombia had maintained for most of the 1990s—had proved ineffective in reducing inflation and too costly to sustain in the presence of volatile private capital inflows. Congress approved a banking reform to strengthen financial supervision, and the government intervened a number of insolvent financial institutions.

2. **The efforts worked well initially but encountered difficulties in 2002.** The fiscal tightening advanced through early 2002, although the fiscal targets were eased in 2001 due to slower economic growth and increased security requirements. President Pastrana had been attempting to negotiate a peace agreement with the guerillas, but this effort collapsed in February 2002, coinciding with a deterioration in the security situation (Box 2). Public spending increased in the run up to the May 2002 elections. In addition, Colombia was affected by concerns about developments elsewhere in the region, which curtailed access to international capital markets for a number of emerging market countries. Together these factors contributed to a sharp depreciation of the currency and raised the country risk premium to a peak of 1,100 basis points in October 2002.

3. **In August 2002 the administration of President Uribe took office and strengthened economic policies**. It quickly reversed the deterioration in the fiscal position through several revenue measures (a one-time wealth tax, an income tax surcharge, and a broadening of the VAT base) and expenditure restraint. Two pension reforms were also adopted, reducing the actuarial deficit of the pension system from 207 percent of GDP to 187 percent of GDP. Other reforms focused on restructuring and downsizing the nonfinancial public sector, improving financial supervision, and privatizing or liquidating the remaining public banks. Congress also approved in December 2002 a labor market reform that extended regular daytime working hours, lowered the overtime premium for work on Sundays and holidays, reduced severance payments, and cut nonwage costs for certain employee groups.

[1] The Fund has provided support through a three-year Extended Fund Facility approved in December 1999 and a two-year Stand-By Arrangement approved in January 2003.

In addition, the Uribe administration established a policy known as democratic security to try to resolve the civil strife.

4. **Initially the recovery proceeded slowly but in 2003–04 economic performance improved significantly (Table 1)**.

- Real economic growth recovered to 4 percent a year in 2003–04, compared with a 4 percent decline in real GDP in 1999. The national unemployment rate declined from 20 percent at end-2000 to 12 percent at end-2004, while the poverty rate declined from almost 60 percent in 1999 to 52 percent in 2003.

- The combined public sector deficit was reduced from 5.5 percent of GDP in 1999 to an unexpectedly low 1.3 percent of GDP in 2004, reflecting an unanticipated rise in the export price of oil to US$36 per barrel and an unusually large surplus of the autonomous local and regional governments. This outturn—together with the real appreciation of the peso during 2004—helped reduce public debt to 53 percent of GDP by end-2004. Also, public sector deposits reached 10 ½ percent of GDP by end-2004.

- Inflation declined from 9 percent during 1999 to 5.5 percent during 2004—the lowest level in decades—owing to an output gap that reached 4–5 percent in 1999–2000 as well as the effective implementation of the inflation targeting framework.

- The external sector strengthened, led by sustained growth in exports and a recovery in capital inflows. During 2004, the peso appreciated by 11 percent in real effective terms, prompting the central bank to purchase US$2.9 billion (about one-third of the stock of base money) to limit the appreciation. By end-2004, net international reserves reached US$13.2 billion (123 percent of short-term external debt on a remaining maturity basis).

- The health of the financial system recovered, as loan quality improved and bank profits increased. The nonfinancial corporate sector had reduced leverage and managed currency risk more prudently, encouraged by the flexible exchange rate regime.

5. **Nonetheless, there are still important challenges to continue to strengthen economic performance**:

- It would be important to continue to find ways to ensure that sustained growth translates into further declines in unemployment and poverty.

- Ongoing fiscal consolidation is needed to continue reducing Colombia's public debt, which remains relatively high and vulnerable to a weakening of the peso.

- While the financial system is healthy, domestic capital markets are shallow and illiquid. This, together with distortionary taxes on financial transactions, has led to a high cost of capital and deterred investment. The mortgage sector has been stagnant, and since 1999 banks have increased their exposure to government securities.

- The economy remains vulnerable to the risk that the global economic environment becomes less favorable, especially if high world oil prices slow global demand.

- It is crucial to keep economic policies on track during the upcoming political transition—elections are scheduled for March (congress) and May (presidential) 2006—to ensure that the country continues to build the credibility of its commitment to strong policies.

II. Assessing The Medium-Term Policy Strategy

6. **The Article IV consultation discussions provided the opportunity to assess whether the policy strategy followed since 1999 was appropriate.** Overall, the staff and the authorities agreed that this strategy had worked well and should be sustained in the coming years to address the remaining challenges.

7. **Looking forward. the authorities' policies over the medium-term seek to sustain real growth of 4 percent a year, while gradually lowering inflation to 2–4 percent a year (Tables 2-4)**. The government would continue with fiscal reforms to sustain a primary surplus of 2.7 percent of GDP, and it would aim to rely increasingly on domestic currency borrowing to limit the vulnerability of the debt profile to exchange rate fluctuations. The central bank would continue to target inflation. The flexible exchange rate regime would allow the external sector to adapt to shifts in conditions—such as the prospect of a significant decline in the volume of oil exports starting in 2007—and to allow exports to diversify further. The external current account deficit would range from 2½ to 3 percent of GDP through 2010, which could be financed with sustainable net capital inflows. Net international reserves would remain at about 110 percent of short-term debt on a remaining maturity basis. Under these assumptions, public debt is projected to decline to 42.7 percent of GDP by 2010, while total external debt would fall to 32 percent of GDP.

8. **This outlook is subject to several risks, including the effects of a currency depreciation on public debt**: (i) in the event of an exchange rate shock (assumed for illustrative purposes to be a permanent 30 percent depreciation of the peso vis-à-vis the U.S. dollar in 2006), public debt would reach 54 percent of GDP by 2010 and external debt would amount to 41 percent of GDP (Tables 5 and 6); (ii) a combination of adverse fiscal shocks—high real interest rates, low real economic growth and a weak primary balance—would push public debt up to 54 percent of GDP by 2010; and (iii) a combination of adverse external shocks—higher real interest rates, lower GDP measured both in local currency and in U.S. dollars, and a wider external current account deficit—would raise external debt to 49 percent of GDP by 2010.

A. Strengthening Growth and Employment

9. **The authorities noted that a key challenge was to lay the foundation for faster growth, while maintaining real growth of 4 percent a year**. [2] The authorities commented that the civil strife deters faster growth by raising security costs and uncertainty, which in turn reduce investment and factor productivity. The estimates of the effect on the conflict on economic activity range from lowering the level of GDP by 4 percent to cutting annual growth by up to 2 percent a year. The authorities see a need for continued fiscal reforms, including by making the tax system more efficient, and steps to deepen the financial system to help lower the cost of capital and encourage investment and growth.

10. **The authorities noted that another challenge would be to reduce unemployment further**. In February 2005, national unemployment amounted to 14.0 percent, compared with 15.4 percent a year earlier. Studies suggest that the natural rate of unemployment in Colombia is about 10–12 percent. This high level of structural unemployment reflects several factors, including high nonwage labor costs, a relatively high minimum wage, labor market regulations, and an excess supply of lower-skilled workers. Also, the civil strife had created many refugees, adding to unemployment.[3] The authorities noted that the labor reform of 2002 had increased the flexibility of labor contracts and improved human capital formation through apprenticeships. They pointed to evidence indicating that the reform had already stimulated additional growth in employment and added that the benefits of this reform would still be felt in the coming years. Staff agreed that the first results of the reform were encouraging.

B. Sustaining Fiscal Structural Reforms

11. **The authorities' medium-term fiscal framework presented to Congress in June 2004 aims to reduce public debt to 39 percent of GDP by 2015**. The authorities estimated that—based on the current outlook—a primary surplus of 2.7 percent of GDP over the medium term would be consistent with this path. The staff recommended that taking advantage of the favorable global economy, especially the high world oil prices, to raise the primary surplus to 3.0 percent of GDP and reduce public debt more quickly. The authorities noted that they wanted to support a sustainable path for public debt, and would adjust the primary surplus if necessary to achieve this objective. They added that a significant share of any oil price windfall would be saved in 2005–06.

12. **The authorities and the staff considered that the pace of fiscal adjustment was sensitive to the political climate**. While the broad goal of fiscal discipline enjoyed sufficient political support, there was often a strong debate about the nature of the fiscal measures. For

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[2] This is broadly in line with estimates of growth in potential GDP.

[3] These issues are discussed in Chapter 1 of the Selected Issues Paper.

example, on several occasions the government had proposed to reform the tax structure by narrowing the number of VAT rates and broaden the base of the VAT and income taxes. However, Congress has resisted steps that could have been perceived as effectively raising the VAT. In December 2003, it approved increases in the wealth tax and the financial transaction tax. In December 2004, the government withdrew its tax proposal in the face of strong congressional opposition. In addition, the constitutional court has used its broad mandate to rule on economic policies. For example, in 2003, the court nullified part of the VAT increase approved in December 2002 and it required the government to increase public wages by at least the rate of inflation in the previous year. In 2004, the court nullified part of the 2002 pension reform (the shortening of the transition period to the new pension regime adopted in 1994), which raised the actuarial deficit of the pension system by 17 percent of GDP.

13. **Structural fiscal issues also present significant challenges.** The revenues of the state oil company (Ecopetrol) are likely to decline as oil production is projected to fall by 10 percent a year in the period 2005–10, assuming no discoveries of major oil fields that would reverse the decline in proven reserves. The central government (central administration, social security, and decentralized agencies) must contend with rigid noninterest expenditures. The authorities added that, if the demobilization talks were to proceed well, the government would need to provide financial support to help ex-combatants reintegrate into civilian life.

14. **Against this background, the authorities and staff discussed the medium term agenda for fiscal structural reforms**:

- **Tax reform**. With total public revenues of about 32 percent of GDP, the authorities and the staff saw little need for net revenue enhancing measures. However, it was agreed that the current structure of taxes complicated tax collection and discouraged growth. For example, the value added tax includes 8 different rates, many more than in neighboring countries, and a narrow base, with only about 50 percent of eligible goods subject to this tax. Also, the tax system relies on several distortionary taxes, such as the financial transactions tax with a tax rate of 0.4 percent (one of the highest in the region) and a bank stamp tax of 1.5 percent—a very high rate in the context of low inflation. The authorities still believe that simplifying the VAT and the income taxes and phasing out distortionary taxes are important medium-term measures.

- **Spending rigidities**. Congress is currently considering a revised budget code designed to cut expenditure rigidities by scaling back revenue earmarking (which applies to about 50 percent of tax revenues), trimming the carry over of spending commitments from year to year, and restricting the ability to make multi-year spending commitments. This revised code is an important step forward but will not resolve all of the difficulties with expenditure management. For this reason, the staff encouraged the authorities to continue to find ways to enhance the flexibility of spending further.

- **Pensions**. Congress approved the government's pension reforms in December 2002 and May 2003 that reduced the actuarial deficit to about 190 percent of GDP (Box 3). Even with these reforms, the central government's net pension costs are projected to rise sharply through 2015. In July 2004, the government introduced a constitutional amendment aimed at lowering the actuarial deficit further to about 160 percent of GDP and at reducing net pension costs starting early next decade. The authorities agreed that additional pension reforms would be needed over the medium term. However, they added that it would be very difficult to reduce the actuarial deficit below 140 percent of GDP, reflecting payments to current retirees and to workers who accumulated benefits under the PAYG system. As a result, the nonpension balance of the public sector would have to continue to strengthen over time.

- **Domestic fuel prices**. The government's system of regulating the prices of regular gasoline and diesel has led to an implicit subsidy of about 1 percent of GDP a year for the past five years. The government has been setting wholesale prices well below international levels, which discourages investment by Ecopetrol in upgrading its refining capacity or in exploration and production. Retails prices are also regulated at a fixed margin over the wholesale price to allow for taxes and distribution costs. At the retail level, the price of regular gasoline is the same as in the United States, while diesel is significantly cheaper. Over the past two years, the authorities have been raising these domestic prices faster than inflation to try to cut the implicit subsidy, but these adjustments have not kept pace with the rise in world oil prices since late 2003. The staff urged the authorities to deregulate the wholesale and retail prices of gasoline and diesel over the next few years as a way to eliminate the subsidy and to ensure efficient pricing of gasoline and diesel at all stages of production. The authorities agreed that price deregulation would be an important medium-term reform. However, in the near term, the authorities preferred to retain the current system, which sought to gradually bring domestic wholesale prices in line with international levels to help insulate domestic consumers from price fluctuations.

- **Strengthening social spending**. The authorities noted that an important share of social spending (which includes subsidies estimated at 7 percent of GDP excluding pensions)—such as public childcare centers, primary education and subsidized health insurance—has benefited the poor. However, they added that other programs—such as subsidies for tertiary education and housing—have tended to help the middle and upper classes. The authorities intend to channel social spending more effectively and agreed that there may be some scope to trim some poorly targeted subsidies. The government is preparing a poverty reduction strategy to help Colombia achieve its Millennium Development Goals (Box 4).

- **Revenue sharing**.[4] Transfers from the central administration to local and regional governments are constitutionally mandated to increase by 2 percentage points in real terms in the period 2002–05, and by 2.5 percentage points during 2006–08. Starting in 2009, revenue sharing is to return to the pre-2002 system, with transfers growing in line with the average growth in the central government's current revenues for the preceding four years. Also transfers—now about 35 percent of current revenues—may not be less than 42 percent of current revenues—the share in 2001. The staff and the authorities agreed that—provided current revenues grow in line with GDP—this would lead to a significant increase in the central administration deficit starting in 2009 and in the CPS deficit as well, if local and regional governments were to spend the additional transfers. Staff calculations suggest that holding these transfers constant in real terms would strengthen the central government balance and the overall fiscal position, if the current legal framework continues to restrain the ability of local and regional governments to run deficits. The authorities felt it was too soon to consider modifications to the revenue sharing framework, but intend to prepare by December 2005 a study that evaluates the current system.

- **Strengthening other aspects of fiscal decentralization**. An FAD mission on decentralization recommended that the authorities strengthen the monitoring, information flow, and coordination of budgetary policies among different levels of the government. In particular, the mission recommended that the authorities establish an agency that would monitor and coordinate the budgets of the different levels of government. The authorities underlined that the fiscal responsibility laws adopted earlier this decade have controlled spending and indebtedness of regional and local governments, which ran a large overall surplus in 2004. Moreover, the constitution granted a high degree of autonomy to local and regional governments, which made it difficult to create a centralized agency with any meaningful authority. However, the authorities are taking steps to strengthen the quality of information on the operations of all levels of government.

- **Public investment**. Colombia participated in the FAD pilot project on public investment. The authorities have been emphasizing the need to increase the level of public investment to improve infrastructure in certain sectors (Box 5). They agreed fully that any plan to strengthen public investment must be consistent with the medium-term policy framework. They noted that investment of several public companies is constrained by the fiscal targets for the overall public sector, and would prevent these enterprises from carrying out productive investments. Staff encouraged the authorities to intensify the use of public-private partnerships (PPPs) to finance

[4] This issue is discussed in more detail in Chapter 2 of the Selected Issues paper.

infrastructure investments, provided these projects had strong rates of return and an appropriate degree of risk transfer to the private sector. Staff also urged the authorities to increase the commercial orientation of public enterprises, including Ecopetrol.

C. Continuing to Reduce Inflation

15. **Staff and the authorities agreed that the inflation targeting (IT) framework had been useful (Box 6)**. In a country, such as Colombia, with a long history of moderate inflation, this framework helps guide the market's inflation expectations, which—the authorities noted—are now broadly in line with the inflation target for 2005. Over the medium term, the Banco de la República intends to lower inflation by ½ percentage point each year until annual inflation reaches the range of 2–4 percent, broadly in line with inflation in Colombia's trading partners.

16. **The staff and the authorities agreed that the flexible exchange rate regime adopted in September 1999 had served Colombia well**. Since 1999, the external sector has experienced several shocks. Colombia's terms of trade have been volatile, reflecting in part strong fluctuations in the world price of oil. The flexibility of the exchange rate has allowed for continued export growth and diversification, and kept the external current account deficit at sustainable levels.[5] The depreciation of the peso vis-à-vis the U.S. dollar helped sustain modest economic growth in 2002, when access to international capital markets was sharply curtailed for part of the year. The staff noted that since 1999 the private sector appears to managing its foreign exchange risk more carefully. Nonfinancial corporations had cut their peso exposure, while pension funds had built up foreign currency assets, including holdings of Colombian government securities denominated in U.S. dollars.[6] Hedging of exchange rate risk has grown sharply since 1997, and by 2004, forward contracts in foreign exchange were equivalent to about 60 percent of all international trade transactions.[7] Looking forward, the authorities noted that the flexible regime would help the external sector adapt to the prospect of declining oil exports over the next few years by encouraging a further diversification of exports.

17. **The staff noted that external competitiveness seemed broadly adequate**. Exports performed well 2004—growing by more than 20 percent—even while the peso appreciated significantly in real effective terms. While traditional exports benefited from high commodity prices, industrial exports—which account for almost 40 percent of the total—also increased

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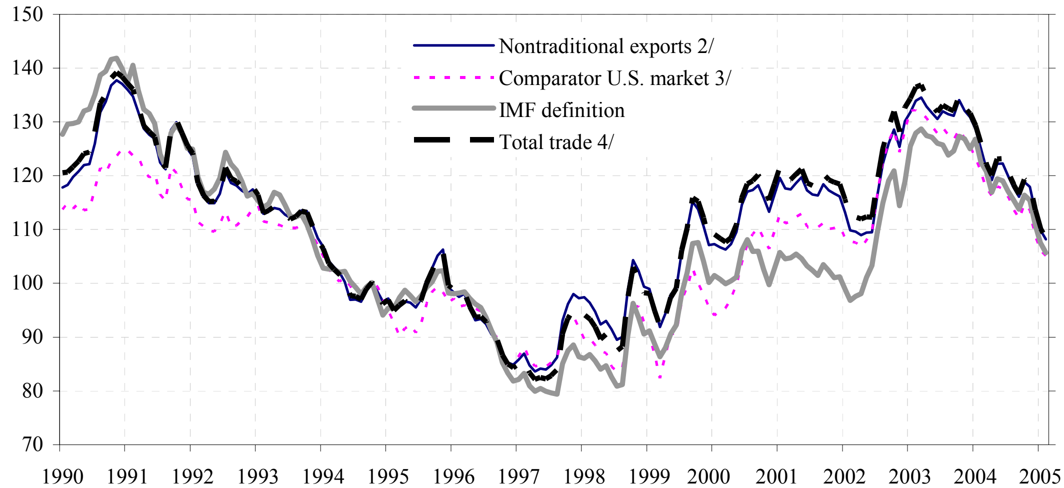
[5] Petroleum and coal are Colombia's most important export products, accounting for 25 and 11 percent of the total in 2004. Other important exports products are chemical goods (10 percent of total exports), coffee (6 percent), textiles (6 percent), and flowers (5 percent).

[6] A balance sheet analysis is discussed in Chapter 3 of the Selected Issues Paper.

[7] An analysis of hedging in Colombian financial markets is presented in Chapter 4 of the Selected Issues paper.

significantly, aided by the economic recovery in neighboring Venezuela. At end-2004, the peso was 15 percent more depreciated in real effective terms than in September 1999.

REER Indicators 1/
(Index: 1994=100)



Sources: Central Bank of Colombia; and Fund staff estimates.
1/ Using CPI.
2/ Using weights from nontraditional exports and imports from 20 trading partners.
3/ Relative to 23 countries that compete with Colombia in the U.S. market.
4/ Relative to the main 20 trading partners.

18. **The authorities were concerned that continued appreciation could present difficulties for external competitiveness**. They commented that previous episodes of sustained real appreciation, such as in the early 1980s and the mid-1990s, had often been followed by difficulties. They noted that exports were projected to grow slowly in 2005, partly reflecting the lagged effects of the real effective appreciation in 2004. There was also concern that a strong currency could adversely affect the competitiveness of legitimate crops in the agricultural sector, which employ many low-income workers who might otherwise be involved in the cultivation of illicit crops. For this reason, they had been intervening in the foreign exchange market since late 2003. However, they emphasized that the Banco de la Republica would always give priority to achieving its inflation target. The staff urged the authorities to guard against excessive foreign exchange intervention, which could create inflationary pressures or add to quasi-fiscal costs.

19. **The authorities noted that trade liberalization has helped strengthen external competitiveness**. In the late 1980s and early 1990s, Colombia lowered its average tariff from more than 40 percent to the current level of about 11 percent, and now there are no economically significant nontariff barriers. As a result, exports have doubled from 8 percent of GDP in 1987-88 to over 16 percent of GDP in 2004, with strong diversification into exports of industrial and other nontraditional products. In this period, non-oil exports doubled from about 6 percent of GDP to 12 percent of GDP. Colombia, together with Peru and Ecuador, is negotiating a free-trade agreement with the United States, with a view to liberalizing trade further.

20. **The authorities agreed with staff that it would be important to continue to facilitate the development of market-based hedging mechanisms**. While hedging has increased significantly since 1997, the market is very short term, with 80 percent of forward contracts maturing one month. The staff suggested several steps to strengthen the use of hedging instruments. The establishment of a single reference interest rate would allow for more credible valuation of derivatives contracts and improve disclosure in the financial statements. Also easing the limit on banks' foreign currency cash position (which has not been allowed to be in a negative balance since March 2004) would give banks more flexibility to take forward positions with offsetting spot transactions. The authorities have requested technical assistance in this area from the Fund's International Capital Markets Department.

21. **The government purchased net international reserves to prepay an expensive emergency loan from the IDB in the amount of US$1.25 billion in early April 2005.** After this operation, net international reserves amounted to 110 percent of short-term debt with a remaining maturity. The authorities and the staff agreed that this would still provide an adequate reserve cushion. The central bank emphasized that the government was purchasing the reserves, using the proceeds from issuance of government securities, and that the central bank was not granting a credit to the government.

D. Creating A More Effective Financial Sector

22. **The authorities agreed with the main conclusions of the FSSA update (Box 7)**. They noted that the efforts to improve financial supervision and restructure weak banks, together with the economic recovery, had strengthened the financial system.

23. **The Superintendency of Financial Institutions (SIF) intends to continue strengthening the legal and regulatory framework**. It plans to address the challenges associated with the new risk-based provisioning system, in part by expanding its technical staff significantly over the next few years to monitor the risk assessments of financial institutions. The authorities noted that this new framework would allow for a more accurate measurement of market and other risks and of the value of foreclosed assets, which would probably lead to some increase in provisioning and capital. They supported the recommendation to grant more autonomy to the SIF, but added that in 2003 Congress had rejected a draft law to grant budgetary independence to the SIF.

24. **The authorities agreed that banks held a large and growing share of their assets in government securities, increasing their exposure to interest rate and liquidity risk**. This situation reflected in part limited opportunities for loans or investment to the private sector. However, they added that banks were exposed to less credit risk.

25. **The authorities commented that the mortgage sector remained stagnant for several reasons**. Demand for mortgages was weak, as many home buyers were still reluctant to acquire mortgage debt even 5–6 years after the crisis. Also several judicial and regulatory decisions have discouraged banks from offering mortgages. During the 1999 crisis, the

constitutional court ordered a retroactive change in the indexation formula used in mortgages, leading to a significant decline in the outstanding value of mortgages. In addition, the court set a limit on the real interest rate on most mortgages. Moreover, completing a foreclosure often takes up to 5 years. The authorities noted that many mortgage banks have recovered by diversifying into consumer and corporate lending and that the few remaining weak mortgage banks were operating under restructuring plans. They added that the program to securitize mortgages that began in 2003 would help mortgage banks restructure their balance sheets further.

26. **The authorities shared the view that domestic capital markets could play a more important role in financing investment**. For this reason, the government submitted to Congress a new securities market law, with approval expected by June 2005, and was drafting a new corporate accounting law. These laws would provide more security and transparency to securities trading by protecting investors' rights, improve contract enforcement, and reduce regulatory arbitrage. Both the staff and the authorities agreed that several distortions—such as the financial transactions tax and the bank stamp tax of 1½ percent—contributed to financial disintermediation (Box 8).

III. Short-Term Macroeconomic Outlook

27. **Economic policies in 2005–06 have been framed in the context of this medium-term strategy**. The specific goals are to support real economic growth of 4 percent a year and lower inflation to 5 percent during 2005 and to 3–5 percent during 2006. The CPS deficit would amount to 2.5 percent of GDP in 2005, assuming an export price of oil of US$31 per barrel as a prudent baseline and a gradual decline in the surplus of local and regional governments to historical levels. In 2006, the CPS deficit would decline to 2.0 percent of GDP, lowering public debt to about 50 percent of GDP by end-2006. These targets will be lowered by a significant share of any oil price windfall. Monetary policy would continue to be conducted in the context of an inflation targeting framework, and the exchange rate regime would remain flexible. The external current account deficit would rise to about 2½ to 3 percent of GDP in 2005–06, reflecting a fall in the volume of oil exports as well as the lagged effects of the real exchange rate appreciation during 2004. Net international reserves would remain comfortable at US$12.3 billion in 2005 (110 percent of short-term debt on a remaining maturity basis), reflecting the reserves purchased to prepay the IDB loan.

28. **The authorities will seek to advance structural reforms already before Congress**. They intend to press for congressional approval by June 2005 of several measures: (i) the revised budget code; (ii) the constitutional amendment to reduce the actuarial deficit of the pension system; and (iii) the new securities market law. They noted that Congress is now considering the draft law for the legal framework for demobilization of paramilitaries and other combatants, and may consider a possible free trade agreement with the United States in the second half of 2005.

29. **The authorities will continue to build support for the rest of the structural reform agenda**. However, they commented that it would be difficult to introduce new reforms to congress ahead of the elections.

IV. Staff Appraisal

30. **The economic policy strategy of fiscal consolidation, lowering inflation and strengthening the financial system has been effective**. This approach has benefited from the favorable global economic environment in recent years. Since 1999, real economic growth has recovered, while unemployment and poverty have declined. Inflation has fallen to the lowest level in decades. The external sector has strengthened, with sustained export growth and restored access to international capital markets. The financial system has returned to a sound position.

31. **The authorities' intention to maintain this strategy in the coming years is welcome**. Their framework is wisely based on an outlook for steady economic growth, which—together with the effects of the 2002 labor reform—should contribute to further reductions in unemployment. The plan to maintain fiscal discipline to lower public debt to 39 percent of GDP by 2015 will help diminish risks further. The central bank will continue to target inflation in the context of a flexible exchange rate regime. Financial supervision will continue to strengthen and the new securities market law, if approved, would help broaden domestic capital markets.

32. **The main challenge to this strategy comes from the need to sustain the pace structural fiscal reforms to keep public debt on a sustainable path**. The reforms already presented to Congress—the revised budget code and the pension reform—will play an important role in containing expenditure growth. Over the medium term, reforms will be needed in several areas. The staff welcomes the authorities' intention to continue to build support for steps to simplify the VAT and the income tax and scale back distortionary taxes. The constitutional amendment for pension reform currently before Congress represents an important step forward to reduce the actuarial deficit further. It would be crucial to consider additional pension reforms as quickly as feasible to help limit the expected rapid rise in net pension costs. The staff encourages the authorities to deregulate the domestic prices of gasoline and diesel over the medium term to eliminate the implicit subsidies and to allow for efficient pricing of these products. The system of fiscal decentralization needs to be strengthened by modifying the revenue sharing mechanism, which presents a significant risk and weakens the credibility of the authorities' fiscal strategy. The staff urges the authorities to consider steps to limit the increase in transfers—preferably to the rate of inflation—to strengthen the medium-term position of the central administration and of the combined public sector. The staff also encourages the authorities to establish an agency that would help ensure a close coordination of fiscal policy at all levels of government.

33. **The inflation targeting framework has helped guide inflation expectations**. During 2004, the central bank achieved the lowest inflation rate in decades and expectations

for 2005 are broadly in line with the inflation target. The plan to gradually reduce inflation to the range of 2–4 percent a year is appropriate.

34. **The flexible exchange rate regime has served Colombia well**. Over the medium term, continued exchange rate flexibility will be essential to help the economy adjust to the prospect of a significant decline in oil production and exports. The staff judges that external competitiveness is broadly adequate, in view of the broad-based growth in exports in 2004 and the sustainable level of the external current account deficit. The staff sees the appreciation of the peso vis-à-vis the U.S. dollar during 2004 as a market-based response to increased confidence in the Colombian economy and a favorable external environment. The staff urges the authorities to guard against pressures for excessive foreign exchange intervention, which could generate inflationary pressures or raise quasi-fiscal costs through sterilization operations. In this regard, the staff agrees that continued trade liberalization would strengthen export competitiveness further.

35. **The financial system has recovered from the 1999, owing to the government's financial restructuring operations as well as the economic recovery**. It will be important to continue to strengthen the legal and regulatory framework for financial supervision. The new securities law will encourage a deepening of domestic capital markets. Also phasing out the financial transactions tax and the bank stamp tax would promote financial intermediation. With more opportunities for lending and investment, banks would be able to gradually diversify their portfolio away from government securities and limit their risk to interest rate fluctuations and to the sovereign. In the mortgage sector, decisions intended to protect borrowers are actually making it more difficult for borrowers to acquire housing.

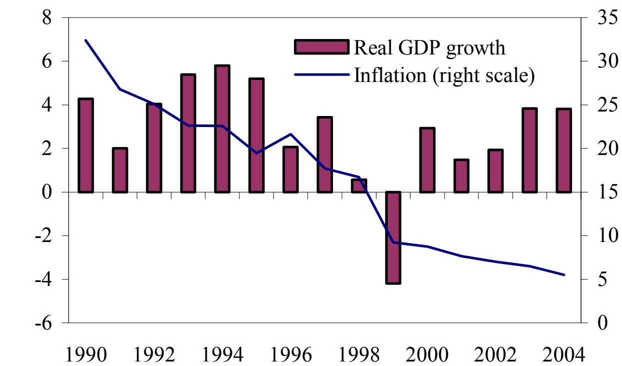
36. **Colombia has accepted the obligations of Article VIII, Sections 2, 3, and 4**. However, the authorities have not indicated a timetable for removing the two remaining restrictions. For this reason, staff does not recommend approval of these restrictions.

37. **It is proposed that the next Article IV consultation will be held on the 24-month cycle**, subject to the provision of decision No. 127 94, (02/76) on Article IV consultations.

Box 1. The Economic Crisis of 1999

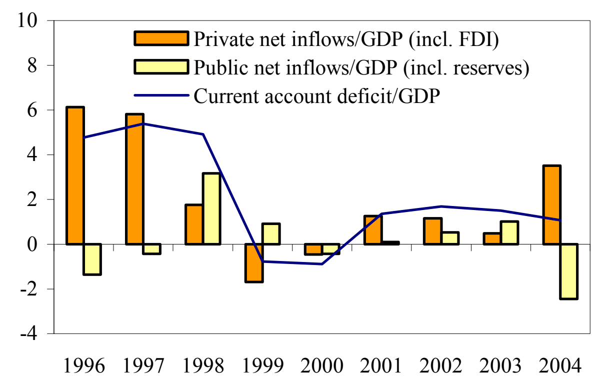
In the 1970s and 1980s, Colombia's real economic growth averaged 4 percent a year. Inflation—anchored by a crawling peg with the US dollar—was moderate but stable, ranging from 20–30 percent a year. In the mid 1990s growth accelerated**,** supported by strong private capital inflows owing to (i) foreign direct investment in the oil sector, (ii) large scale privatizations, and (iii) financial inflows following steps to liberalize the capital account.

Real GDP Growth and Inflation



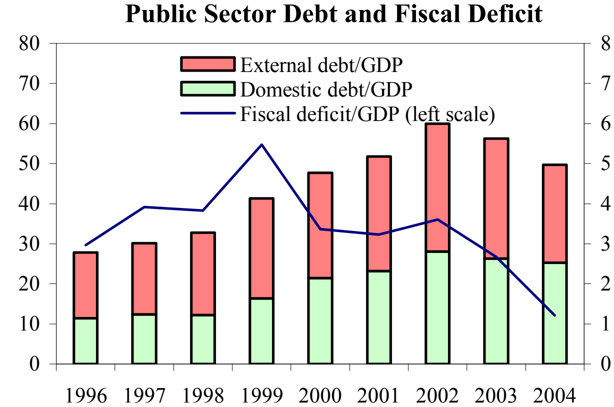
Capital flows reversed abruptly in the aftermath of the Asian and Russian crises of 1997/98, forcing a sharp adjustment of the current account. In late 1998, the crawling exchange rate band came under intense pressure. At first, the Central Bank defended the arrangement with high interest rates, causing severe stress for the financial sector. A banking crisis ensued, which was concentrated in poorly supervised public banks and mortgage lending institutions. In September 1999, the Central Bank floated the peso. The sharp devaluation that followed reinforced financial stress for many companies, which had accumulated sizeable foreign currency liabilities.

Current Account and Net Inflows



In 1999, real GDP fell for the first time in more than 30 years. The economic downturn coincided with an deterioration in Colombia's security situation. Moreover, public debt increased sharply, owing in part to the effect of the depreciation on foreign currency debt and the cost of recapitalizing the banking system. In late 1999, the sovereign lost its investment grade rating for foreign currency debt over concerns about the sustainability of Colombia's long-term fiscal position.

Public Sector Debt and Fiscal Deficit



Box 2: Security Situation

Colombia's civil strife—whose roots go back to the 1950s—reached a peak in the late 1990s and early 2000s. All indicators of violence—such as homicides, kidnappings, and acts of economic sabotage—rose to extremely high levels. About one-third of the country's municipalities were controlled by the guerillas by 2000.

There are three main illegal armed groups, with about 30,000 combatants. The FARC (Revolutionary Armed Forces of Colombia) is a peasant-based guerilla group that started as a communist militia and now comprises about 15,000 fighters. The ELN (National Liberation Army) grew out of Cuba-inspired student protests and now counts about 5,000 guerilla fighters. The AUC (United Autodefense Forces of Colombia) is a loose association of paramilitary organizations with an estimated 10,000 fighters. Some paramilitaries served originally to protect landholdings against the FARC and the ELN. All three groups are considered terrorist organizations by the United States and the European Union. They finance themselves with kidnappings, robberies, and extortion. Moreover, the FARC and the AUC are deeply involved in the drug trade, with each group earning US$100–300 million a year from this source.

After taking office in August 2002, the Uribe administration laid out a democratic security strategy. The government stepped up pressure on insurgents by strengthening the army, increasing police presence in rural areas, and granting the military a wide range of police powers. It also eradicated coca plantations to undercut the financial base of the illegal armed groups. It also initiated demobilization negotiations with groups that agree to end hostilities.

Thus far, the policy has yielded notable successes:

- Between 2002 and 2004, this policy resulted in sharp declines in homicides and kidnappings and in acreage devoted to coca cultivation. Also, by 2004 all municipalities were under government control.
- Demobilization talks have started with the paramilitaries, and by end-2004, several thousand paramilitary fighters had handed in their weapons. Congress is currently debating a legal framework for demobilization to decide criminal penalties for ex-combatants, determine how to fund reparations to the victims of the violence, and establish programs to help ex-combatants reintegrate into civilian life.
- However, the FARC has shown no interest in entering into peace talks, and intensified its attacks on the Colombian military in early 2005

Box 3. Pension Reforms

- In December 1993, Congress approved a pension reform that sought to provide adequate and sustainable retirement benefits for workers. It strengthened the pay-as-you-go (PAYG) system by raising contributions and reducing retirement benefits. It also established a fully funded, private system that coexists with the PAYG system. With a few exceptions, workers can choose either system and have the right to change systems once every three years.

- However, this reform excluded the generous special pension regimes for certain kinds of employees, such as teachers. It also established a long transition period for workers already participating in the PAYG system.

- As a result, the actuarial deficit of the pension system reached 210 percent of GDP by 2002. In December 2002 and May 2003, Congress raised contribution rates and cut retirement benefits again and shortened the transition period. However, the constitutional court subsequently reinstated the original transition period, leaving the government with significant increases in net pension costs over the next decade and an actuarial deficit close to 190 percent of GDP.

Colombia: Social Security, 2003-2015 1/
(in percent of GDP)

	2003	2004	2005	2006	2007	2008	2009	2010	2015
Contributions	1.3	1.8	1.8	1.8	1.7	1.7	1.6	1.6	1.4
Benefits	5.5	6.0	6.4	6.4	6.5	6.7	6.8	7.0	7.3
Deficit	-4.2	-4.2	-4.6	-4.6	-4.8	-5.0	-5.2	-5.4	-5.9

Source: Ministry of Finance.
1/ Net pension costs of ISS, excluding transfers from the central administration.

- In June 2004, the government presented a constitutional amendment for pension reform that proposes inter alia to eliminate all special pension regimes and remove the 14th monthly pension payment for new retirees, which would lower the actuarial deficit to 160 percent of GDP and reduce net pension costs starting next decade. The proposed amendment also clarifies the definition of acquired rights to pave the way for possible additional pension reforms. Congress must decide on this reform by June 2005.

- The authorities noted that—even after the government exhausts all reform efforts—the actuarial deficit will remain at 140 percent of GDP, reflecting payments to current retirees and to workers who accumulated benefits under the PAYG system.

Box 4. Poverty

In the past 25 years, progress in alleviating poverty has been modest. Despite robust growth and large increases in subsidies and transfers, Colombia's poverty rate declined from 59 percent in 1978 to 52 percent in 2003. By regional standards, poverty and income inequality in Colombia are high. Other social indicators, however—such as access to safe drinking water, life expectancy and infant mortality—compare favorably with neighboring countries.

Labor market rigidities limit formal employment and contribute to poverty. These include high nonwage labor costs, extensive labor market regulation, and a lack of high-skilled workers. Studies suggest that the structural unemployment rate is 10–12 percent. Moreover, about one-third of the workforce is underemployed, but preliminary evidence indicates that the reforms passed in the 2002 to increase labor market flexibility have encouraged more formal employment.

Another source of poverty is the civil strife. The number of internal refugees ("desplazados") increased sharply in the late 1990s, and is estimated at about 2–3 million—out of a total population of 45 million. Desplazados are often from rural areas and have little formal education. As a consequence, they depend heavily on work in the informal economy and humanitarian assistance from NGOs, such as church support groups, as well as from the government.

Colombia: Social Indicators

Indicators	1996-2003	Latin America and Caribbean	Colombia's 2015 Goals
Poverty (% Pop)	51.8	36.0	35.7
Extreme Poverty (% Pop)	16.6	…	9.5
Income Inequality (Gini coef.)	0.56	0.50	…
Net Primary school enrollment rate	87.0	94.0	100.0
Male (% age group)	87.0	94.0	100.0
Female (% age group)	86.0	95.0	100.0
Access to improved water resources (% of population)	91.0	86.0	…
Child malnutrition (% under 5 years)	7.0	9.0	5.0
Life expectancy at birth (years)	72	71	…
Mortality			
Infant (per 1,000 live births)	19	28	17
Maternal (modeled, per 100,000 live births)	86	…	45

Box 5. Financing Higher Investment

Colombia has sustained relatively high public infrastructure investments, compared with other countries in the region. In recent years, public investment has averaged 7½ to 8 percent of GDP, well above the average for Argentina, Brazil, Mexico, Peru, and Uruguay. About two-thirds of this investment is carried out by local and regional governments. Access to basic household services such as water, sanitation, and electricity is high by regional standards. However, the World Bank has found that Colombia's infrastructure lags behind other Latin American countries in areas such as paved roads.

The government is assessing ways to finance higher infrastructure investment while safeguarding public debt sustainability. One option is to make more use of Public-Private Partnerships (PPPs)—private investment under PPPs is not reflected in the public sector accounts. Since the early 1990s, Colombia has been one of the most active countries in Latin America in developing PPPs. There have been some 150 contracts for private participation, leading to estimated investments on the order of US$5 billion since 1991. Contractual approaches have included BOTs, concessions, joint ventures, and licenses. A sophisticated methodology has been developed to evaluate contingent liabilities of the public sector, which are published in the government's medium-term fiscal framework.

Another option is to increase the commercial orientation of public enterprises. In 2004, ISA, an electricity transmission company, was excluded from the definition of the public sector, after its commercial orientation was determined against a set of preliminary criteria proposed by Fund staff. ISA has significant private ownership, strong protection of minority shareholder rights, an arms-length relationship with the government, and a sound financial condition.

Box 6: Inflation Targeting (IT) Regimes in Latin America

Colombia is one of the five countries in Latin America and 20 countries worldwide that conduct monetary policy based on an IT framework. IT is intended to help discipline policy discussions and communicate policy actions to the public. This framework entails: (i) a stated commitment to price stability as principal goal of monetary policy; (ii) an explicit target for inflation; (iii) a high degree of transparency with regard to monetary policy formulation; and (iv) some mechanism for accountability.

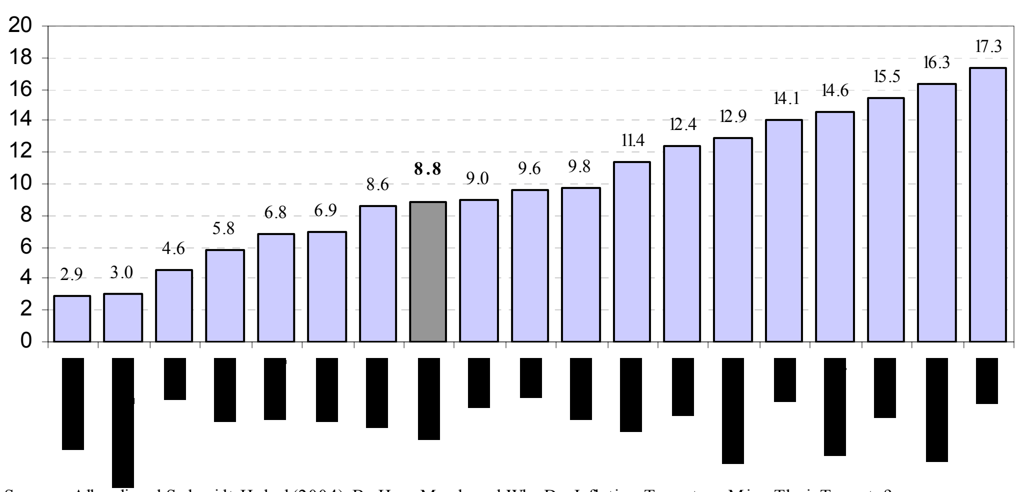
Key Characteristics of the Inflation Targeting Regime Among Latin American Countries

	Brazil	Chile	Mexico	**Colombia**	Peru
1. Adoption Date	Jun. 1999	Jan. 2001	Jan. 1999	**Sep. 1999**	Jan. 2002
2. Prior policy framework	Soft peg	Soft peg (crawling band and 'weak' IT)	Soft peg, followed by 'weak' IT, 1995-98	**Soft peg (band)**	Monetary and 'weak' IT.
3. Current Target	4.5%± 2.5% annual CPI inflation	2-4% annual CPI centered on 3%	3%± 1% annual CPI inflation	**4.5-5.5% (2005), 3-5% (2006) annual CPI inflation**	2.5%± 1% annual CPI inflation
4. Time Horizon	End-year	12-24 months	Unspecified	**12-months**	12- months
5. Official Forecasts					
a) Inflation	9 quarters- fan chart	8 quarters- fan chart	no	**8 quarters**	1 year
b) Output Gap	no	no	no	**8 quarters**	no
c) GDP Growth	5 quarters- fan chart	6 quarters- fan chart	1 year	**annual**	1 year
d) Policy Rate	constant	no	no	**no**	constant

Sources: Kuttner K. (2004), in the "Future of Inflation Targeting", Reserve Bank of Australia, 2004.; and central banks' websites.

Colombia's performance under IT compares favorably with other IT countries. Albagli and Schmidt-Hebel (2004) looked at the typical deviation of actual inflation from the target and the typical large inflation episode for countries with IT in the period 1990-2003. Switzerland, England, Chile, and Sweden are among the most accurate IT countries, with fewer episodes of target misses and shorter spells of deviations.

IT Performance Rankings According to Inflation Deviations and Large Deviations Episodes



Source: Albagli and Schmidt-Hebel (2004), By How Much and Why Do Inflation Targeters Miss Their Targets?, paper presented at the Conference "Strategies for Implementing Monetary Policy in the Americas: The Role of Inflation Targeting", sponsored by the Federal Reserve of Atlanta, October 2004.

Box 7. Financial System Stability Assessment Update: Main Findings

- **Since the 1999 FSAP, financial sector legislation has been improved, the banking system has been recapitalized, and the supervisory framework has been revamped.** The financial sector appears relatively stable and resilient to potential adverse shocks. However, the banking system still faces considerable challenges. Solvency and profitability of commercial banks have improved, but provisioning for nonperforming loans could be strengthened, especially in the mortgage sector. Bank capital adequacy may be overstated by some over-valuation of foreclosed assets and under-estimation of market risk. The mortgage sector has improved its performance, but a few institutions remain weak.

- **The legal and regulatory framework could be strengthened further.** The Superintendency of Banks needs to keep pace with the technical and administrative requirements of implementing the new risk-based system for determining capital and provisioning standards. The Superintendency would benefit from greater autonomy and independence, and the legal framework needs to effectively protect bank supervisors and the Superintendent. Some of the funds lent for bank recapitalization have been prepaid and the prospects for repayment of remaining Deposit Insurance Fund (FOGAFIN) credits appear favorable as most recapitalized banks have regained market access or are backed by prominent financial holding companies. However, the two largest institutions are still under FOGAFIN control.

- **Banks allocate a significant share of their portfolios to government securities.** The government response to the crisis and the lower demand for credit have increasingly transformed credit risk exposure into a market risk or sovereign risk exposure. The government's success in lengthening the maturity of its debt has, to a large extent, transferred interest rate and liquidity risk from the public sector to the banking sector.

- **Credit risk and interest rate risk are the main vulnerabilities**. The impact of the greatest interest rate shock on capital would come from a precipitous rise in the yield curve. Foreign exchange risk appears limited, while equity price risk affects mostly finance corporations.

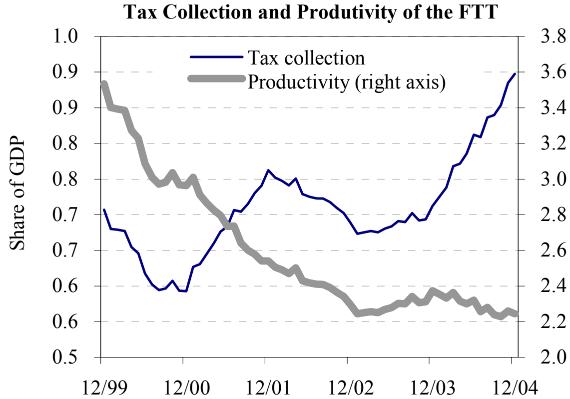
- **Private capital markets continue to be illiquid and shallow, with most resources channeled through the banking sector.** This reflects the scarce supply of investment securities by local corporations, and deficiencies in clearance and settlement systems. In this context, the modernization of the securities markets regulatory framework is critical to increase liquidity, stimulate investment and promote economic growth. The corporate insolvency regime introduced under emergency conditions during the crisis has not yet been replaced by new instruments more favorable to financial intermediation.

Box 8. The Financial Transactions Tax (FTT)

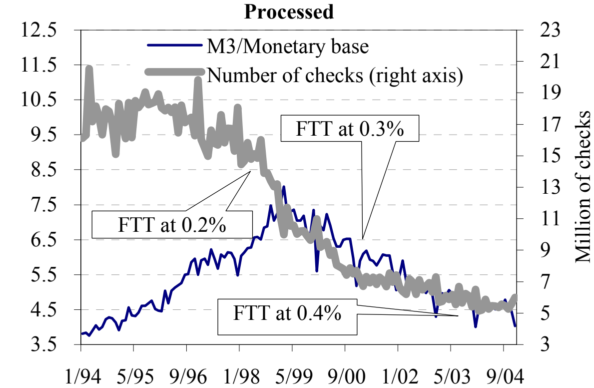
The FTT was introduced in 1998 as a transitory measure to finance the fiscal cost of the banking crisis. The tax rate was set initially at 0.2 percent and then raised to 0.3 percent in 2001 (and made permanent) and further to 0.4 percent in 2004. It is mostly levied on transactions through savings and checking accounts, credit cards and loan disbursements.

The FTT contributes to financial disintermediation. Kirilenko and Perry (2004),[1/] using data for Argentina, Brazil, Colombia, Ecuador, Peru, and Venezuela, found that on average the FTT has resulted in a permanent erosion of the tax base—disintermediation—ranging from 4 cents for every dollar of revenue for Venezuela to 44 cents for Colombia. This disintermediation has undermined the productivity of the FTT as a revenue source in Colombia.

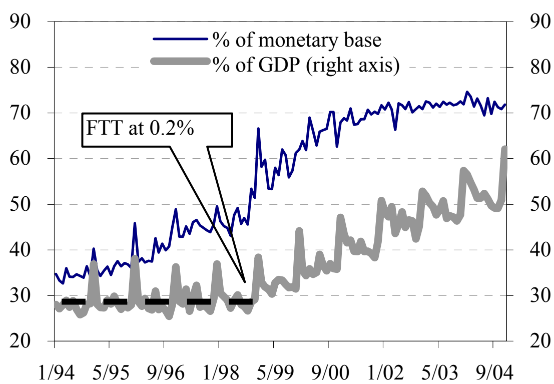
Tax Collection and Produtivity of the FTT



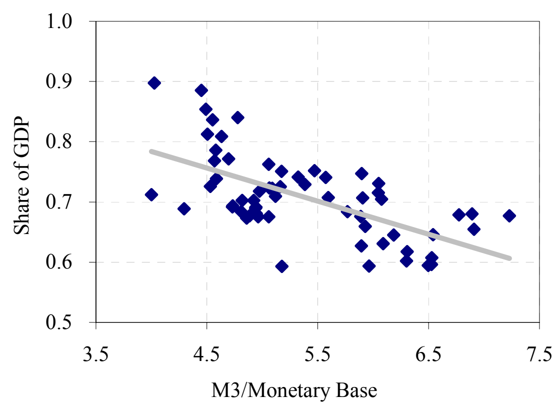
Money Multiplier (M3) and Number of Checks Processed



Currency in Circulation



Money Multiplier and FTT Collection, December 1999 to December 2004



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

[1/] Kirilenko, A. and Perry, V. (2004), "On the Financial Disintermediation of Bank Transaction Taxes," mimeo.

Table 1. Colombia: Selected Economic and Financial Indicators

					2004		Proj.	
	2000	2001	2002	2003	Rev. Prog.	Prel.	2005	2006
(Percentage changes, unless otherwise indicated)								
National income and prices								
Real GDP	2.9	1.5	1.9	4.0	4.0	4.0	4.0	4.0
GDP deflator	12.1	6.2	6.5	8.2	5.9	7.0	5.3	4.3
Consumer prices (average)	9.2	8.0	6.3	7.1	6.0	5.9	5.2	4.8
Consumer prices (end of period)	8.7	7.6	7.0	6.5	5.5	5.5	5.0	4.5
External sector (on the basis of US$)								
Exports (f.o.b.)	14.0	-6.4	-4.1	11.2	11.2	23.6	-0.1	3.2
Imports (f.o.b.)	8.1	10.6	-1.6	9.8	15.1	19.9	15.7	2.7
Export volume	1.1	0.9	-4.4	2.6	2.9	6.7	0.7	6.5
Import volume	10.0	10.5	-1.6	5.2	7.6	13.3	16.9	2.5
Terms of trade (deterioration -)	14.8	-7.3	0.3	3.9	1.1	9.3	0.2	-3.3
Real effective exchange rate (depreciation -)	-2.6	1.5	-17.4	-5.2	…	11.4	…	…
Central administration								
Revenue	25.7	20.8	10.1	13.9	15.4	16.0	10.1	8.3
Expenditure	11.9	16.7	12.6	6.8	10.7	15.7	13.2	8.8
Money and credit 1/								
Broad money	-2.1	7.0	5.3	6.5	10.2	16.7	11.1	10.3
Credit to the private sector	-8.6	1.7	4.0	9.2	11.5	12.2	14.6	14.0
Interest rate (90-day time deposits; percent per year)								
Nominal	13.4	11.5	7.7	7.9	…	7.7	…	…
Real	4.2	3.6	0.7	1.4	…	2.2	…	…
(In percent of GDP)								
Central administration balance	**-5.7**	**-5.7**	**-6.4**	**-5.4**	**-5.6**	**-5.5**	**-6.1**	**-6.2**
Nonfinancial public sector balance	-3.5	-3.5	-4.2	-3.2	-2.8	-1.7	-2.5	-2.1
NFPS primary balance	**0.9**	**1.5**	**0.4**	**1.7**	**2.2**	**2.7**	**2.7**	**2.7**
Public sector balance	**-3.4**	**-3.2**	**-3.7**	**-2.7**	**-2.8**	**-1.3**	**-2.5**	**-2.0**
Foreign financing	1.6	2.3	0.6	1.0	1.7	-0.3	-0.5	0.5
Domestic financing 2/	1.2	0.9	3.1	1.8	0.8	1.7	3.0	1.5
Privatization	0.5	0.0	-0.1	-0.1	0.3	0.0	-0.1	0.0
Public debt 3/4/	**47.7**	**51.8**	**60.2**	**56.0**	**52.1**	**52.9**	**50.4**	**49.8**
Gross domestic investment	13.7	14.5	14.2	14.9	15.5	14.0	15.3	17.0
Gross national savings	14.6	13.2	12.6	13.5	13.4	12.9	12.5	14.4
Current account (deficit -)	0.9	-1.4	-1.7	-1.5	-2.2	-1.0	-2.8	-2.6
External debt	46.1	47.5	52.3	46.0	43.7	37.1	35.9	36.2
Of which : public sector	26.3	28.5	31.9	29.6	28.6	24.1	22.7	22.5
NIR in percent of short-term debt	111.5	98.4	106.1	127.3	124.4	110.4	110.5	116.3
(In percent of exports of goods, services, and income)								
External debt service	50.1	50.2	64.0	56.4	47.7	35.5	52.1	45.2
Of which : public sector	21.7	28.2	37.0	33.4	23.8	18.4	30.9	23.6
Interest payments	15.9	16.3	16.8	15.0	15.9	12.0	14.5	14.2
Of which : public sector	8.9	10.4	11.3	10.6	11.2	8.3	10.3	10.2
(In millions of U.S. dollars)								
Overall balance of payments	870	1,217	138	-184	712	2,583	-855	313
Net official reserves 4/	8,800	9,982	10,507	10,524	11,408	13,195	12,340	12,653
Net official reserves (in months of imports of goods and services)	6.6	7.8	7.6	6.5	7.2	7.1	6.5	6.3

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

1/ All annual changes in foreign currency stocks valued at constant exchange rate.
2/ Includes the quasi-fiscal balance of Banco de la Republica, sales of assets, phone licenses, and statistical discrepancy.
3/ Includes bonds issued to recapitalize financial institutions.
4/ Program definition. Assumes no purchases under the current SBA arrangement. Includes valuation changes.

Table 2. Colombia: Medium-Term Outlook

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
I. Output and Prices											
(Annual percentage changes)											
Real GDP	2.9	1.5	1.9	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Consumer prices											
End of period	8.7	7.6	7.0	6.5	5.5	5.0	4.5	3.5	3.0	3.0	3.0
Period average	9.2	8.0	6.3	7.1	5.9	5.2	4.8	4.0	3.3	3.0	2.5
(In percent of GDP, unless indicated otherwise)											
II. Saving and investment											
Gross national saving	14.6	13.2	12.6	13.5	12.9	12.5	14.4	14.8	15.3	15.9	16.3
Private sector	10.0	8.3	9.2	8.0	6.4	7.5	8.9	8.4	8.7	9.1	9.2
Public sector	4.5	5.1	3.3	5.5	6.5	5.0	5.5	6.4	6.6	6.9	7.0
Gross domestic investment	13.7	14.5	14.2	14.9	14.0	15.3	17.0	17.5	17.9	18.5	18.8
Private sector	5.8	6.2	6.1	6.4	6.1	7.8	9.5	9.1	9.5	10.1	10.4
Public sector capital expenditure	7.9	8.3	8.1	8.5	7.8	7.5	7.5	8.4	8.4	8.4	8.4
External current account balance	0.9	-1.4	-1.7	-1.5	-1.0	-2.8	-2.6	-2.7	-2.6	-2.6	-2.5
Private sector	4.2	1.9	1.9	1.2	0.3	-0.3	-0.6	-0.7	-0.8	-1.0	-1.2
Public sector	-3.4	-3.2	-3.6	-2.6	-1.3	-2.5	-2.0	-2.0	-1.8	-1.5	-1.4
III. Nonfinancial and consolidated public sector											
Nonfinancial public sector											
Revenue	28.0	29.6	29.6	30.7	31.6	31.2	31.3	31.0	31.1	31.1	31.0
Expenditure	31.5	33.3	33.8	33.6	33.1	33.7	33.4	33.2	33.2	33.0	32.7
Current expenditure	23.6	24.9	25.6	25.2	25.4	26.2	25.8	24.8	24.8	24.6	24.3
Capital expenditure	7.9	8.3	8.1	8.5	7.8	7.5	7.5	8.4	8.4	8.4	8.4
Primary balance	0.9	1.5	0.4	1.7	2.7	2.7	2.7	2.6	2.6	2.6	2.6
Overall balance	-3.5	-3.5	-4.2	-3.2	-1.7	-2.5	-2.1	-2.3	-2.1	-1.9	-1.8
Combined public sector balance	-3.4	-3.2	-3.7	-2.7	-1.3	-2.5	-2.0	-2.0	-1.8	-1.5	-1.4
IV. Financial system											
Velocity (GDP / broad money)	3.2	3.2	3.3	3.5	3.3	3.3	3.2	3.2	3.2	3.2	3.2
Real growth in private sector credit	-16.3	-5.8	-2.2	1.9	5.9	8.9	8.9	10.8	7.1	6.1	6.3
V. Balance of payments											
External current account balance	0.9	-1.4	-1.7	-1.5	-1.0	-2.8	-2.6	-2.7	-2.6	-2.6	-2.5
Trade balance	3.1	0.7	0.3	0.5	1.0	-1.3	-1.3	-2.0	-1.9	-1.7	-1.4
Exports	16.4	15.7	15.1	17.1	17.4	15.1	15.7	15.4	15.8	16.3	17.0
Imports	13.2	15.0	14.8	16.6	16.3	16.4	17.0	17.4	17.7	18.0	18.5
Capital and financial account balance	0.0	3.0	1.6	1.0	3.3	2.0	2.9	3.1	3.0	3.0	3.0
Public sector	0.5	1.8	0.4	0.5	-0.3	-0.5	0.5	0.5	0.2	0.3	0.4
Private sector	-0.5	1.3	1.2	0.5	3.7	2.5	2.3	2.7	2.8	2.7	2.5
Overall balance	1.0	1.5	0.2	-0.2	2.7	-0.8	0.3	0.4	0.5	0.5	0.4
VI. Debt											
Total external debt	46.1	47.5	52.3	46.0	37.1	35.9	36.2	35.6	34.1	32.9	31.9
Public debt	26.3	28.5	31.9	29.6	24.1	22.7	22.5	21.9	20.8	20.0	19.3
Private debt	19.8	19.0	20.4	16.3	13.0	13.1	13.7	13.6	13.2	12.9	12.7
Total public debt	47.7	51.8	60.2	56.0	52.9	50.4	49.8	48.2	46.2	44.5	42.7
Domestic debt	21.4	23.2	28.3	26.4	28.8	27.7	27.3	26.2	25.4	24.5	23.5
External debt	26.3	28.5	31.9	29.6	24.1	22.7	22.5	21.9	20.8	20.0	19.3
Memorandum items:											
Nominal GDP (billions of Col$)	174,896	188,559	204,530	230,091	255,984	280,267	304,051	332,333	359,876	386,199	413,546
U.S. LIBOR	6.6	3.7	1.9	1.2	1.8	3.2	3.8	4.3	4.7	5.0	5.0

Sources: Colombian authorities; and Fund staff estimates.

Table 3. Colombia: Selected Vulnerability Indicators

	2000	2001	2002	2003	2004 1/	2005 1/	Latest observation
Key economic and market indicators							
Real GDP growth (in percent)	2.9	1.5	1.9	4.0	4.0	4.0	Proj.
CPI inflation (period average, in percent)	8.7	7.6	7.0	6.5	5.5	5.0	Proj.
Short-term (ST) interest rate (in percent)	10.4	10.2	5.9	7.0	2.1	3.9	Oct-04
EMBI secondary market spread (bps, end of period)	668.2	602.0	679.1	431.0	332.0	364.6	Jan-05
Exchange rate NC/US$ (end of period)	2229.2	2291.2	2864.8	2778.2	2389.8	2367.8	Jan-05
External sector						Managed	
Exchange rate regime			Free Floating			Float	
Current account balance (percent of GDP)	0.9	-1.4	-1.7	-1.5	-1.0	-2.8	Proj.
Net FDI inflows (percent of GDP)	2.5	3.1	1.5	1.1	2.7	2.1	Proj.
Exports (percentage change of US$ value, GNFS)	14.0	-6.4	-4.1	11.2	23.6	-0.1	Proj.
Real effective exchange rate ([year] = 100)	99.8	105.2	87.5	88.4	102.1	94.9	Proj.
Gross international reserves (GIR) in US$ billion	9.0	10.2	10.7	10.7	13.4	12.5	Proj.
GIR in percent of ST debt at remaining maturity (RM) 2/	111.5	98.4	103.3	127.3	110.4	110.5	Proj.
GIR in percent of ST debt at RM and banks' FX deposits.					116.8	...	Dec-04
Net international reserves (NIR) in US$ billion	8.8	10.0	10.5	10.5	13.2	12.3	Proj.
Total gross external debt (ED) in percent of GDP	46.1	47.5	52.3	46.0	37.1	36.0	Proj.
o/w ST external debt (original maturity, in percent of total ED	7.0	8.0	9.4	8.8	12.7	13.0	Proj.
ED of domestic private sector (in percent of total ED)	43.0	40.0	39.0	35.6	35.4	35.5	Proj.
ED to foreign official sector (in percent of total ED)					25.3	...	Proj.
Total gross external debt in percent of exports of GNFS	118.1	134.9	134.9	129.7	113.8	108.9	Proj.
Gross external financing requirement (in US$ billion) 3/	8.8	10.2	11.7	11.2	11.9	14.3	Proj.
Public sector (PS) 4/							
Overall balance (percent of GDP)	-3.4	-3.2	-3.6	-2.6	-1.3	-2.5	Proj
Primary balance (percent of GDP)	1.0	1.8	0.9	2.1	3.1	2.7	Proj
Debt-stabilizing primary balance (percent of GDP) 5/	...	...	...	...	...	2.5	Proj
Gross PS financing requirement (in percent of GDP) 6/	8.3	9.5	10.0	9.8	5.5	9.9	Proj
Public sector gross debt (PSGD, in percent of GDP)	47.7	51.8	60.2	56.0	52.9	50.4	Proj
o/w Exposed to rollover risk (in percent of total PSGD) 7/					12.9	...	Proj.
Exposed to exchange rate risk (in percent of total PSGD) 8/	55.1	55.1	53.2	53.2	49.1	48.0	Proj.
Exposed to interest rate risk (in percent of total PSGD) 9/					...	0.0	date
Public sector net debt (in percent of GDP)	47.7	51.8	60.2	56.0	52.9	50.4	Proj
Financial sector (FS) 10/							
Capital adequacy ratio (in percent)	13.2	13.0	12.6	13.1	14.0	...	Sep-04
NPLs in percent of total loans	10.6	10.2	9.2	6.8	3.6	...	Sep-04
Provisions in percent of NPLs	56.6	77.5	86.5	83.5	111.3	...	Jun-04
Return on average assets (in percent)	-2.3	0.1	1.1	2.5	2.7	...	Sep-04
Return on equity (in percent)	-20.7	1.1	9.6	17.0	23.4		Sep-04
FX deposits held by residents (in percent of total deposits)	0.4	0.5	0.4	0.0	2.0	...	Sep-04
FX loans to residents (in percent of total loans)	13.1	11.0	11.6	8.8	6.1	...	Sep-04
Net open forex position (in percent of capital) 11/	-1.4	4.8	7.8	4.3	4.8	...	Sep-04
Government debt held by FS (percent of total FS assets)	7.8	11.4	18.4	18.0	22.2	...	Sep-04
Credit to private sector (percent change)	-8.6	1.7	4.0	9.2	12.2	14.6	Proj.
Memorandum item:							
Nominal GDP in billions of U.S. dollars	83.8	82.0	81.6	80.0	97.4	112.3	Proj.

1/ Staff estimates, projections, or latest available observations as indicated in the last column.
2/ Net international reserves in percent of ST debt at remaining maturity (RM) provided.
3/ Current account deficit plus amortization of external debt.
4/ Public sector covers: general government, public enterprises, and quasi-fisca operations of the central bank.
5/ Based on averages for the last five years for the relevant variables (i.e., growth, interest rates).
6/ Overall balance plus debt amortization.
7/ ST debt and maturing medium- and long-term debt, domestic and external, excluding external debt to official creditors. (Short term)
8/ Debt in foreign currency or linked to the exchange rate, domestic and external, excluding external debt on concessional terms. (Short
9/ ST debt and maturing medium- and long-term debt at variable interest rates, domestic and external. (Short term)
10/ Financial sector includes banks and excludes credit unions and public sector specialized institutions.
11/ Sum of on- and off-balance sheet exposure.

Table 4. Colombia: Summary Balance of Payments, 2000-2008

					2004		Proj.			
	2000	2001	2002	2003	Prog.	Est.	2005	2006	2007	2008
	(In millions of U.S. dollars)									
Current account balance	**737**	**-1,114**	**-1,371**	**-1,191**	**-1,978**	**-1,013**	**-3,150**	**-2,858**	**-3,122**	**-3,131**
Trade balance	2,633	579	239	435	-222	1,016	-1,500	-1,465	-2,340	-2,332
Exports, f.o.b.	13,722	12,848	12,316	13,693	15,039	16,918	16,905	17,446	17,607	19,254
Coffee	1,069	764	772	806	913	1,012	1,129	1,145	1,207	1,280
Petroleum products	4,569	3,285	3,275	3,383	3,991	4,227	3,795	3,443	1,885	1,862
Non-traditional	6,200	6,613	6,287	6,120	6,560	7,793	7,789	8,634	10,197	11,567
Other	1,884	2,186	1,982	3,383	3,575	3,886	4,192	4,223	4,318	4,545
Imports, f.o.b.	11,090	12,269	12,077	13,258	15,260	15,902	18,405	18,911	19,947	21,586
Services (net)	-1,282	-1,433	-1,466	-1,513	-1,632	-1,568	-1,785	-1,845	-1,957	-2,076
Income (net)	-2,286	-2,615	-2,848	-3,446	-3,423	-4,123	-3,669	-3,576	-3,071	-3,189
Interest (net)	-1,663	-1,738	-1,905	-2,001	-2,282	-2,037	-2,026	-1,883	-1,815	-1,893
Of which : public sector	-889	-1,087	-1,262	-1,452	-1,660	-1,429	-1,555	-1,436	-1,383	-1,460
Other Income (net)	-623	-877	-944	-1,445	-1,141	-2,086	-1,643	-1,693	-1,256	-1,297
Current transfers (net)	1,673	2,354	2,704	3,334	3,299	3,661	3,804	4,027	4,246	4,467
Financial account balance	**24**	**2,475**	**1,303**	**810**	**2,690**	**3,245**	**2,295**	**3,171**	**3,600**	**3,697**
Public sector (net)	402	1,443	363	428	1,450	-327	-515	576	551	290
Nonfinancial public sector	1,243	1,915	495	720	1,513	60	-481	842	596	315
Medium- and long-term (net)	1,662	3,462	-1,093	1,457	748	934	-613	-347	509	383
Disbursements	3,238	5,743	2,469	4,915	2,723	2,889	3,145	1,922	2,776	3,370
Amortization	1,576	2,281	3,561	3,459	1,975	1,955	3,759	2,269	2,267	2,986
Other long-term flows	-40	-35	-30	-30	-26	-50	-29	-29	-29	-29
Short term 1/	-379	-1,512	1,617	-707	792	-825	161	1,218	116	-40
Of which : change in public assets	-259	-1,534	1,567	-570	792	-939	161	1,218	116	-40
Financial public sector	-841	-473	-131	-293	-63	-387	-35	-267	-45	-26
Private sector (net)	-378	1,032	939	382	1,240	3,572	2,811	2,595	3,049	3,407
Nonfinancial private sector (net)	28	1,063	1,113	823	1,063	3,067	2,392	2,596	2,838	3,000
Direct investment	2,069	2,509	1,258	855	1,265	2,646	2,343	2,137	2,372	2,537
Of which : Privatization	465	0	0	0	0	0	0	0	0	0
Leasing finance	-109	-211	-160	-319	-278	107	-214	-133	-71	-235
Long-term loans	-479	126	-970	-726	-243	-1,109	337	567	700	614
Short term 2/	-1,453	-1,360	985	1,012	319	1,423	-75	25	-163	84
Financial private sector (net)	-406	-31	-174	-441	176	505	418	-1	211	408
Net errors and omissions	**108**	**-143**	**207**	**197**	**0**	**351**	**0**	**0**	**0**	**0**
Changes in GIR 3/	**870**	**1,217**	**138**	**-184**	**712**	**2,583**	**-855**	**313**	**478**	**566**
Changes in NIR, program definition 3/	**687**	**1,182**	**525**	**17**	**883**	**2,671**	**-855**	**313**	**478**	**566**
	(In percent of GDP)									
Current account balance	0.9	-1.4	-1.7	-1.5	-2.2	-1.0	-2.8	-2.6	-2.7	-2.6
	(In months of imports of goods and services)									
Gross international reserves 4/	6.8	8.0	7.8	6.6	7.2	8.1	6.5	6.7	6.6	6.4

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/ Does not include valuation changes of reserves denominated in other currencies than U.S. dollars.
4/ Not including Fund purchases under the standby arrangement.

Table 5. Colombia: External Debt Sustainability Framework, 2000-2010
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2000	2001	2002	2003	2004			2005	2006	2007	2008	2009	2010	
								I. Baseline Projections						**Debt-stabilizing non-interest current account 6/**
1 **External debt**	46.1	47.5	52.3	46.0	37.1			**35.9**	**36.2**	**35.6**	**34.1**	**32.9**	**31.9**	**-1.6**
2 Change in external debt	0.6	1.5	4.8	-6.3	-8.9			-1.2	0.3	-0.6	-1.5	-1.2	-0.9	
3 Identified external debt-creating flows (4+8+9)	-2.2	-3.8	7.4	-6.8	-12.0			-0.7	-0.8	-0.7	-0.8	-0.8	-0.7	
4 Current account deficit, excluding interest payments	-4.1	-2.0	-1.6	-1.5	-1.4			0.4	0.2	0.5	0.2	0.2	0.2	
5 Deficit in balance of goods and services	-10.2	-7.8	-7.6	-6.9	-6.3			-4.1	-4.2	-3.4	-3.4	-3.4	-3.6	
6 Exports	20.1	18.3	19.9	18.8	17.7			17.4	18.0	17.3	17.6	18.0	18.7	
7 Imports	9.9	10.5	12.2	11.9	11.5			13.3	13.8	13.9	14.2	14.6	15.1	
8 Net non-debt creating capital inflows (negative)	-2.6	-3.0	-1.8	-1.0	-2.5			-2.1	-2.0	-2.1	-2.1	-2.1	-2.0	
9 Automatic debt dynamics 1/	4.6	1.2	10.8	-4.3	-8.1			1.0	1.0	0.9	1.0	1.1	1.1	
10 Contribution from nominal interest rate	3.1	3.4	3.5	2.9	2.3			2.5	2.4	2.2	2.4	2.4	2.3	
11 Contribution from real GDP growth	-1.4	-0.6	-1.1	-1.8	-1.4			-1.5	-1.4	-1.4	-1.3	-1.3	-1.2	
12 Contribution from price and exchange rate changes 2/	2.8	-1.5	8.3	-5.4	-9.0			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	2.8	5.3	-2.6	0.5	3.1			-0.5	1.1	0.1	-0.7	-0.4	-0.2	
External debt-to-exports ratio (in percent)	229.1	260.1	263.3	244.5	209.4			206.3	201.1	205.8	193.4	182.4	170.5	
Gross external financing need (in billions of US dollars) 4/	7.4	9.0	11.5	11.2	10.7			15.3	14.0	14.5	15.9	16.5	17.7	
in percent of GDP	9.4	10.9	16.2	13.5	10.0			14.0	12.9	12.7	13.0	12.8	12.9	
Key Macroeconomic Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	2.9	1.5	1.9	4.0	4.0	2.1	2.6	4.0	4.0	4.0	4.0	4.0	4.0	4.0
GDP deflator in US dollars (change in percent)	-5.8	3.4	-14.9	11.5	24.4	1.4	12.5	-2.0	-4.3	1.0	2.6	1.9	2.0	0.2
Nominal external interest rate (in percent)	6.7	7.7	6.4	6.5	6.6	7.1	0.6	6.8	6.6	6.5	7.1	7.4	7.5	7.0
Growth of exports (US dollar terms, in percent)	12.8	-4.6	-5.7	9.8	21.9	6.3	9.4	0.0	3.0	0.9	8.6	8.4	10.3	5.2
Growth of imports (US dollar terms, in percent)	9.0	11.4	1.1	12.8	24.4	1.1	21.1	18.5	2.9	6.1	9.2	8.5	9.9	9.2
Current account balance, excluding interest payments	4.1	2.0	1.6	1.5	1.4	0.3	2.9	-0.4	-0.2	-0.5	-0.2	-0.2	-0.2	-0.3
Net non-debt creating capital inflows	2.6	3.0	1.8	1.0	2.5	2.4	1.1	2.1	2.0	2.1	2.1	2.1	2.0	2.1
								II. Stress Tests for External Debt Ratio						**Debt-stabilizing non-interest current account 6/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 5/								**35.9**	**33.9**	**32.9**	**31.6**	**30.3**	**29.2**	**-1.4**
B. Bound Tests														
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								**35.9**	**36.8**	**36.9**	**35.4**	**34.2**	**33.3**	**-1.6**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**35.9**	**38.8**	**40.9**	**39.1**	**37.7**	**36.6**	**-1.9**
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								**35.9**	**45.1**	**58.1**	**55.4**	**53.2**	**51.5**	**-2.7**
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								**35.9**	**41.5**	**46.1**	**44.6**	**43.5**	**42.7**	**-1.5**
B5. Combination of B1-B4 using one standard deviation shocks								**35.9**	**43.6**	**53.6**	**51.6**	**50.0**	**48.9**	**-2.1**
B6. One time 30 percent nominal depreciation in 2005								**35.9**	**47.1**	**46.2**	**44.1**	**42.4**	**41.2**	**-2.1**

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 6. Colombia: Public Sector Debt Sustainability Framework, 2000-2010
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	
						I. Baseline Projections						**Debt-stabilizing primary balance 10/**
1 **Public sector debt 1/**	47.7	51.8	60.2	56.0	52.9	**50.4**	**49.8**	**48.2**	**46.2**	**44.5**	**42.7**	**1.6**
o/w foreign-currency denominated	26.3	28.5	31.9	29.6	24.1	22.7	22.5	21.9	20.8	20.0	19.3	
2 Change in public sector debt	6.4	4.1	8.5	-4.2	-3.1	-2.5	-0.6	-1.6	-2.0	-1.7	-1.7	
3 Identified debt-creating flows (4+7+12)	1.9	0.9	7.1	-4.7	-8.1	-2.1	-1.8	-1.9	-1.5	-1.2	-1.1	
4 Primary deficit	-0.9	-1.3	-0.5	-1.9	-3.0	-2.5	-2.6	-2.6	-2.6	-2.6	-2.6	
5 Revenue and grants	28.0	29.5	29.3	30.2	31.6	31.1	31.3	31.0	31.1	31.1	31.0	
6 Primary (noninterest) expenditure	27.1	28.2	28.9	28.3	28.6	28.7	28.7	28.3	28.5	28.4	28.3	
7 Automatic debt dynamics 2/	3.3	2.3	7.5	-2.8	-5.2	0.3	0.7	0.6	1.0	1.4	1.5	
8 Contribution from interest rate/growth differential 3/	-1.1	1.6	0.4	-1.9	-1.2	0.3	0.7	0.6	1.0	1.4	1.5	
9 Of which contribution from real interest rate	-0.1	2.2	1.3	0.2	0.8	2.3	2.6	2.5	2.8	3.1	3.1	
10 Of which contribution from real GDP growth	-1.0	-0.7	-0.9	-2.1	-2.0	-1.9	-1.9	-1.8	-1.8	-1.7	-1.7	
11 Contribution from exchange rate depreciation 4/	4.4	0.7	7.1	-0.9	-4.0	...	...	...	...	...	...	
12 Other identified debt-creating flows	-0.5	0.0	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	
13 Privatization receipts (negative)	-0.5	0.0	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	4.5	3.1	1.3	0.5	5.0	-0.4	1.2	0.3	-0.4	-0.5	-0.6	
Public sector debt-to-revenue ratio 1/	170.3	175.4	205.3	185.2	167.1	161.9	159.3	155.6	148.8	143.3	138.1	
Gross financing need 6/	5.9	6.3	8.4	7.5	3.7	6.1	4.5	4.5	4.2	3.9	3.5	
in billions of U.S. dollars	5.0	5.1	6.8	6.0	3.6	6.9	5.0	5.1	5.1	5.0	4.8	
Key Macroeconomic and Fiscal Assumptions												Projected Average
Real GDP growth (in percent)	2.9	1.5	1.9	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Average nominal interest rate on public debt (in percent) 7/	12.3	11.3	9.4	8.9	8.9	10.2	10.1	10.7	10.6	10.5	10.6	10.4
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	0.2	5.1	2.9	0.8	1.9	4.9	5.8	5.6	6.4	7.3	7.6	6.3
Nominal appreciation (increase in US dollar value of local currency, in percent)	-15.9	-2.7	-20.0	3.1	16.3	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	12.1	6.2	6.4	8.2	7.0	5.3	4.3	5.1	4.1	3.2	3.0	4.2
Growth of real primary spending (deflated by GDP deflator, in percent)	-5.5	5.5	4.5	1.9	5.2	4.1	4.0	2.9	4.5	3.9	3.7	3.8
Primary deficit	-0.9	-1.3	-0.5	-1.9	-3.0	-2.5	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6
						II. Stress Tests for Public Debt Ratio						**Debt-stabilizing primary balance**
A. Alternative Scenarios												
A1. Key variables are at their historical averages in 2005-09 8/						**50.4**	**49.6**	**48.0**	**45.7**	**43.3**	**40.9**	**-1.0**
B. StressTests												
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006						**50.4**	**50.6**	**49.8**	**47.8**	**46.2**	**44.5**	**1.7**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						**50.4**	**55.8**	**62.7**	**65.4**	**68.6**	**71.9**	**2.7**
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006						**50.4**	**55.1**	**58.9**	**57.2**	**55.9**	**54.6**	**2.1**
B4. Combination of B1-B3 using one standard deviation shocks						**50.4**	**54.6**	**58.0**	**56.3**	**54.9**	**53.4**	**2.0**
B5. One time 30 percent real depreciation in 2005 9/						**50.4**	**59.6**	**58.2**	**56.6**	**55.2**	**53.9**	**2.0**
B6. 10 percent of GDP increase in other debt-creating flows in 2005						**50.4**	**59.8**	**58.5**	**56.8**	**55.5**	**54.1**	**2.0**
C. Country Specific tests												
C1. Per capita real GDP is constant from 2005 thru 2010						**51.6**	**52.7**	**52.0**	**50.9**	**50.2**	**49.5**	
C2. Primary balance falls by 0.5 of GDP from 2006 thru 2010						**50.4**	**50.4**	**49.4**	**48.1**	**47.0**	**46.0**	

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 - □□ g□- g + □□ r□]/(1+g+□+g□)) times previous period debt ratio, with r = interest rate; □ = growth rate of GDP deflator; g = real GDP growth rate; □ = share of foreign-currency denominated debt; and □ = 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 - π (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as □□(1+r).
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ Derived as nominal interest expenditure divided by previous period debt stock.
8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
9/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 7. Colombia: Social Indicators

	1988	1995	1999	2004
Income per capita in U.S. dollars	1,297	2,562	2,212	2,094
Income share highest 20 percent/ lowest 20 percent	17.6	17.2	20.2	20.3
(In percent of relevant population)				
Poverty rate 1/	65	60	64	51.8
Extreme poverty rate 1/	29	21	23	16.6
Illiteracy rate (12 years or older) 2/	3.3	2.8	2.6	7.9
Complete primary school (ages 12 to 17) 3/	78.7	77.7	89.8	90
Child labor, ages 10 to 14 2/	5.0	5.2	3.7	5.8
Access to public utilities				
Water 4/	97	98	99	91
Sewerage 4/	95	96	97	86

Sources: United Nations Development Programme: Human Development Report 2004; and Carlos Eduardo Velez, Poverty Report, The World Bank, 2002.

1/ 2004 figure refers to 2003.
2/ 2004 figure refers to 2002.
3/ 2004 figure refers to 2001.
4/ 2004 figure refers to 2000.

COLOMBIA: FUND RELATIONS

(As of February 28, 2005)

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	117.15	102.

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	April 14, 2005	1,548.00	0.00
EFF	Dec. 20, 1999	Dec. 19, 2002	1,957.00	0.00

VI. Projected Obligations to Fund (in SDR Million):

			Forthcoming		
Type	**20005**	**2006**	**2007**	**2008**	**2009**
Principal	0	0	0	0	0
Charges/Interest	0.01	0.01	0.01	0.01	0.01
Total	0.01	0.01	0.01	0.01	0.01

VII. Safeguards Assessments:

Under the safeguards policy, Colombia was 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, 2003. The assessment noted no significant vulnerabilities.

VIII. Exchange Rate Arrangement:

In September 1999 the Banco de la República floated the peso. The authorities accepted the obligations of Article VIII in August 2004. At end-February 2005, the exchange rate was Col$2,324 per U.S. dollar.

IX. Last Article IV Consultation:

The 2002 Article IV consultation was concluded on January 15, 2003.

X. FSAP Participation:

The Executive Board discussed the Financial Sector Stability Assessment (FSSA) in 1999.

XI. Statistics: Colombia subscribes to the SDDS.

XII. Recent Technical Assistance:

Dept.	**Purpose**	**Time of Delivery**
FAD	Advice on the reform of the budget code	March 2003
FAD	Follow-up on the reform of the budget code	November 2003
MFD	Inflation forecast under inflation target framework	May 2004
FAD	Assessment of fiscal decentralization	May 2004

XIII. Resident Representative: None.

XIV. Fourth Amendment: Colombia has accepted this amendment.

Colombia: Relations with the World Bank [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 (WBG's) strategy seeks to support Colombia's quest for development and peace. The Country Assistance Strategy (CAS) for Colombia was discussed by the Bank's Board in January 2003 and since then, Colombia has received US$1.5 billion in loans to date. Between 50–60 percent of the lending program would consist of fast-disbursing operations. A CAS Progress Report will be prepared for July 2005.

The World Bank Program for FY 2005–06

In line with the CAS, since June 2004, the IBRD has continued the preparation of adjustment loans to support fiscal adjustment, financial sector adjustment, the labor and social sector reform, and environmental management. Labor and social sector reforms are being supported by a technical assistance loan that aims at improving knowledge, developing effective instruments, and strengthening ability to carry out such reforms. The environment adjustment loan is being complemented by a technical assistance loan to support the inclusion of environmental and social policies in government programs and to strengthen the capacity of the major relevant institutions.

The IBRD will also support a program in the infrastructure sector, covering water supply and sanitation services and a project to reduce Colombia's vulnerability to natural disasters in terms of state fiscal liability. IFC focuses on supporting new forms of public-private partnership. MIGA focuses 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.

Bank-Fund Collaboration in Specific Areas

The WBG 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 (IBRD/IDA and grants)
As of March 1, 2005
(In millions of U.S. dollars)

Closed Projects	**163**
Active Projects	**15**
IBRD/IDA *	
Total Disbursed (Active)	303.4
Of which has been repaid	0.0
Total Disbursed (Closed)	10,045.1
Of which has been repaid	8,423.8
Total Disbursed (Active + Closed)	10,348.5
Of which has been repaid	8,423.8
Total Undisbursed (Active)	674.9
Total Undisbursed (Closed)	0.3
Total Undisbursed (Active + Closed)	675.2

Loan Information (IBRD)

As of March 1, 2005
(In millions of U.S. dollars)

Fiscal Year*	2001	2002	2003	2004	2005
Total disbursements	264	369	948	491	403
Repayment amount	225	243	223	205	156
Net disbursements	39	126	725	286	247

* Fiscal Year: July 1–June 30.

IFC Operations

As of January 1, 2005
(In millions of U.S. dollars)

	Loans	**Equity (+Quasi)**	**Participation**	**Total**
Total commitments	299.6	129.0	117.2	545.8
Total undisbursed	102.2	19.8	95.2	217.2

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

(As of February 25, 2005)

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: (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. These objectives constitute the framework for the Bank activities in Colombia.

To help **reinvigorate the economy** the Bank will foster competitiveness and will 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 social protection systems and will promote the coverage, quality, and efficiency of essential social services. In the **governance and modernization of the State** area the Bank will support national public sector reforms and local governments management capacity building, moreover, the Bank will promote initiatives to foster transparency and combat corruption, and will support judicial branch reforms.

From the Bank's standpoint, the implementation of the strategy is constrained by the country's fiscal deficit and the armed conflict. Both constraints have implications for the size of the lending program, the mix of lending and non-lending products, and the prospects for achieving the strategy objectives.

II. LENDING

As of February 25, 2005 the country's portfolio consists of 26 loans an amount equivalent to US$1,901 million. These resources are distributed among 24 investment loans (US$ 901 million) and two policy-based loans (US$1,000 million). In addition, the country portfolio with Colombia includes 45 non-reimbursable technical cooperation (US$25,7 million) and four small projects (US$1.67 million). Through the Multilateral Investment Fund (MIF), which finances private sector investment projects, Colombia has 30 non-reimbursable operations (US$18.3 million).

In 2004 six loans for US$737 million were approved. These operations include policy-based loans to support the Public Utilities Reform (US$600 million). In 2005, the Bank estimates the approval of seven investment loans by US$ 626.1 million (in the areas of transportation, health, citizens security, energy and agriculture) and a policy-based loan by US$ 400 million to support the Country's Competitiveness Strategy.

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[1] Prepared by IADB staff. Questions may be addressed to Mr. Luis Giorgio, Country Officer, at (202) 623-1663 or giorgio@iadb.org.

COLOMBIA: FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK
(As of February 28, 2005)

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

	Commitments	Disbursements	Undisbursed amounts
Agricultural and rural development	92.1	83.1	9.0
Modernization of State	692.7	248.8	443.9
Social Investment	312.2	218.8	93.4
Education	26.0	13.9	12.1
Health	472.0	265.0	207.0
Sanitation	49.4	31.3	18.1
Natural resource management	55.4	30.4	25.0
Urban development and household	180.0	14.8	165.2
Transportation	21.7	14.3	7.4
Grand total	**1,901.5**	**920.4**	**981.2**

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

	1998	1999	2000	2001	2002	2003	2004*	2005**
Gross disbursement	412.9	952.4	241.2	785.3	151.8	2,011.7	332.0	835.2
Amortization, interest and contributions	369.1	445.8	473.2	408.2	819.4	1,017.5	648.6	534.1
Net cash flow	43.8	506.6	-232.0	377.1	-667.6	994.2	-316.6	301.1

(*) Preliminary.
(**) Projections.

Source: IADB.

COLOMBIA: STATISTICAL ISSUES

The data provided by the authorities are generally adequate for surveillance. Colombia has subscribed and is in observance of the Special Data Dissemination Standard (SDDS) and its metadata are posted on the Fund's Dissemination Standards Bulletin Board (DSBB). Colombia takes flexibility option on the timeliness of the production index and it is also taking the extensive branch banking system flexibility for the timeliness of the data on the analytical accounts of the banking sector.

Real sector

The National Department of Statistics (DANE) is responsible for the compilation of the national accounts, though the Banco de la República (BR) compiles the financial accounts. In 1999, the DANE revised the national accounts by moving the base year from 1970 to 1994, incorporating transactions in the free trade zones, and including part of the illegal activities.

Government finance statistics

The Ministry of Finance and Public Credit (MFPC) is responsible for the compilation on public revenue, expenditure, and financing data. While significant progress has been made, there is still a need to improve the timeliness and coverage of fiscal data, develop timely and reliable data on the finances of local governments, and improve monitoring of floating debts by gradually extending the coverage from the central government to other public sector entities.

A technical assistance mission of the Statistics Department (STA) of the IMF in the area of Government Finance Statistics (GFS) visited Bogotá in 2002. This mission found that the General Accounting Office (GAO) has made good progress in the development of a single accounting database for the public sector. Currently, the GAO is using this revised chart of accounts for the preparation of the GFS classification keys. These classification keys follow the analytical framework of the *GFS Manual 2001* and are used for the preparation of GFS to be published in the *Government Finance Statistics Yearbook (GFSY)*. The GAO accounting database is used to convert accounting data to the GFS classifications on both the accrual and cash bases.

Monthly data have been reported for publication in IFS and, annual data on the consolidated central government on accrual and cash basis have been reported for publication in the *2004 GFS Y*. The last year for which data have been reported is 2002.

Financial sector statistics

The BR is in charge of compiling data on the financial sector , while the Superintendency of Banks and the Superintendency of Securities compile data in their respective areas. Fund technical assistance missions have placed special emphasis on issues of data quality, interagency cooperation, and procedures to ensure data consistency.

Balance of payments and external debt

The BR is in charge of compiling and disseminating balance of payments data. Quarterly data are produced since 1994, and the BR adopted the *BPM5* standard in 1998. Balance of payment statistics have been extended to cover transactions in the free trade zones. Improved surveys, particularly in the service sector, have enhanced coverage and consistency. Financial account data are now based on actual disbursement rather than registers. Monthly data on public sector short-term external debt , and the calculation of interest payments for the private sector debt need to be improved.

The BR compiles and disseminates data on International Investment Position statistics and the Data Template on International Reserves and Foreign Currency Liquidity.

Colombia: Table of Common Indicators Required for Surveillance
As of March 29, 2005

	Date of latest observation	Date received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of publication[1]
Exchange Rates	2/28/05	3/5/05	D	W	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	2/28/05	3/9/05	M	M	M
Reserve/Base Money	1/31/05	3/5/05	D	W	W
Broad Money	1/31/05	3/5/05	D	W	W
Central Bank Balance Sheet	1/31/05	3/5/05	M	M	M
Consolidated Balance Sheet of the Banking System	1/31/05	3/5/05			
Interest Rates[3]	2/28/05	3/5/05	D	W	D
Consumer Price Index	Feb. 2005	03/21/05	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4] – General Government[5]	Dec. 2004	Feb. 2005	Q	Q	Q
Revenue, Expenditure, Balance and Composition of Financing[4] – Central Government	Dec. 2004	Feb. 2005	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt[6]	Dec. 2004	Feb. 2005	Q	Q	Q
External Current Account Balance	Jun. 2004	Oct. 2004	Q	Q	Q
Exports and Imports of Goods and Services	Dec. 2004	Feb. 2005	Q	Q	Q
GDP/GNP	Q3/2004	Feb. 2005	Q	Q	Q
Gross External Debt	Jun. 2004	Sept. 2004	Q	Q	Q

[1] Daily (D); Weekly (W); Monthly (M); Bi-monthly (B); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).
[2] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[3] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[4] Foreign, domestic bank, and domestic nonbank financing.
[5] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[6] Including currency and maturity composition.

INTERNATIONAL MONETARY FUND

COLOMBIA

Fourth Review Under the Stand-By Arrangement, Requests for Waiver of Nonobservance of Performance Criteria and the Completion of the Fourth Review, and Request for Stand-By Arrangement

Prepared by the Western Hemisphere Department
(In consultation with other Departments)

Approved by José Fajgenbaum and Carlo Cottarelli

April 14, 2005

Two staff reports. The policy discussions covered issues related to the Fund-supported programs as well as a broader assessment of economic policies in the context of the Article IV consultation. This report reviews performance under the current Stand-By Arrangement (SBA) and presents the policies and objectives to be supported by the proposed SBA. It is a complement to the companion report on the Article IV consultation discussions.

Current arrangement. In January 2003, the Board approved a SBA in the amount of SDR 1,548 million (100 percent of quota at an annual rate). In March 2005, the arrangement was extended to May 14, 2005. The authorities have treated the arrangement as precautionary. Colombia has no outstanding credit to the Fund (Appendix I).

Completion of fourth review. All quantitative performance criteria at end-2004 were observed. The authorities are requesting waivers for the nonobservance of the structural performance criterion on congressional approval of the revised budget code and for nonobservance of the continuous performance criterion on the introduction of multiple currency practices. On this basis, the authorities are requesting completion of the fourth review under the current program. The staff supports the authorities' requests.

Proposed new arrangement. In their letter to the Managing Director dated April 13, 2005, the authorities are requesting continued support from the Fund through a new SBA for a period of 18 months and in the amount of SDR 405 million (35 percent of quota on an annual basis). The authorities want this arrangement to provide a smooth exit from Fund's financial assistance by supporting their policies for 2005–06, which aim at continuing to reduce the vulnerabilities of the economy and strengthening the basis for sustained real economic growth. The staff supports the authorities' request.

Discussions. A staff team held discussions in Bogotá during December 1–10, 2004 and January 25 and February 3–17, 2005. The team met with the Minister of Finance, the General Manager and the Board of Directors of the Banco de la República, the Director of the National Planning Department and other senior government officials and representatives of the private sector. The staff team comprised R. Rennhack (Head), R. Garcia-Saltos, O. Hendrick, (all WHD), I. Adenauer (FAD), and J. Wiegand (PDR). C. Schnure (WHD), J. Cayazzo (MFD) and J. Acevedo (MFD-consultant) joined the December mission. Li Lian Ong (ICM) joined the second mission. Mr. Fajgenbaum (WHD) participated in the final policy discussions in February. Mr. Steiner, Alternate Executive Director for Colombia, participated in all policy discussions.

Contents Page

Contents Page

Attachment

Annexes

EXECUTIVE SUMMARY

Performance under the current program continued to be very good. Economic performance continued to improve in 2004, broadly in line with the program. All quantitative performance criteria at end-2004 were observed and most structural benchmarks were met. The staff supports the authorities' request for completion of the fourth review under the current arrangement and for two waivers**.**

The authorities are requesting continued Fund support for their economic policies in 2005–06. The proposed arrangement would be a Stand-By Arrangement for 18 months, ending soon after the next government takes office. It would be in the amount of SDR 405 million (35 percent of quota on an annual basis), well below access under the current arrangement. This would provide a transparent and sound policy framework during the upcoming political cycle and allow for a gradual exit from formal Fund support.

The program would preserve the macroeconomic framework supported by the current arrangement. Real GDP would rise by 4 percent a year in 2005–06, while inflation would decline to 5 percent in 2005 and to 3–5 percent in 2006. Net international reserves would be equivalent to 110 percent of short-term debt at the end of both years.

Fiscal policy in 2005–06 is consistent with reducing public debt to close to 40 percent of GDP by 2010. The combined public sector deficit would amount to 2.5 percent of GDP in 2005 and decline to 2.0 percent of GDP in 2006. As a result, public debt would decline to about 50 percent of GDP by end-2006. These targets will be reduced by a significant share of any oil price windfall, lowering public debt further.

The government will press for congressional approval of the revised budget code and the constitutional amendment for pension reform by June 2005. However, it will be difficult to introduce new structural reforms ahead of the elections in March and May 2006. Congress is currently considering an important political reform and may consider a possible free trade agreement with the United States later in 2005.

The Banco de la República stressed that it would assign top priority to the inflation objective. The authorities agreed to narrow the consultation band for the inflation target to +/- 1 percentage point. They remain fully committed to the flexible exchange rate regime, although intervention policy could be considered at times.

The authorities will strengthen the financial system further. They will Granahorrar to the point of sale by end-2005. Bancafé was restructured with a view to eventually bringing this institution to the point of sale. A governance framework for public banks will be put in place by September 2005. A new securities market law is before Congress.

The staff supports the authorities' request for a new Stand-By Arrangement, as the policies envisaged under the program are consistent with reaching its objectives.

I. Recent Economic Developments and Review of Performance Under Current Arrangement

1. **Economic performance improved in 2004, reflecting strong policy implementation as well as the favorable external environment.** Real GDP grew by 4 percent, while inflation declined to 5.5 percent during 2004, the lowest rate in decades (Table 1). The external current account deficit fell to 1.0 percent of GDP in 2004, owing to strong export performance. At the same time, net capital inflows rose sharply, as the country risk premium stayed below 400 basis points for most of the year—well below the peak of 1,100 basis points in October 2002. Reflecting these developments and intervention by the Banco de la República, net international reserves reached US$13.2 billion (123 percent of short-term debt on a remaining maturity basis) by end-2004.

2. **In 2004, a moderate oil windfall and an unusually high surplus by the autonomous local and regional governments led to an unusually strong fiscal position.** The average price of Colombia's exports rose unexpectedly to US$36 per barrel, generating additional income for the state petroleum enterprise (Ecopetrol). Also, 2004 was the first year in office for local and regional governments, which ran unusually large overall surpluses probably because of delays in developing plans for spending. As a result, the combined public sector (CPS) deficit declined from 2.7 percent of GDP in 2003 to 1.3 percent in 2004—well below the adjusted program target of 2.1 percent of GDP (Tables 2 and 3; Memorandum of Economic Policies (MEP), Table 1).[1] The primary surplus increased from 1.7 percent of GDP in 2003 to 2.7 percent of GDP in 2004. This fiscal outturn, together with a significant appreciation of the peso in 2004, reduced public debt from 60 percent of GDP at end-2002 to 53 percent by end-2004. In addition, public sector deposits rose sharply from 8 percent of GDP at end-2002 to 10½ percent by end-2004, well above historical levels (Table 4).

Key Fiscal Trends
(In percent of GDP)

	2000	2001	2002	2003	2004
CPS balance	-3.4	-3.2	-3.7	-2.7	-1.3
Of which					
Ecopetrol operating surplus	3.0	2.5	2.3	2.9	3.5
Local and regional overall balance	-0.1	0.1	0.4	0.2	1.6

3. **In 2004, total public revenues rose from 30.7 percent of GDP in 2003 to 31.6 percent of GDP in 2004**. Several tax packages and pension reforms adopted in 2002 and 2003, together with better tax administration, boosted tax revenues to 20.3 percent of GDP in 2004, from 19.5 percent in 2003. Also, the operating surplus of the state petroleum enterprise (Ecopetrol) benefited from the rise in world oil prices. Also the domestic prices of gasoline and diesel—which are regulated—were increased faster than inflation to try to reduce the implicit subsidy with respect to international prices. Total public expenditures fell

[1] The program target of 2.5 percent of GDP was adjusted downward by 0.4 percent of GDP for deposits made into the Petroleum Stabilization Fund (FAEP) related to higher world oil prices. The program also allowed for additional investment financed by privatization proceeds, but these proceeds never materialized.

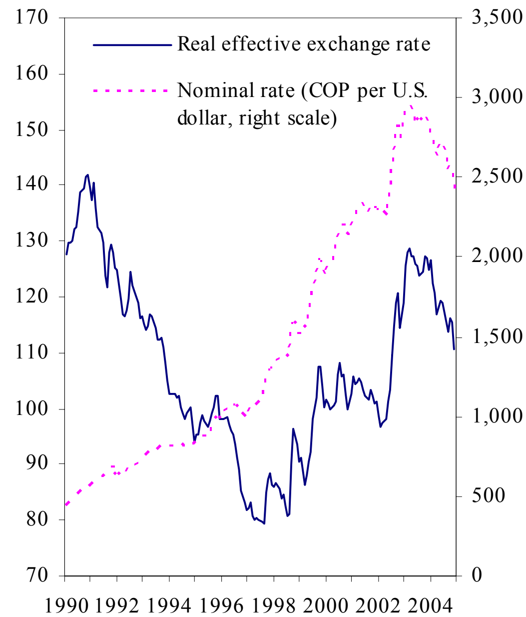
from 33.6 percent of GDP in 2003 to 33.1 percent in 2004. Current spending remained stable at 25 percent of GDP, despite the rising transfers to the private sector related to pensions. Fixed capital formation fell by over 1 percentage point of GDP to 7.3 percent of GDP.

4. **The authorities continued to pursue structural reforms (MEP, Table 2).** The government is fully committed to reducing the actuarial deficit of the pension system, which remains at 187 percent of GDP even after the reforms of 2002 and 2003. In June 2004, it submitted a constitutional amendment (which requires approval by two consecutive sessions of Congress) designed to reduce the actuarial deficit to about 160 percent of GDP. This reform would inter alia eliminate most of the generous special pension regimes and clarify the definition of acquired pension rights to pave the way for additional reforms, if necessary. The revised budget code—which is expected to strengthen expenditure management and also requires approval by two sessions of Congress—passed in the first session of Congress but was delayed in the second session. Congressional approval was a structural performance criterion. The authorities intend to secure approval of the revised budget code by June 2005, which will be a structural performance criterion under the proposed arrangement. The government continued to reduce staffing in the public sector and to restructure public enterprises, as part of the effort to modernize the state. Colombia, together with Ecuador and Perú, continued to discuss a free trade agreement with the United States. However, the plan to improve the reporting of the financing of the public sector was not implemented. Also, in spite of the government's efforts, the public procurement law has not advanced in congress, and instead the government adopted several decrees and regulations that strengthened this area.

5. **The Banco de la República lowered inflation as targeted in 2004, while slowing the strengthening of the peso in 2004 (Table 5).** In early 2004, the central bank lowered its policy interest rates on two occasions by a total of 50 basis points to 6.75 percent. In December 2004, it eased monetary policy further by lowering its interest rate on expansionary monetary operations to 6.5 percent while closing its window for contractionary operations. During 2004, the central bank also intervened in the foreign exchange market, purchasing US$2.9 billion (about 35 percent of base money) and sterilizing about half of these purchases. The government scaled back net external financing of the CPS deficit to minus 0.4 percent of GDP, compared with 1.0 percent in 2003, to improve the currency composition of public debt and to ease upward pressures on the peso.

6. **Additional measures to help contain the appreciation of the peso were introduced in December 2004.** To try to lower short-term capital inflows, foreign investors were required to hold newly acquired portfolio investments for at least one year.[2] Interest payments, capital gains on assets, and dividends could still be transferred abroad at any time without penalty. To help exporters of bananas and flowers, the authorities granted subsidies of Col$200 per U.S. dollar to those exporters that reduce their exposure to foreign exchange risk through forward transactions and other means. The estimated fiscal cost of this subsidy is less than 0.1 percent of GDP a year. The eligibility period for this subsidy expired on February 28, 2005. Fund staff determined that the subsidies constitute a multiple currency practice by creating the potential for some exporters to benefit from a more depreciated exchange rate in forward transactions in foreign exchange. During 2004, the peso appreciated by 16 percent vis-à-vis the U.S. dollar and by 11 percent in real effective terms.

Exchange Rate Trends



7. **The health of the financial system continued to improve (Table 6).** The solvency and profitability of the banking system have recovered, reflecting economic growth, a successful recapitalization scheme, and improved supervision. Nonperforming loans declined to 3.6 percent of total loans by late 2004 and were fully covered by provisions. In 2004, credit to the private sector continued to grow strongly, after falling sharply between 1999 and 2002. The bank restructuring agency (FOGAFIN) continued to trim the government's participation in the banking system by selling several banks that were intervened in 1999. It also brought Bancafé (the country's fourth largest bank) to the point of sale in February 2004, but no bids were received, probably because of the bank's high labor costs. Progress continued in implementing risk-based financial supervision and actions to combat money laundering.

Key Banking System Indicators
(In percent)

	1999	2002	Sep. 2004
Capital adequacy ratio (with market risk)	11.3	12.6	14.0
Nonperforming loans as a share of total loans	12.4	9.2	3.6
Return on assets	-3.5	1.1	2.7
Liquid assets to total assets	11.9	19.7	18.0
Spread between lending and deposit rates	4.4	7.4	7.3

Sources: Superintendencia Bancaria; IFS; and Fund staff estimates.

[2] On March 2, 2005, it was announced that this control will be removed in six months.

8. **The external sector performed well (Table 7).** The rise in world oil prices boosted oil exports to US$4.2 billion (4½ percent of GDP) in 2004, even as the volume of oil exports declined. Non-oil exports grew by 23 percent in 2004, partly on the strength of world coal prices as well as marked growth in nontraditional exports. Also remittances from Colombians living abroad reached US$3.5 billion (3½ percent of GDP) in 2004, making this one of the Colombia's largest sources of foreign exchange. While the public sector registered a modest capital outflow, the private sector experienced a surge in net inflows, reflecting in part higher net foreign direct investment. The overall balance of payments surplus reached US$2.7 billion (about 2¾ percent of GDP).

9. **The political situation remains stable, although uncertainty could rise in the run up to the elections in March (congress) and May (president) 2006.** President Uribe has sustained approval ratings on the order of 70 percent since taking office in August 2002, partly for his success in promoting an economic recovery and improving the security situation. In late 2004, Congress approved a constitutional amendment to allow for re-election of presidents, which would enable President Uribe to run in May 2006. However, the constitutional court is reviewing challenges to this amendment, and is expected to issue its ruling later this year.

10. **The security situation continues to improve but remains fragile.** The government's program of democratic security has helped reduce numerous indicators of violence, which has improved confidence. Since 2003, the government has been involved in demobilization talks with the paramilitary forces and recently submitted legislation to establish possibly reduced penalties for crimes committed by ex-combatants and to develop a program to help former combatants re-enter civilian life. However, the guerilla armies are still engaged in hostilities.

II. The 2005–06 Economic Program

11. **The authorities have designed their economic policies for 2005–06 to continue to reduce the vulnerability of the economy and promote steady economic growth.** While economic performance improved in 2003–04, public debt remains high and sensitive to exchange rate fluctuations. The authorities are requesting continued Fund support to help provide a transparent policy framework during the upcoming political transition. The new arrangement would also allow for a gradual exit from formal Fund support. The program seeks to:

- Continue fiscal consolidation by achieving a primary surplus in 2005–06 consistent with reducing public debt to close to 40 percent of GDP by 2010;
- Move forward with fiscal structural reforms, including the approval of the budget code and the pension reform;

- Retain the commitment to the inflation targeting framework, which aims to lower inflation to the range of 2–4 percent a year over the medium term;
- Continue strengthening the financial system, including by improving bank supervision further, bringing Granahorrar to the point of sale and seeking congressional approval of the new securities law.

Macroeconomic Framework: Main Elements 2003-10

	2003	2004		Projection			
		Rev. Prog.	Rev.	2005	2006	2007	2010
	(Annual percentage change)						
Real growth	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Inflation 1/	6.5	5.5	5.5	5.0	4.5	3.5	3.0
	(In percent of GDP)						
External current account balance	-1.5	-2.2	-1.0	-2.8	-2.6	-2.7	-2.5
NFPS primary balance 2/	1.7	2.5	2.7	2.7	2.7	2.7	2.7
Combined public sector balance 2/ 3/	-2.7	-2.5	-1.3	-2.5	-2.0	-1.8	-1.4
Total public debt	56.0	52.1	52.9	50.4	49.8	48.2	42.7
Public deposits	8.6	…	10.6	…	…	…	…
	(In billions of U.S. dollars)						
Net international reserves 4/	10.5	10.4	13.2	12.3	12.7	13.1	14.9
	(In U.S. dollars per barrel)						
Crude oil, spot price 5/	28.9	....	37.8	40.5	38.0	36.0	34.0

1/ For 2007 and beyond, inflation projection consistent with achieving medium-term inflation target of 2-4 percent a year
2/ At projected WEO price of oil in 2005-06, adjusted to reflect Colombia export price.
3/ Excludes the effect of the program adjustor for any oil windfall.
4/ Takes into account the prepayment of the IDB loan in 2005.
5/ Petroleum price is average of spot prices for UK Brent, Dubai, and West Texas Intermediate.

12. **The program would give continuity to the macroeconomic framework supported by the current arrangement.** Real GDP is projected to grow by 4 percent a year, reflecting an expansion in domestic demand. Inflation is targeted to fall to 5 percent during 2005 and to 3–5 percent during 2006. The external current account deficit is projected to rise to close to 2½ to 3 percent of GDP a year in 2005–06, while net international reserves are targeted at US$12.3 billion during 2005 (110 percent of short-term debt on a remaining maturity basis), following the prepayment of an emergency loan from the Inter-American Development Bank of US$1.25 billion in early April 2005.

A. Fiscal Policy

13. **Fiscal policy in 2005–06 is to be consistent with the medium-term framework presented to Congress in June 2004 (MEP, paragraphs 10–12).** The specific objectives are to limit the CPS deficit to 2.5 percent of GDP in 2005, which is in line with the budget approved by Congress in October 2004. This target assumes an average export price of oil of

US$31 per barrel as a conservative baseline. Also, the authorities explained that the unusually low deficit in 2004 also resulted from an unusually large surplus by the autonomous local and regional governments. For 2006, the authorities intend to submit to Congress by July 2005 a budget for 2006 consistent with a CPS deficit of 2.0 percent of GDP, and this action will be a structural performance criterion. With this fiscal profile, public debt would decline to about 50 percent of GDP by end-2006. Also it is expected that the public sector would gradually run down its stock of deposits from the unusually high level at end-2004.

14. **These deficit targets are subject to an adjustor for any oil windfall (Technical Memorandum of Understanding (TMU), Paragraph 9).**[3] These targets will be reduced by a significant share of any windfall arising from average export prices above US$31 per barrel, lowering public debt further. This adjustment will prevent a possible increase in non-oil spending above its sustainable path, which is important in view of the expected decline in oil production.

15. **In 2005, the authorities expected revenues to decline slightly to 31.2 percent of GDP, owing to a decline in non-tax revenue.** Tax revenues are expected to remain broadly stable in relation to GDP. The operating surplus of Ecopetrol is projected to remain constant in relation to GDP, as the government has sped up the real increases in the domestic prices of gasoline and diesel with a view to trimming the implicit subsidy further, which would be offset by the ongoing decline in production as well as the assumed decline in the average export price of oil.

16. **Total expenditure is projected to rise to 33.7 percent of GDP in 2005.** Current spending would rise in relation to GDP, reflecting continued growth in transfers to the private sector for pensions and higher interest payments. Also the wage bill would remain at 6.8 percent of GDP, as wages have been increased in line with expected inflation in 2005 and the workforce has risen, mainly in the area of defense. Fixed capital formation is projected to increase to 8.1 percent of GDP, allowing for a moderate recovery of investment spending by local and regional governments.[4] The central government would be prepared to adjust its spending as needed to achieve the fiscal target. If investment spending by local and regional

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[3] The fiscal targets may also be adjusted upwards by up to 0.5 percent of GDP for the grant element of concessional financing of expenditures related to the demobilization process. Previously this adjustor allowed for increased military spending financed concessionally.

[4] While these entities are unlikely to raise current spending rapidly because of the limits imposed by the legal framework for decentralization, they could use the deposits built up by end-2004 to finance a rapid increase in investment. Earlier this decade Congress limited current spending by these governments to current revenues and allowed borrowing to finance investment only if their financial indicators meet certain minimum standards.

governments stays below projections, possibly because of capacity constraints, the central government could undertake additional investment projects.

17. **In this context, the staff and the authorities agreed on steps to strengthen the information on the operations of local and regional governments.** The authorities will aim to publish comprehensive quarterly data by December 2005. As a first step, they will review the quality of the existing information by June 2005, and if necessary will issue regulations to improve information reporting by September 2005.

18. **The decline in the CPS deficit in 2006 is expected to be achieved mainly through restraint on current expenditure**. The government's proposed pension reform—if approved—would yield some fiscal savings starting in 2006 by eliminating the 14th monthly pension payment for new retirees. The revised budget code—also if approved—would allow for other savings in current expenditure. The wage bill would remain stable in relation to GDP. These steps would help more than offset a small decline in revenues arising from a fall in the operating surplus of Ecopetrol due to lower oil production. The authorities stressed that these projections were preliminary but remained committed to developing the measures necessary to reach the stated target.

19. **The authorities agreed not to grant any further export subsidies (MEP, paragraph 15).** However, they emphasized that the subsidies for agricultural exports granted by many industrialized countries put developing countries such as Colombia at a competitive disadvantage. In this context, they indicated that they may seek other options to support the agricultural sector within the program fiscal target.

20. **To reduce the public sector's exposure to exchange rate fluctuations, the government will reduce its net foreign currency financing to minus 0.5 percent of GDP in 2005 (MEP, paragraph 13).** This will be monitored by an indicative quarterly target. The government may consider additional placements through a global bond denominated in pesos, with the investor bearing the exchange rate risk. This bond has brought in US$825 million since November 2004. The prepayment of the emergency loan from the IDB will also improve the currency profile of the debt.

21. **The authorities clarified that the government's forward transactions in foreign exchange—which started in February 2005—were a debt management tool (MEP, paragraph 13)**. The government wanted to buy foreign exchange forward, with an offsetting spot market sale, to minimize the cost of holding foreign currency assets, which reached about US$1.1 billion by end-2004. The government will publish the details of these operations to provide for full transparency and to help limit the potential fiscal risk. It will also provide the Banco de la República with a schedule of its planned forward transactions to ensure consistency with monetary and exchange rate policy. The government also agreed to limit its forward sales of foreign exchange to US$100 million.

Fiscal structural reforms

22. **The authorities commented that the upcoming elections will limit the scope for structural reforms after mid-2005, although efforts in a number of areas will continue (MEP, paragraph 18).** They noted that Congress was considering important legislation related to the demobilization process and that the free trade agreement with the United States could enter the legislative agenda in the second half of 2005. In this context, they intend to continue to advance key structural fiscal reforms:

- **Revised budget code.** The authorities are seeking congressional approval of the revised budget code by June 2005, which is a structural performance criterion under the program. This step should help scale back revenue earmarking, budgetary carryovers, and multiyear spending commitments.

- **Pension reform**. The government is working for congressional approval of its proposed constitutional amendment by June 2005.

The government will also try to privatize several smaller public enterprises. The government intends to bring Ecogas—the public enterprise that operates the country's natural gas pipelines—to the point of sale in 2005. It will also hire an investment bank to prepare to bring several regional electricity firms to the point of sale in 2006. Together these public enterprises have an estimated book value of 0.8 percent of GDP.

23. **The authorities will continue to lay the foundation for other structural reforms that could be implemented after 2006 (MEP, paragraph 19)**. They firmly believe that a more efficient tax code would encourage faster economic growth. On two occasions, the government proposed legislation to broaden the base of the VAT and the income tax and to reduce the high number of VAT rates, but both proposals encountered strong political resistance. The authorities will continue to look for ways to build a consensus for tax reform. The government is also aware that the current revenue sharing mechanism places a burden on the central government, especially starting in 2009, and will prepare a study evaluating the current mechanism by December 2005.[5] The government is evaluating ways to channel its network of subsidies more effectively to the poor, possibly leaving some room to trim poorly-targeted subsidies.

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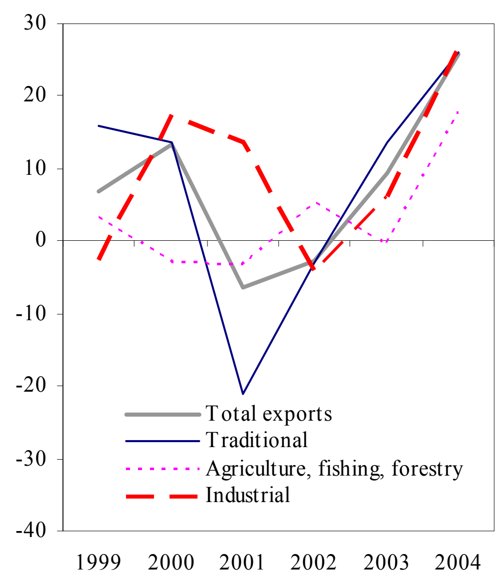
[5] Currently transfers to local governments are mandated by the constitution to grow by 2 percent in real terms in 2005, 2½ percent in real terms in 2006–08 and in line with the growth in current revenues subsequently, which would likely imply even faster real growth.

B. Monetary and Exchange Rate Policies

24. **The Banco de la República reaffirmed its commitment to achieving the inflation target of 5 percent during 2005 (MEP, paragraphs 19-20).** The authorities explained that their technical analysis of inflation justified the shift in the stance of monetary policy in December 2004. In particular the output gap had remained wider than expected at over 1 percent and inflation in nontraded goods prices had been stable at about 5½ percent since mid-2004 (Figure). They noted that market expectations of inflation during 2005 were broadly in line with the central bank's target, and stressed that the central bank is prepared to tighten monetary policy if necessary by raising the interest rate on its expansionary monetary operations, re-opening its window for contractionary operations and continuing to sterilize foreign exchange purchases. For this reason, the authorities agreed to narrow the consultation band for the inflation target to +/- 1 percentage point and to provide staff with the central bank's internal monthly inflation report on a regular basis.[6]

25. **There was a discussion of the authorities' concerns about the strength of the peso.** The staff pointed out that many different exports—a wide range of nontraditional products as well as oil, coal, and other traditional products—performed well in 2004. Also the peso remained 15 percent more depreciated in real effective terms than in September 1999, when Colombia adopted the flexible exchange rate regime. The authorities noted that they remain fully committed to the flexible exchange rate regime and agreed that their approach since end-2003 could be characterized as a managed float. This approach reflected the need to avoid past episodes of sustained real appreciations followed by difficult periods. However, they stressed that the central bank would continue to assign top priority to the inflation objective. In March, the central bank purchased US$170 million, compared with US$600 million in January–February. Inflation declined further to 5.0 percent year-on-year in March 2005.

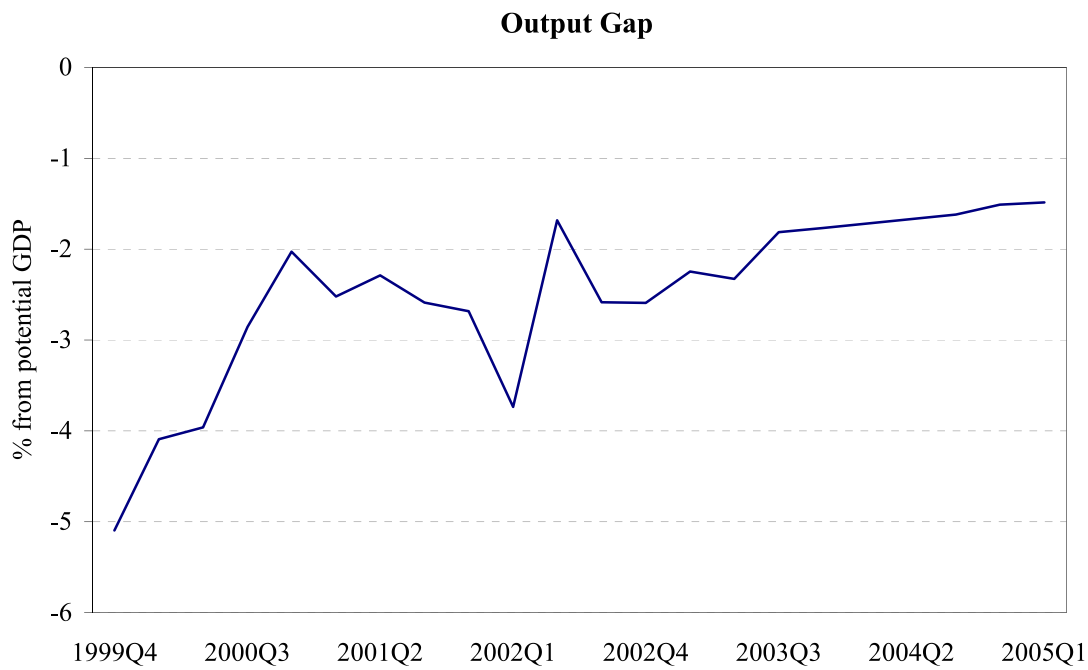
Export Growth by Product
(In annual percentage increase)

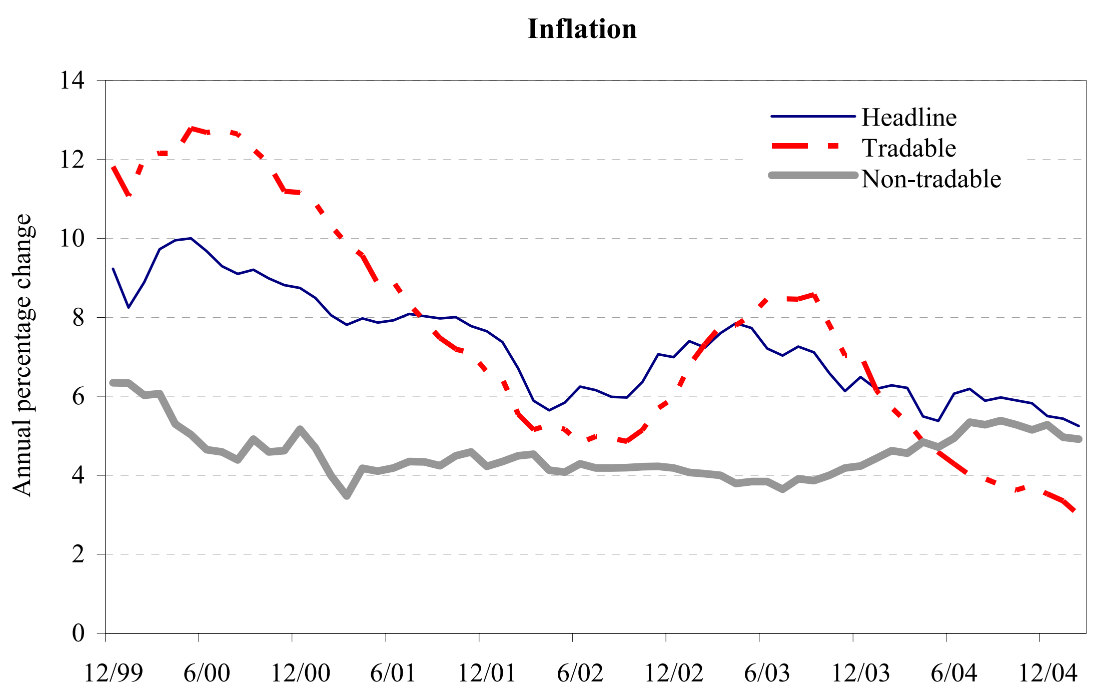


Source: Department of National Planning (DANE).

[6] The current program has a consultation band of +/- 2 percentage points. If inflation falls outside this band, Colombia must complete a consultation with the Fund to bring the program back on track.

Figure. Output Gap and Inflation





Sources: Central Bank of Colombia; and DANE.

C. Financial Sector

26. **The authorities will strengthen financial supervision further (MEP, paragraphs 22–24).** They are continuing to gradually phase in a new risk-based approach to capital adequacy and loan-loss provisions in line with Basle II principles. In this context, they intend to improve the measurement of market risk and of the value of foreclosed assets, and intend to devote sufficient resources to ensure the success of the new approach. They are also strengthening the framework for consolidated supervision and are unifying the supervision of the financial sector and securities markets to limit the possibilities for regulatory arbitrage. The financial superintendency is continuing to monitor the situation of the weak mortgage banks, which continue to operate under restructuring plans that require additional provisioning and capital as necessary.

27. **The authorities reiterated their commitment to reducing the public sector's involvement in the financial system (MEP, paragraph 25).** They noted that FOGAFIN had made significant progress in divesting many of the institutions intervened following the 1999 crisis. FOGAFIN has already started the process of divesting Granahorrar, which will be brought to the point of sale by end-2005. In early March 2005, FOGAFIN divided Bancafé into two banks. One bank (named Bancafé) will be liquidated to allow for the restructuring of the generous labor contract. The other bank (called Granbanco-Bancafé) was created to manage the good assets and deposits of Bancafé, and will be staffed by some of the employees of the old Bancafé at competitive compensation levels. The authorities intend to eventually bring the new bank (Granbanco-Bancafé) to the point of sale. A framework for governance of Granbanco–Bancafé and the other publicly-owned bank—Banco Agrario—will be developed by September 2005.

28. **The government will also seek congressional approval of the new securities market law by June 2005 to help deepen local capital markets (MEP, paragraph 26).** The authorities also intend to facilitate the development of hedging instruments in the financial system.

D. Medium-Term Outlook

29. **The baseline medium-term scenario is based on cautious assumptions (Table 8).** These include a moderate real depreciation of the peso in 2006–10, owing in part to a mild deterioration in the terms of trade and lower oil export earnings; a gradual decline in inflation; and a slight reduction in the country's risk premium.

Baseline Scenario: Assumptions

	Prel.	Projections			
	2004	2005	2006	2007	2010
(In percent)					
Real GDP	4.0	4.0	4.0	4.0	4.0
Inflation	5.5	5.0	4.5	3.5	3.0
Average real peso depreciation (-)	9.2	5.4	-6.4	-4.0	-0.7
LIBOR	1.8	3.2	3.8	4.3	5.0
(In percent of GDP)					
Primary public sector balance	2.7	2.7	2.7	2.7	2.7
(In basis points)					
Country risk premium	400	380	383	354	290

Source: Fund staff estimates and projections.

30. **Economic policies would remain strong over the medium term.** The government would continue with fiscal reforms to sustain a primary surplus of 2.7 percent of GDP, and it would aim to rely increasingly on domestic currency borrowing to limit the vulnerability of the debt profile to exchange rate fluctuations. The central bank would continue to target inflation. The flexible exchange rate regime would allow the external sector to adapt to shifts in conditions—such as the prospect of a significant decline in the volume of oil exports starting in 2007—and to allow exports to diversify further. The external current account deficit would range from 2½ to 3 percent of GDP through 2010, which could be financed with sustainable net capital inflows. Net international reserves would remain at about 110 percent of short-term debt on a remaining maturity basis.

31. **Under these assumptions, Colombia's public and external debt profiles are sustainable.** Public debt is projected to decline to 42.7 percent of GDP by 2010, while total external debt would fall to 32 percent of GDP.

Public Debt: Baseline and Alternative Scenarios
(In percent of GDP)

	Prel.	Projections			
	2004	2005	2006	2007	2010
Baseline	**52.9**	**50.4**	**49.8**	**48.2**	**42.7**
Alternative					
Primary balance falls by 0.5 of GDP from 2006 thru 2010	52.9	50.4	50.4	49.4	46.0
Per capita real GDP is constant from 2005 thru 2010	52.9	51.6	52.7	52.0	49.5
One time 30 percent real depreciation in 2006	52.9	50.4	59.6	58.2	53.9

Source: Fund staff estimates and projections.

32. **A shock of a sharp exchange rate depreciation would present the biggest risk to the public debt outlook (Tables 9 and 10).** With a permanent 30 percent nominal depreciation of the peso in 2006, public debt would increase by more than 10 percentage points of GDP, compared with the baseline. Average real growth of 2½ percent (constant per capital GDP) would leave public debt at about 50 percent of GDP. A deterioration in the primary fiscal balance by ½ percent of GDP—which could be triggered by a drop in petroleum prices of US$15 per barrel, or a 10 percent increase in interest payments (absent compensating fiscal measures)—would slow the pace of debt reduction but without reversing the declining trend.

E. Program Modalities and Risks

Current arrangement

33. **The authorities are requesting the completion of the fourth and final review under the current arrangement.** All quantitative performance criteria at end-2004 were observed with ample margins, and most but not all structural benchmarks were met. The authorities are requesting a waiver for the nonobservance of the structural performance criterion on congressional approval of the revised budget code. The staff supports this request. The authorities remain committed to adopting this measure, but with a delay that does not affect significantly the overall strength of the program. They are also requesting a waiver of the continuous performance criterion on the nonintroduction of multiple currency practices. The staff supports their request for this waiver, because the eligibility period for the export subsidies that gave rise to the multiple currency practice ended on February 28, 2005. The current arrangement would be cancelled before approval of the proposed one.

Proposed arrangement

34. **Access would be SDR 405 million (35 percent of quota per year)—about one-third of the access under the current arrangement (Table 11).** This is consistent with the progress made in reducing the vulnerabilities of the economy. The first purchase, equivalent to SDR 193.5 million (25 percent of quota), would be available upon Board approval, and the remaining amount would be available in 5 purchases of SDR 42.3 million each (Table 12). The arrangement would end in October 2006, after the next government takes office in August 2006. The authorities intend to treat the arrangement as precautionary.

35. **Quarterly performance criteria will apply to the overall deficit of the combined public sector, net international reserves (NIR) of the central bank, inflation and short-term external public debt.** If inflation falls outside a band of +/- 1 percentage point, Colombia will need to complete a consultation with the Fund to resume purchases under the

Stand By Arrangement. The net disbursement of foreign currency public debt is subject to an indicative quarterly target. Adjustors to these targets are explained in the Technical Memorandum of Understanding. There will be semi-annual program reviews to be completed by September 2005, March 2006, and September 2006.

36. **Structural conditionality.** The authorities have already adopted the prior action to require banks to strengthen their reporting of their operations with the nonfinancial public sector, which is crucial to improve the timeliness and quality of the information on the financing of the combined public sector. There will be structural performance criteria on the approval of the revised budget code by June 2005 and on the submission of a 2006 budget to Congress by June 2005 that is consistent with a CPS deficit of 2.0 percent of GDP. Structural benchmarks include congressional approval of the constitutional amendment for pension reform and of the new securities law, steps to strengthen the information on the operations of local and regional governments, and bringing Granahorrar to the point of sale. Further structural measures for 2006, if necessary, would be introduced at the time of the second review.

37. **Colombia would be able to repay the Fund, if all purchases were made under the proposed arrangement** (Table 13). Fund credit would be equivalent to 0.6 percent of GDP in 2006. Debt service to the Fund would peak at 3.2 percent of exports of goods and nonfactor services in 2006.

38. **There are several risks to the program.** The debt sustainability analysis shows that public debt is sensitive to exchange rate fluctuations and other shocks. The surplus of local and regional governments could decline faster than expected. A deterioration in the security situation could harm confidence and slow growth. Pressures for increased public spending could mount in the run up to the 2006 elections. The external environment could worsen, especially if a surge in world oil prices slows the growth in the global economy. (These risks are also discussed in the companion report on the 2005 Article IV consultation).

III. Staff Appraisal

39. **The authorities' sound policy implementation has continued to reduce vulnerabilities and foster economic growth.** Real GDP increased steadily in 2003–04, helping reduce unemployment. Inflation declined to the lowest level in decades. The external sector strengthened, with a low current account deficit and strong capital inflows in 2004. Fiscal consolidation, together with the real appreciation of the peso, lowered gross public debt from 60 percent of GDP at end-2002 to 53 percent by end-2004, together with a sizable increase in public deposits. The staff supports the authorities' requests for two waivers and for the completion of the fourth review under the current arrangement.

40. **The proposed program serves an important purpose.** It seeks to support the authorities' macroeconomic framework—especially with regard to fiscal policy and public debt reduction—during the upcoming political transition. By maintaining sound economic

policies in the coming 18 months, the country will strengthen its credibility further and continue to reduce economic vulnerabilities, which are crucial to achieve sustained economic growth. While economic performance improved in 2003–04, the country still faces risks arising from several factors, including high public debt that is sensitive to exchange rate fluctuations, a fragile security situation and a possible deterioration in the global economic environment.

41. **Fiscal policy in 2005–06 will stay on the path to reduce public debt to close to 40 percent of GDP by 2010**. The target for the CPS deficit in 2005 is based on a conservative outlook for the average export price of oil. It also incorporates the reasonable assumption that the overall surplus of the autonomous local and regional governments will decline. If spending by these entities is less than expected, the central government could have room for additional investment projects. However, the central government will need to be ready to adjust its spending if necessary to achieve the fiscal target. To monitor the position of the local and regional governments, the authorities need to improve the quality of information on their operations as quickly as possible.

42. **The authorities have decided to save a significant share of any windfall arising from higher world oil prices to help non-oil public spending on a sustainable path.** If world oil prices stay at current levels, this savings would most likely lead to a faster than envisaged decline in public debt in relation to GDP.

43. **The staff welcomes the authorities' decision not to grant any further export subsidies**. It shares the authorities' concern that subsidies and other trade barriers in many industrialized countries hampers economic activity by slowing export growth in developing countries. However, the staff encourages the authorities to limit budgetary support to the agricultural sector, which could distort relative prices and put pressure on the budget.

44. **The agenda of structural fiscal reforms under the proposed program is realistic, in view of the upcoming political transition**. The authorities will press ahead with key reforms that have already been submitted to Congress. Also Congress has begun to debate one important political issue—the legal framework for the demobilization process—and may begin to consider a possible free trade agreement with the United States later this year. Having said this, it is crucial to secure approval of the proposed reforms by June 2005. The revised budget code will make an important start in addressing spending rigidities, including the revenue earmarking which led to higher spending in 2004 in response to the strong performance of tax revenues. After this code is approved, the government will need to continue to find ways to reduce these rigidities further. The pension reform is also crucial, given the high actuarial deficit of the pension system. Moreover, the staff strongly encourages the authorities to seek opportunities ahead of the elections to continue to advance reforms in tax policy and pensions, if possible. Given the recent run up in world oil prices, it would be advisable to increase domestic prices of gasoline and diesel at a faster pace.

45. **Monetary policy will remain directed at reducing inflation.** The Banco de la República met its inflation target for 2004 in a complicated environment and it has

reaffirmed that it continues to attach top priority to lowering inflation further. The staff notes that the central bank stands ready to tighten monetary conditions as necessary. While exchange rate policy since end-2003 can be characterized as a managed float, the central bank is still committed to the flexible exchange rate regime that has served Colombia well since its adoption in 1999. The staff would have preferred less foreign exchange intervention during 2004 and notes that the best way to support export competitiveness—if concerns do arise—is to continue to reduce the burden of public debt, while undertaking structural reforms. In this regard, the staff urges the authorities to monitor closely the effect of foreign exchange intervention to ensure that inflationary pressures do not build up. The plan to prepay the emergency loan from the IDB will help lower the government's debt servicing costs and exposure to exchange rate risk with a limited reduction in the reserve cushion.

46. **The authorities are continuing to strengthen the financial system.** It will be important to adopt by June 2005 the new securities law, which will help deepen local capital markets further and promote faster economic growth. FOGAFIN has been successful in reducing the public sector's participation in the financial system**.** The staff welcomes the decision to bring Granahorrar to the point of sale by end-2005. The recent decision to restructure Bancafé is an important step forward that resolves a crucial and complex issue. The staff also welcomes the authorities' commitment to establish a governance framework for Bancafé and Banco Agrario by September 2005, and it urges the authorities to bring Bancafé to the point of sale as soon as possible.

47. **The staff support the authorities' request for a Stand-By Arrangement in the amount of SDR 405 million for a period of 18 months.** The authorities remain committed to continue to strengthen economic performance by consolidating the fiscal position, reducing inflation further, and continuing to improve financial supervision. Their policies are adequate to achieve the program objectives.

Table 1. Colombia: Selected Economic and Financial Indicators

					2004		Proj.	
	2000	2001	2002	2003	Rev. Prog.	Prel.	2005	2006
(Percentage changes, unless otherwise indicated)								
National income and prices								
Real GDP	2.9	1.5	1.9	4.0	4.0	4.0	4.0	4.0
GDP deflator	12.1	6.2	6.5	8.2	5.9	7.0	5.3	4.3
Consumer prices (average)	9.2	8.0	6.3	7.1	6.0	5.9	5.2	4.8
Consumer prices (end of period)	8.7	7.6	7.0	6.5	5.5	5.5	5.0	4.5
External sector (on the basis of US$)								
Exports (f.o.b.)	14.0	-6.4	-4.1	11.2	11.2	23.6	-0.1	3.2
Imports (f.o.b.)	8.1	10.6	-1.6	9.8	15.1	19.9	15.7	2.7
Export volume	1.1	0.9	-4.4	2.6	2.9	6.7	0.7	6.5
Import volume	10.0	10.5	-1.6	5.2	7.6	13.3	16.9	2.5
Terms of trade (deterioration -)	14.8	-7.3	0.3	3.9	1.1	9.3	0.2	-3.3
Real effective exchange rate (depreciation -)	-2.6	1.5	-17.4	-5.2	…	11.4	…	…
Central administration								
Revenue	25.7	20.8	10.1	13.9	15.4	16.0	10.1	8.3
Expenditure	11.9	16.7	12.6	6.8	10.7	15.7	13.2	8.8
Money and credit 1/								
Broad money	-2.1	7.0	5.3	6.5	10.2	16.7	11.1	10.3
Credit to the private sector	-8.6	1.7	4.0	9.2	11.5	12.2	14.6	14.0
Interest rate (90-day time deposits; percent per year)								
Nominal	13.4	11.5	7.7	7.9	…	7.7	…	…
Real	4.2	3.6	0.7	1.4	…	2.2	…	…
(In percent of GDP)								
Central administration balance	**-5.7**	**-5.7**	**-6.4**	**-5.4**	**-5.6**	**-5.5**	**-6.1**	**-6.2**
Nonfinancial public sector balance	-3.5	-3.5	-4.2	-3.2	-2.8	-1.7	-2.5	-2.1
NFPS primary balance	**0.9**	**1.5**	**0.4**	**1.7**	**2.2**	**2.7**	**2.7**	**2.7**
Public sector balance	**-3.4**	**-3.2**	**-3.7**	**-2.7**	**-2.8**	**-1.3**	**-2.5**	**-2.0**
Foreign financing	1.6	2.3	0.6	1.0	1.7	-0.3	-0.5	0.5
Domestic financing 2/	1.2	0.9	3.1	1.8	0.8	1.7	3.0	1.5
Privatization	0.5	0.0	-0.1	-0.1	0.3	0.0	-0.1	0.0
Public debt 3/4/	**47.7**	**51.8**	**60.2**	**56.0**	**52.1**	**52.9**	**50.4**	**49.8**
Gross domestic investment	13.7	14.5	14.2	14.9	15.5	14.0	15.3	17.0
Gross national savings	14.6	13.2	12.6	13.5	13.4	12.9	12.5	14.4
Current account (deficit -)	0.9	-1.4	-1.7	-1.5	-2.2	-1.0	-2.8	-2.6
External debt	46.1	47.5	52.3	46.0	43.7	37.1	35.9	36.2
Of which : public sector	26.3	28.5	31.9	29.6	28.6	24.1	22.7	22.5
NIR in percent of short-term debt	111.5	98.4	106.1	127.3	124.4	110.4	110.5	116.3
(In percent of exports of goods, services, and income)								
External debt service	50.1	50.2	64.0	56.4	47.7	35.5	52.1	45.2
Of which : public sector	21.7	28.2	37.0	33.4	23.8	18.4	30.9	23.6
Interest payments	15.9	16.3	16.8	15.0	15.9	12.0	14.5	14.2
Of which : public sector	8.9	10.4	11.3	10.6	11.2	8.3	10.3	10.2
(In millions of U.S. dollars)								
Overall balance of payments	870	1,217	138	-184	712	2,583	-855	313
Net official reserves 4/	8,800	9,982	10,507	10,524	11,408	13,195	12,340	12,653
Net official reserves (in months of imports of goods and services)	6.6	7.8	7.6	6.5	7.2	7.1	6.5	6.3

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

1/ All annual changes in foreign currency stocks valued at constant exchange rate.
2/ Includes the quasi-fiscal balance of Banco de la Republica, sales of assets, phone licenses, and statistical discrepancy.
3/ Includes bonds issued to recapitalize financial institutions.
4/ Program definition. Assumes no purchases under the current SBA arrangement. Includes valuation changes.

Table 2. Colombia: Operations of the Combined Public Sector

(In percent of GDP)

	2000	2001	2002	2003	2004 Rev. Prog.	2004 Prel.	Proj. 2005	Proj. 2006
Total revenue	**28.0**	**29.6**	**29.6**	**30.7**	**31.1**	**31.6**	**31.2**	**31.3**
Current revenue	**28.0**	**29.6**	**29.6**	**30.7**	**31.1**	**31.6**	**31.2**	**31.3**
Tax revenue	17.3	19.2	19.2	19.5	20.0	20.3	20.5	20.5
Nontax revenue	10.7	10.4	10.4	11.3	11.1	11.3	10.8	10.8
Financial income	1.0	1.3	0.9	1.1	1.0	1.0	1.0	1.0
Operating surplus of public enterprises	4.2	4.2	4.0	4.6	4.2	4.8	4.7	4.7
Of which : Ecopetrol 1/	3.0	2.5	2.3	2.9	2.6	3.4	3.1	3.0
Other	5.5	4.8	5.4	5.6	5.9	5.4	5.1	5.1
Total expenditure and net lending 2/	**31.5**	**33.3**	**33.8**	**33.6**	**33.6**	**33.1**	**33.7**	**33.4**
Current expenditure	**23.6**	**24.9**	**25.5**	**25.2**	**26.4**	**25.4**	**26.2**	**25.8**
Wages and salaries	7.2	7.5	7.5	7.4	7.5	6.8	6.8	6.8
Goods and services 3/	3.3	3.5	3.4	3.3	3.4	3.3	3.7	3.5
Interest	4.4	5.0	4.5	4.9	5.0	4.5	5.1	4.7
External	1.6	2.3	2.1	2.2	2.0	1.8	2.0	1.8
Domestic	2.8	2.8	2.4	2.7	3.0	2.7	3.2	2.9
Transfers to private sector	9.0	9.8	9.7	9.8	10.9	10.4	11.0	10.8
Of which: from social security	5.5	6.5	6.7	6.9	7.7	7.1	7.5	7.6
Other 4/	-0.3	-0.9	0.2	-0.1	-0.4	0.4	-0.4	0.0
Capital expenditure	**7.9**	**8.3**	**8.1**	**8.5**	**7.2**	**7.8**	**7.5**	**7.5**
Fixed capital formacition (cash basis)	8.1	8.0	7.9	8.4	7.6	7.3	8.1	7.4
Other (including floating debt) 4/	-0.3	0.2	0.0	0.0	-0.5	0.4	-0.7	0.0
Transfers	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1
Net lending	**0.0**	**0.1**	**0.1**	**0.0**	**0.0**	**-0.1**	**0.0**	**0.0**
Statistical discrepancy	0.0	0.2	-0.1	-0.3	0.0	-0.3	0.0	0.0
Additional Investment Projects 5/					0.3	0.0	0.0	0.0
Nonfinancial public sector balance	**-3.5**	**-3.5**	**-4.2**	**-3.2**	**-2.8**	**-1.7**	**-2.5**	**-2.1**
Quasi-fiscal balance (BR cash profits)	0.5	0.7	0.8	0.6	0.3	0.5	0.2	0.2
Fogafin balance	0.0	0.2	0.3	0.3	0.1	0.3	0.2	0.2
Net cost of financial restructuring 6/	-0.4	-0.7	-0.6	-0.4	-0.4	-0.4	-0.4	-0.2
Overall balance	**-3.4**	**-3.2**	**-3.7**	**-2.7**	**-2.8**	**-1.3**	**-2.5**	**-2.0**
Overall financing	**3.4**	**3.2**	**3.7**	**2.7**	**2.8**	**1.3**	**2.5**	**2.0**
Foreign, net	1.6	2.3	0.6	1.0	1.7	-0.3	-0.5	0.5
Of which								
Changes in assets held abroad (-increase)	-0.1	-1.9	1.9	-0.7	0.9	-1.0	0.1	1.1
Domestic, net	1.2	0.9	3.1	1.8	0.8	1.7	3.0	1.5
Financial system 7/	-0.5	-1.1	-1.4	-0.6	0.5	0.3	1.2	-0.1
Bonds 8/	2.3	2.8	3.9	2.5	1.0	2.1	2.3	1.8
Change in floating debt and accrual adjustments	-0.6	-0.7	0.7	-0.2	-0.7	0.7	-0.9	0.0
Privatization (including concessions) 9/	0.5	0.0	-0.1	-0.1	0.3	0.0	-0.1	0.0
Memorandum items:								
NFPS savings	4.4	4.7	4.1	5.6	4.6	6.3	5.0	6.3
NFPS primary balance	0.9	1.5	0.4	1.7	2.2	2.7	2.7	2.7
NFPS non-oil balance	-5.5	-5.3	-5.9	-5.2	-4.4	-3.9	-4.2	-3.9
NFPS non-oil primary balance	-1.1	-2.1	-1.4	-0.3	0.6	0.6	0.9	0.8

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

1/ Includes higher domestic and diesel prices announced by the authorities.
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/ These projects will be implemented only if privatization proceeds materialize.
6/ Interest payments on public banks restructuring bonds and mortgage debt relief related costs.
7/ Includes changes in public sector loans and deposits in the financial system.
8/ Includes changes in holdings of public securities by banks and nonbanks.
9/ Includes nonrecurrent fees from telecommunications licensing.

Table 3. Colombia: Operations of the Central Administration

(In percent of GDP)

				Est.	2004		Proj.	
	2000	2001	2002	2003	Rev. Prog.	Est.	2005	2006
Total revenue	**13.0**	**14.7**	**15.0**	**15.4**	**15.4**	**16.0**	**16.3**	**16.1**
Current revenue	**13.0**	**14.7**	**15.0**	**15.4**	**15.4**	**16.0**	**16.3**	**16.1**
Tax revenue 1/	11.2	13.2	13.4	14.1	14.0	14.7	14.9	14.9
Net income tax and profits	4.3	5.3	5.3	6.0	5.7	6.1	6.1	6.3
Goods and services	5.3	5.9	5.8	6.3	6.7	6.4	6.4	6.5
Value-added tax	4.8	5.3	5.3	5.9	6.2	6.0	6.0	6.1
Gasoline tax	0.5	0.6	0.5	0.5	0.5	0.4	0.5	0.5
International trade	1.0	1.1	1.0	1.0	0.9	0.9	0.9	0.8
Financial transaction tax	0.6	0.8	0.7	0.7	0.7	0.9	0.9	0.8
Stamp and other taxes	0.0	0.0	0.7	0.0	0.0	0.4	0.5	0.4
Nontax revenue	1.8	1.5	1.6	1.4	1.4	1.3	1.4	1.2
Property income	0.5	0.3	0.3	0.2	0.3	0.2	0.2	0.2
Other	1.3	1.2	1.3	1.1	1.1	1.1	1.2	1.0
Total expenditure and net lending	**18.8**	**20.4**	**21.4**	**20.9**	**21.0**	**21.7**	**22.6**	**22.5**
Current expenditure	**15.3**	**15.8**	**18.2**	**17.4**	**18.2**	**18.1**	**19.7**	**19.4**
Wages and salaries	2.9	3.0	3.0	3.0	3.1	2.9	2.9	2.9
Goods and services	1.3	1.5	1.5	1.5	1.6	1.5	1.5	1.5
Interest	3.0	3.5	3.5	4.0	4.4	3.9	4.7	4.6
External	1.2	1.6	1.7	1.9	1.8	1.7	1.9	1.7
Domestic	1.8	1.9	1.7	2.1	2.6	2.2	2.9	2.8
Other expenditure 2/	-0.1	-0.9	0.7	-0.1	-0.3	0.5	-0.4	0.0
Current transfers 3/	8.2	8.6	9.5	9.0	9.5	9.4	10.9	10.4
Capital expenditure	**3.0**	**3.8**	**2.5**	**3.0**	**2.5**	**3.4**	**2.7**	**2.9**
Fixed capital formation 2/	1.0	1.3	1.3	1.1	0.5	1.5	0.7	0.8
Capital transfers	2.1	2.5	1.2	2.0	2.0	1.9	2.1	2.1
Net lending	**0.5**	**0.8**	**0.6**	**0.4**	**0.3**	**0.1**	**0.1**	**0.2**
Overall balance	**-5.7**	**-5.7**	**-6.4**	**-5.4**	**-5.6**	**-5.6**	**-6.3**	**-6.4**
Memorandum item:								
Primary balance	**-2.7**	**-2.2**	**-2.9**	**-1.4**	**-1.3**	**-1.7**	**-1.6**	**-1.8**

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

1/ Excludes proceeds of financial transaction tax in 1999 from revenue and expenditure.
2/ Includes change in the budget carryover. A negative number corrects for current cash payments of expenditures incurred in previous periods.
3/ Includes interest payment to the rest of the nonfinancial public sector.

Table 4. Colombia: Public Debt and Deposits
(In percent of GDP)

	2000	2001	2002	2003	Est. 2004
Total outstanding gross debt 1/	**47.7**	**51.8**	**60.2**	**56.0**	**52.9**
Domestic debt	21.4	23.2	28.3	26.4	28.8
External debt	26.3	28.5	31.9	29.6	24.1
Nonfinancial public sector gross debt	**42.8**	**47.0**	**55.2**	**52.0**	**49.6**
Domestic debt	18.9	20.1	24.9	23.4	26.2
External debt	24.0	26.9	30.3	28.6	23.4
Financial public sector gross debt	**4.9**	**4.7**	**5.1**	**4.0**	**3.3**
Domestic debt	2.6	3.1	3.4	3.0	2.6
External debt	2.3	1.6	1.6	1.0	0.7
Total public sector deposits	**7.6**	**9.3**	**8.2**	**8.6**	**10.6**
Domestic	4.5	4.4	4.8	4.9	6.4
Foreign	3.1	4.9	3.4	3.7	4.2
Nonfinancial public sector deposits	**7.6**	**9.3**	**8.2**	**8.6**	**9.9**
Domestic	4.5	4.4	4.8	4.9	6.4
Foreign	3.1	4.9	3.4	3.7	3.5
Financial public sector deposits	**0.0**	**0.0**	**0.0**	**0.0**	**0.7**
Domestic	...	...	...	...	0.0
Foreign	0.0	0.0	0.0	0.0	0.7
Total outstanding net debt 1/	**40.1**	**42.4**	**52.0**	**47.4**	**42.2**
Domestic debt	17.0	18.8	23.5	21.5	22.4
External debt	23.1	23.6	28.5	25.9	19.9
Nonfinancial public sector net debt	**35.2**	**37.7**	**47.0**	**43.4**	**39.7**
Domestic debt	14.4	15.7	20.1	18.6	19.8
External debt	20.9	22.1	26.9	24.9	19.8
Financial public sector net debt	**4.9**	**4.7**	**5.1**	**4.0**	**2.6**
Domestic debt	2.6	3.1	3.4	3.0	2.5
External debt	2.3	1.6	1.6	1.0	0.0
Memorandum items:					
Floating Debt	2.3	1.7	2.0	1.5	2.2
GDP (Billions of COL Pesos)	174,896	188,559	204,530	230,091	255,984

Source: Colombian authorities; and Fund staff estimates.

1/ Includes floating debt

Table 5. Colombia: Monetary Indicators

					2004		Proj.	
	2000	2001	2002	2003	Rev. Prog.	Prel.	2005	2006
	(In billions of Colombian pesos, unless otherwise stated)							
Central bank								
Net international reserves 1/	19,239	23,027	29,576	29,544	31,260	31,533	31,682	35,421
billions of US$	8.8	10.0	10.5	10.5	11.2	13.2	12.3	12.7
Net domestic assets	-8,529	-11,379	-15,471	-12,929	-12,679	-12,273	-9,316	-10,975
Net credit to public sector	2,913	1,716	2,097	2,866	3,628	-199	3,938	3,700
TES	2,752	2,016	2,363	3,193	4,022	975	4,074	3,835
Other, including deposits and REPOs	160	-300	-267	-327	-394	-1,174	-136	-136
Net credit to financial system	2,678	1,927	3,198	4,673	3,674	3,512	4,428	6,289
Other	-14,119	-15,022	-20,766	-20,469	-19,981	-15,586	-17,682	-20,963
Monetary base	10,710	11,648	14,105	16,615	18,581	19,260	22,366	24,447
Currency in circulation	7,276	8,349	9,993	11,953	13,737	13,799	15,371	16,954
Banking system reserves	3,434	3,298	4,111	4,662	4,844	5,461	6,996	7,493
Banking system								
Net foreign assets 1/	18,353	21,499	27,012	28,714	30,084	29,150	28,050	31,469
billions of US$	8.4	9.3	9.6	10.3	10.8	12.2	10.9	11.2
Net domestic assets	36,634	37,354	34,989	37,296	44,942	47,892	57,537	62,933
Net credit to public sector	10,957	11,465	13,021	14,277	10,786	13,340	18,370	18,415
Credit to private sector	45,261	46,049	47,891	52,287	59,064	58,661	67,218	76,649
Other net	-19,585	-20,159	-25,922	-29,268	-24,909	-24,109	-28,051	-32,131
Broad money 2/	54,987	58,853	62,001	66,010	75,026	77,043	85,587	94,401
	(Annual percentage change)							
Credit to public sector, net	35.2	4.6	13.6	9.7	-4.3	-6.6	37.7	0.2
Credit to private sector	-8.6	1.7	4.0	9.2	11.5	12.2	14.6	14.0
Currency	16.3	14.8	19.7	19.6	14.9	15.5	11.4	10.3
Monetary base	10.0	8.8	21.1	17.8	13.0	15.9	16.1	9.3
Broad money 2/	-2.1	7.0	5.3	6.5	10.2	16.7	11.1	10.3
	(Percent of GDP)							
Credit to public sector, net	6.3	6.1	6.4	6.2	4.4	5.2	6.6	6.1
Credit to private sector	25.9	24.4	23.4	22.7	24.0	22.9	24.0	25.2
Currency	4.2	4.4	4.9	5.2	5.6	5.4	5.5	5.6
Monetary base	6.1	6.2	6.9	7.2	7.6	7.5	8.0	8.0
Broad money 3/	31.4	31.2	30.3	28.7	30.5	30.1	30.5	31.0
	(Annual percentage change)							
Central bank inflation target 3/	10.0	8.0	6.0	5.9	5.5	5.5	4.5-5.5	3-5
Consumer price index	8.8	7.6	7.0	6.5	...	5.5	5.0	4.5
Exchange rate (+ depreciation)	19.0	2.8	25.0	-3.0	...	-14.0	...	...
Memorandum item:								
Broad money/net international reserves	2.9	2.6	2.1	2.2	2.4	2.4	2.7	2.7

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

1/ Assets on and liabilities to nonresident entities. Net international reserves include liabilities in foreign currency to resident entities. Exclude valua effect.

2/ Currency in circulation plus deposit liabilities of the private sector.

3/ 2003 target was revised upward by 0.4 percentage point in account of the first round effect of the VAT reform.

Table 6. Colombia: Banking System Indicators 1/

(In percent)

	2000	2001	2002	2003	2004 2/
Capital adequacy ratio (with market risk) 3/	13.2	13.0	12.6	13.1	14.0
Regulatory Tier I capital to risk weighted assets	9.2	9.3	9.7	10.5	11.4
Capital to assets	11.3	11.2	11.0	11.5	11.9
Nonperforming loans net of provisions to capital	15.6	5.6	1.1	-3.8	-10.5
Nonperforming loans to total loans 4/ 5/	10.6	10.2	9.2	6.8	3.6
Classified loans 5/	18.7	18.1	16.0	12.1	7.9
Specific provisions to classified loans and leases	27.7	37.5	43.0	47.6	54.0
Sectoral distribution of loans to total loans 5/					
commercial	58.7	58.4	61.9	62.8	65.8
consumer	14.1	15.6	15.6	18.0	19.1
housing	27.2	26.0	21.7	18.1	14.1
Foreign currency loans to total loans	8.1	7.0	7.4	4.7	5.2
Return on average equity	-20.7	1.1	9.6	17.0	23.4
Return on average assets	-2.3	0.1	1.1	1.9	2.7
Interest margin to gross income	38.1	32.7	35.5	37.4	39.5
Noninterest expenses to gross income	93.7	85.6	80.7	69.8	59.8
Personnel expenses to noninterest income	36.2	37.3	38.3	38.4	41.5
Liquid assets to total assets 6/	12.9	16.5	19.7	18.7	18.0
Liquid assets to short-term liabilities 7/	20.4	25.2	30.2	29.0	28.1
Customer deposits to total (noninterbank) loans	122.3	136.1	136.1	136.0	126.2
Spread between reference lending and deposit rates	6.6	8.3	7.4	7.4	7.3
Spread between highest and lowest interbank rates					
Foreign currency liabilities to total liabilities	9.1	8.6	7.0	6.2	6.0
Net open position in equities to capital					
Net open position in foreign exchange to capital	-1.4	4.8	7.8	4.3	4.8

Sources: Superintendencia Bancaria; IFS; and Fund staff estimates.

1/ Excluding credit unions and public sector special institutions (IOE).
2/ Data to Sept. 2004 except data on foreign currency loans and liabilties, which are to June 2004. Returns are annualized as necessary.
3/ Market risks requirements, effective only as of 2001, are weighted 60 percent until 2003, 80 percent in 2003, and 100 percent thereafter.
4/ Loans past-due 90 days or more (120 days or more in the case of mortgages).
5/ Loan data includes leases as of 2004.
6/ Liquid assets include cash, deposits in other financial institutions and interbank repos, and securities held for trading.
7/ Customer deposits used as proxy for short-term liabilities.

Table 7. Colombia: Summary Balance of Payments, 2000-2006

	2000	2001	2002	2003	2004 Prog.	2004 Est.	Proj. 2005	Proj. 2006
	(In millions of U.S. dollars)							
Current account balance	**737**	**-1,114**	**-1,371**	**-1,191**	**-1,978**	**-1,013**	**-3,150**	**-2,858**
Trade balance	2,633	579	239	435	-222	1,016	-1,500	-1,465
Exports, f.o.b.	13,722	12,848	12,316	13,693	15,039	16,918	16,905	17,446
Coffee	1,069	764	772	806	913	1,012	1,129	1,145
Petroleum products	4,569	3,285	3,275	3,383	3,991	4,227	3,795	3,443
Non-traditional	6,200	6,613	6,287	6,120	6,560	7,793	7,789	8,634
Other	1,884	2,186	1,982	3,383	3,575	3,886	4,192	4,223
Imports, f.o.b.	11,090	12,269	12,077	13,258	15,260	15,902	18,405	18,911
Services (net)	-1,282	-1,433	-1,466	-1,513	-1,632	-1,568	-1,785	-1,845
Income (net)	-2,286	-2,615	-2,848	-3,446	-3,423	-4,123	-3,669	-3,576
Interest (net)	-1,663	-1,738	-1,905	-2,001	-2,282	-2,037	-2,026	-1,883
Of which : public sector	-889	-1,087	-1,262	-1,452	-1,660	-1,429	-1,555	-1,436
Other Income (net)	-623	-877	-944	-1,445	-1,141	-2,086	-1,643	-1,693
Current transfers (net)	1,673	2,354	2,704	3,334	3,299	3,661	3,804	4,027
Financial account balance	**24**	**2,475**	**1,303**	**810**	**2,690**	**3,245**	**2,295**	**3,171**
Public sector (net)	402	1,443	363	428	1,450	-327	-515	576
Nonfinancial public sector	1,243	1,915	495	720	1,513	60	-481	842
Medium- and long-term (net)	1,662	3,462	-1,093	1,457	748	934	-613	-347
Disbursements	3,238	5,743	2,469	4,915	2,723	2,889	3,145	1,922
Amortization	1,576	2,281	3,561	3,459	1,975	1,955	3,759	2,269
Other long-term flows	-40	-35	-30	-30	-26	-50	-29	-29
Short term 1/	-379	-1,512	1,617	-707	792	-825	161	1,218
Of which : change in public as	-259	-1,534	1,567	-570	792	-939	161	1,218
Financial public sector	-841	-473	-131	-293	-63	-387	-35	-267
Private sector (net)	-378	1,032	939	382	1,240	3,572	2,811	2,595
Nonfinancial private sector (net)	28	1,063	1,113	823	1,063	3,067	2,392	2,596
Direct investment	2,069	2,509	1,258	855	1,265	2,646	2,343	2,137
Of which : Privatization	465	0	0	0	0	0	0	0
Leasing finance	-109	-211	-160	-319	-278	107	-214	-133
Long-term loans	-479	126	-970	-726	-243	-1,109	337	567
Short term 2/	-1,453	-1,360	985	1,012	319	1,423	-75	25
Financial private sector (net)	-406	-31	-174	-441	176	505	418	-1
Net errors and omissions	**108**	**-143**	**207**	**197**	**0**	**351**	**0**	**0**
Changes in GIR 3/	**870**	**1,217**	**138**	**-184**	**712**	**2,583**	**-855**	**313**
Changes in NIR, program definition	**687**	**1,182**	**525**	**17**	**883**	**2,671**	**-855**	**313**
	(In percent of GDP)							
Current account balance	0.9	-1.4	-1.7	-1.5	-2.2	-1.1	-2.9	-2.6
	(In months of imports of goods and services)							
Gross international reserves 4/	6.8	8.0	7.8	6.6	7.2	8.1	6.5	6.7

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

1/ Includes movements of short-term assets owned by the public sector abroad.
2/ Includes net portfolio investment.
3/ Does not include valuation changes of reserves denominated in other currencies than U.S. dollars.
4/ Not including Fund purchases under the standby arrangement.

Table 8. Colombia: Medium-Term Outlook

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
I. Output and Prices											
(Annual percentage changes)											
Real GDP	2.9	1.5	1.9	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Consumer prices											
End of period	8.7	7.6	7.0	6.5	5.5	5.0	4.5	3.5	3.0	3.0	3.0
Period average	9.2	8.0	6.3	7.1	5.9	5.2	4.8	4.0	3.3	3.0	2.5
(In percent of GDP, unless indicated otherwise)											
II. Saving and investment											
Gross national saving	14.6	13.2	12.6	13.5	12.9	12.5	14.4	14.8	15.3	15.9	16.3
Private sector	10.0	8.3	9.2	8.0	6.4	7.5	8.9	8.4	8.7	9.1	9.2
Public sector	4.5	5.1	3.3	5.5	6.5	5.0	5.5	6.4	6.6	6.9	7.0
Gross domestic investment	13.7	14.5	14.2	14.9	14.0	15.3	17.0	17.5	17.9	18.5	18.8
Private sector	5.8	6.2	6.1	6.4	6.1	7.8	9.5	9.1	9.5	10.1	10.4
Public sector capital expenditure	7.9	8.3	8.1	8.5	7.8	7.5	7.5	8.4	8.4	8.4	8.4
External current account balance	0.9	-1.4	-1.7	-1.5	-1.0	-2.8	-2.6	-2.7	-2.6	-2.6	-2.5
Private sector	4.2	1.9	1.9	1.2	0.3	-0.3	-0.6	-0.7	-0.8	-1.0	-1.2
Public sector	-3.4	-3.2	-3.6	-2.6	-1.3	-2.5	-2.0	-2.0	-1.8	-1.5	-1.4
III. Nonfinancial and consolidated public sector											
Nonfinancial public sector											
Revenue	28.0	29.6	29.6	30.7	31.6	31.2	31.3	31.0	31.1	31.1	31.0
Expenditure	31.5	33.3	33.8	33.6	33.1	33.7	33.4	33.2	33.2	33.0	32.7
Current expenditure	23.6	24.9	25.6	25.2	25.4	26.2	25.8	24.8	24.8	24.6	24.3
Capital expenditure	7.9	8.3	8.1	8.5	7.8	7.5	7.5	8.4	8.4	8.4	8.4
Primary balance	0.9	1.5	0.4	1.7	2.7	2.7	2.7	2.6	2.6	2.6	2.6
Overall balance	-3.5	-3.5	-4.2	-3.2	-1.7	-2.5	-2.1	-2.3	-2.1	-1.9	-1.8
Combined public sector balance	-3.4	-3.2	-3.7	-2.7	-1.3	-2.5	-2.0	-2.0	-1.8	-1.5	-1.4
IV. Financial system											
Velocity (GDP / broad money)	3.2	3.2	3.3	3.5	3.3	3.3	3.2	3.2	3.2	3.2	3.2
Real growth in private sector credit	-16.3	-5.8	-2.2	1.9	5.9	8.9	8.9	10.8	7.1	6.1	6.3
V. Balance of payments											
External current account balance	0.9	-1.4	-1.7	-1.5	-1.0	-2.8	-2.6	-2.7	-2.6	-2.6	-2.5
Trade balance	3.1	0.7	0.3	0.5	1.0	-1.3	-1.3	-2.0	-1.9	-1.7	-1.4
Exports	16.4	15.7	15.1	17.1	17.4	15.1	15.7	15.4	15.8	16.3	17.0
Imports	13.2	15.0	14.8	16.6	16.3	16.4	17.0	17.4	17.7	18.0	18.5
Capital and financial account balance	0.0	3.0	1.6	1.0	3.3	2.0	2.9	3.1	3.0	3.0	3.0
Public sector	0.5	1.8	0.4	0.5	-0.3	-0.5	0.5	0.5	0.2	0.3	0.4
Private sector	-0.5	1.3	1.2	0.5	3.7	2.5	2.3	2.7	2.8	2.7	2.5
Overall balance	1.0	1.5	0.2	-0.2	2.7	-0.8	0.3	0.4	0.5	0.5	0.4
VI. Debt											
Total external debt	46.1	47.5	52.3	46.0	37.1	35.9	36.2	35.6	34.1	32.9	31.9
Public debt	26.3	28.5	31.9	29.6	24.1	22.7	22.5	21.9	20.8	20.0	19.3
Private debt	19.8	19.0	20.4	16.3	13.0	13.1	13.7	13.6	13.2	12.9	12.7
Total public debt	47.7	51.8	60.2	56.0	52.9	50.4	49.8	48.2	46.2	44.5	42.7
Domestic debt	21.4	23.2	28.3	26.4	28.8	27.7	27.3	26.2	25.4	24.5	23.5
External debt	26.3	28.5	31.9	29.6	24.1	22.7	22.5	21.9	20.8	20.0	19.3
Memorandum items:											
Nominal GDP (billions of Col$)	174,896	188,559	204,530	230,091	255,984	280,267	304,051	332,333	359,876	386,199	413,546
U.S. LIBOR	6.6	3.7	1.9	1.2	1.8	3.2	3.8	4.3	4.7	5.0	5.0

Sources: Colombian authorities; and Fund staff estimates.

Table 9. Colombia: External Debt Sustainability Framework, 2000-2010
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2000	2001	2002	2003	2004			2005	2006	2007	2008	2009	2010	
								I. Baseline Projections						**Debt-stabilizing non-interest current account 6/**
1 **External debt**	46.1	47.5	52.3	46.0	37.1			**35.9**	**36.2**	**35.6**	**34.1**	**32.9**	**31.9**	**-1.6**
2 Change in external debt	0.6	1.5	4.8	-6.3	-8.9			-1.2	0.3	-0.6	-1.5	-1.2	-0.9	
3 Identified external debt-creating flows (4+8+9)	-2.2	-3.8	7.4	-6.8	-12.0			-0.7	-0.8	-0.7	-0.8	-0.8	-0.7	
4 Current account deficit, excluding interest payments	-4.1	-2.0	-1.6	-1.5	-1.4			0.4	0.2	0.5	0.2	0.2	0.2	
5 Deficit in balance of goods and services	-10.2	-7.8	-7.6	-6.9	-6.3			-4.1	-4.2	-3.4	-3.4	-3.4	-3.6	
6 Exports	20.1	18.3	19.9	18.8	17.7			17.4	18.0	17.3	17.6	18.0	18.7	
7 Imports	9.9	10.5	12.2	11.9	11.5			13.3	13.8	13.9	14.2	14.6	15.1	
8 Net non-debt creating capital inflows (negative)	-2.6	-3.0	-1.8	-1.0	-2.5			-2.1	-2.0	-2.1	-2.1	-2.1	-2.0	
9 Automatic debt dynamics 1/	4.6	1.2	10.8	-4.3	-8.1			1.0	1.0	0.9	1.0	1.1	1.1	
10 Contribution from nominal interest rate	3.1	3.4	3.5	2.9	2.3			2.5	2.4	2.2	2.4	2.4	2.3	
11 Contribution from real GDP growth	-1.4	-0.6	-1.1	-1.8	-1.4			-1.5	-1.4	-1.4	-1.3	-1.3	-1.2	
12 Contribution from price and exchange rate changes 2/	2.8	-1.5	8.3	-5.4	-9.0			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	2.8	5.3	-2.6	0.5	3.1			-0.5	1.1	0.1	-0.7	-0.4	-0.2	
External debt-to-exports ratio (in percent)	229.1	260.1	263.3	244.5	209.4			206.3	201.1	205.8	193.4	182.4	170.5	
Gross external financing need (in billions of US dollars) 4/	7.4	9.0	11.5	11.2	10.7			15.3	14.0	14.5	15.9	16.5	17.7	
in percent of GDP	9.4	10.9	16.2	13.5	10.0			14.0	12.9	12.7	13.0	12.8	12.9	
Key Macroeconomic Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	2.9	1.5	1.9	4.0	4.0	2.1	2.6	4.0	4.0	4.0	4.0	4.0	4.0	4.0
GDP deflator in US dollars (change in percent)	-5.8	3.4	-14.9	11.5	24.4	1.4	12.5	-2.0	-4.3	1.0	2.6	1.9	2.0	0.2
Nominal external interest rate (in percent)	6.7	7.7	6.4	6.5	6.6	7.1	0.6	6.8	6.6	6.5	7.1	7.4	7.5	7.0
Growth of exports (US dollar terms, in percent)	12.8	-4.6	-5.7	9.8	21.9	6.3	9.4	0.0	3.0	0.9	8.6	8.4	10.3	5.2
Growth of imports (US dollar terms, in percent)	9.0	11.4	1.1	12.8	24.4	1.1	21.1	18.5	2.9	6.1	9.2	8.5	9.9	9.2
Current account balance, excluding interest payments	4.1	2.0	1.6	1.5	1.4	0.3	2.9	-0.4	-0.2	-0.5	-0.2	-0.2	-0.2	-0.3
Net non-debt creating capital inflows	2.6	3.0	1.8	1.0	2.5	2.4	1.1	2.1	2.0	2.1	2.1	2.1	2.0	2.1
								II. Stress Tests for External Debt Ratio						**Debt-stabilizing non-interest current account 6/**
A. Alternative Scenarios														
A1. Key variables are at their historical averages in 2005-09 5/								**35.9**	**33.9**	**32.9**	**31.6**	**30.3**	**29.2**	**-1.4**
B. Bound Tests														
B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								**35.9**	**36.8**	**36.9**	**35.4**	**34.2**	**33.3**	**-1.6**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**35.9**	**38.8**	**40.9**	**39.1**	**37.7**	**36.6**	**-1.9**
B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								**35.9**	**45.1**	**58.1**	**55.4**	**53.2**	**51.5**	**-2.7**
B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								**35.9**	**41.5**	**46.1**	**44.6**	**43.5**	**42.7**	**-1.5**
B5. Combination of B1-B4 using one standard deviation shocks								**35.9**	**43.6**	**53.6**	**51.6**	**50.0**	**48.9**	**-2.1**
B6. One time 30 percent nominal depreciation in 2005								**35.9**	**47.1**	**46.2**	**44.1**	**42.4**	**41.2**	**-2.1**

1/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, ε = nominal appreciation (increase in dollar value of domestic currency), and α = share of domestic-currency denominated debt in total external debt.
2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) and rising inflation (based on GDP deflator).
3/ For projection, line includes the impact of price and exchange rate changes.
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.
5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 10. Colombia: Public Sector Debt Sustainability Framework, 2000-2010

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	
								I. Baseline Projections				**Debt-stabilizing primary balance 10/**
1 **Public sector debt 1/**	47.7	51.8	60.2	56.0	52.9	**50.4**	**49.8**	**48.2**	**46.2**	**44.5**	**42.7**	**1.6**
o/w foreign-currency denominated	26.3	28.5	31.9	29.6	24.1	22.7	22.5	21.9	20.8	20.0	19.3	
2 Change in public sector debt	6.4	4.1	8.5	-4.2	-3.1	-2.5	-0.6	-1.6	-2.0	-1.7	-1.7	
3 Identified debt-creating flows (4+7+12)	1.9	0.9	7.1	-4.7	-8.1	-2.1	-1.8	-1.9	-1.5	-1.2	-1.1	
4 Primary deficit	-0.9	-1.3	-0.5	-1.9	-3.0	-2.5	-2.6	-2.6	-2.6	-2.6	-2.6	
5 Revenue and grants	28.0	29.5	29.3	30.2	31.6	31.1	31.3	31.0	31.1	31.1	31.0	
6 Primary (noninterest) expenditure	27.1	28.2	28.9	28.3	28.6	28.7	28.7	28.3	28.5	28.4	28.3	
7 Automatic debt dynamics 2/	3.3	2.3	7.5	-2.8	-5.2	0.3	0.7	0.6	1.0	1.4	1.5	
8 Contribution from interest rate/growth differential 3/	-1.1	1.6	0.4	-1.9	-1.2	0.3	0.7	0.6	1.0	1.4	1.5	
9 Of which contribution from real interest rate	-0.1	2.2	1.3	0.2	0.8	2.3	2.6	2.5	2.8	3.1	3.1	
10 Of which contribution from real GDP growth	-1.0	-0.7	-0.9	-2.1	-2.0	-1.9	-1.9	-1.8	-1.8	-1.7	-1.7	
11 Contribution from exchange rate depreciation 4/	4.4	0.7	7.1	-0.9	-4.0	...	...	...	...	...	...	
12 Other identified debt-creating flows	-0.5	0.0	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	
13 Privatization receipts (negative)	-0.5	0.0	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	4.5	3.1	1.3	0.5	5.0	-0.4	1.2	0.3	-0.4	-0.5	-0.6	
Public sector debt-to-revenue ratio 1/	170.3	175.4	205.3	185.2	167.1	161.9	159.3	155.6	148.8	143.3	138.1	
Gross financing need 6/	5.9	6.3	8.4	7.5	3.7	6.1	4.5	4.5	4.2	3.9	3.5	
in billions of U.S. dollars	5.0	5.1	6.8	6.0	3.6	6.9	5.0	5.1	5.1	5.0	4.8	
Key Macroeconomic and Fiscal Assumptions												Projected Average
Real GDP growth (in percent)	2.9	1.5	1.9	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Average nominal interest rate on public debt (in percent) 7/	12.3	11.3	9.4	8.9	8.9	10.2	10.1	10.7	10.6	10.5	10.6	10.4
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	0.2	5.1	2.9	0.8	1.9	4.9	5.8	5.6	6.4	7.3	7.6	6.3
Nominal appreciation (increase in US dollar value of local currency, in percent)	-15.9	-2.7	-20.0	3.1	16.3	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	12.1	6.2	6.4	8.2	7.0	5.3	4.3	5.1	4.1	3.2	3.0	4.2
Growth of real primary spending (deflated by GDP deflator, in percent)	-5.5	5.5	4.5	1.9	5.2	4.1	4.0	2.9	4.5	3.9	3.7	3.8
Primary deficit	-0.9	-1.3	-0.5	-1.9	-3.0	-2.5	-2.6	-2.6	-2.6	-2.6	-2.6	-2.6
								II. Stress Tests for Public Debt Ratio				**Debt-stabilizing primary balance**
A. Alternative Scenarios												
A1. Key variables are at their historical averages in 2005-09 8/						**50.4**	**49.6**	**48.0**	**45.7**	**43.3**	**40.9**	**-1.0**
B. StressTests												
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006						**50.4**	**50.6**	**49.8**	**47.8**	**46.2**	**44.5**	**1.7**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006						**50.4**	**55.8**	**62.7**	**65.4**	**68.6**	**71.9**	**2.7**
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006						**50.4**	**55.1**	**58.9**	**57.2**	**55.9**	**54.6**	**2.1**
B4. Combination of B1-B3 using one standard deviation shocks						**50.4**	**54.6**	**58.0**	**56.3**	**54.9**	**53.4**	**2.0**
B5. One time 30 percent real depreciation in 2005 9/						**50.4**	**59.6**	**58.2**	**56.6**	**55.2**	**53.9**	**2.0**
B6. 10 percent of GDP increase in other debt-creating flows in 2005						**50.4**	**59.8**	**58.5**	**56.8**	**55.5**	**54.1**	**2.0**
C. Country Specific tests												
C1. Per capita real GDP is constant from 2005 thru 2010						**51.6**	**52.7**	**52.0**	**50.9**	**50.2**	**49.5**	
C2. Primary balance falls by 0.5 of GDP from 2006 thru 2010						**50.4**	**50.4**	**49.4**	**48.1**	**47.0**	**46.0**	

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; α = 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/ For projections, this line includes exchange rate changes.

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

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

8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

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

10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 11. Colombia: External Financing Requirements and Sources, 2000-2006

(In millions of U.S. dollars)

					Est.	Proj.	
	2000	2001	2002	2003	2004	2005	2006
1. Gross financing requirements	8,801	10,226	11,655	11,180	11,865	14,249	14,338
External current account deficit	-737	1,114	1,371	1,191	1,013	3,150	2,858
Debt amortization	8,668	7,894	10,146	10,173	8,269	11,953	11,167
Medium and long term debt	5,728	5,380	7,023	6,681	4,903	6,951	5,912
Public sector	2,128	2,824	3,821	3,670	2,100	3,796	2,561
Private sector	3,601	2,556	3,202	3,011	2,804	3,155	3,352
Short-term debt 1/	2,940	2,514	3,122	3,492	3,365	5,002	5,254
Public sector	672	199	320	429	224	389	389
Private sector	2,267	2,315	2,802	3,063	3,141	4,614	4,866
Gross reserves accumulation	870	1,217	138	-184	2,583	-855	313
2. Available financing	8,801	10,226	11,655	11,180	11,865	14,249	14,338
Foreign direct investment (net)	2,069	2,509	1,258	855	2,646	2,343	2,137
Medium and long-term debt disbursements	5,645	7,904	4,239	6,485	4,357	6,076	5,374
Public sector	3,238	5,763	2,518	4,934	2,904	3,148	1,947
of which : multilaterals	...	...	856	2404	1,194	1,992	...
Private sector	2,407	2,141	1,720	1,551	1,452	2,928	3,427
Public sector use of external assets	-259	-1,534	1,567	-570	-939	161	1,218
Short-term debt 2/	2,514	3,122	3,492	3,365	5,002	5,254	5,304
Public sector	199	320	429	224	389	389	389
Private sector	2,315	2,802	3,063	3,141	4,614	4,866	4,915
Other capital flows (net) 3/	-1,169	-1,775	1,099	1,044	799	414	306
Exceptional financing and arrears	0	0	0	0	0	0	0
of which: IMF 4/	0	0	0	0	0	0	0
3. Financing gap	0	0	0	0	0	0	0
Memorandum items (in stocks):							
Gross international reserves	9,006	10,245	10,844	10,674	13,264	12,409	12,721
Net international reserves (traditional concept) 5/	9,004	10,192	10,841	10,668	13,258	12,403	12,715
Net international reserves (program definition) 6/	8,800	9,982	10,507	10,524	13,195	12,340	12,653

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 (Country Report 03/135).

Table 12. Colombia: Schedule of Purchases Under the SBA, 2005-2006

Date	Amount (In millions of SDR)	Amount (In percent of quota)	Conditions
May 2, 2005	193.50	25.0	Board approval.
September 15, 2005	42.30	5.5	Observance of end-June 2005 performance criteria and completion of first review.
December 15, 2005	42.30	5.5	Observance of end-September 2005 performance criteria.
March 15, 2006	42.30	5.5	Observance of end-December 2005 performance criteria and completion of second review.
June 15, 2006	42.30	5.5	Observance of end-March 2006 performance criteria.
September 15, 2006	42.30	5.5	Observance of end-June 2006 performance criteria and completion of third review.
Total	**405.00**	**52.3**	

Source: Fund staff estimates.

Table 13. Colombia: Indicators of Capacity to Repay the Fund, 2005-10 1/

	2005	2006	2007	2008	2009	2010
Fund repurchases and charges						
In millions of SDRs	5.6	11.4	13.1	74.4	185.5	144.3
In millions of U.S. dollars	8.5	17.3	19.9	113.2	282.1	219.2
In percent of exports of goods and NFS	0.0	0.1	0.1	0.5	1.2	0.9
In percent of GDP	0.0	0.0	0.0	0.1	0.2	0.2
In percent of quota	0.7	1.5	1.7	9.6	24.0	18.6
In percent of overall debt service	0.1	0.1	0.1	0.7	1.8	1.3
In percent of gross foreign reserves	0.1	0.1	0.1	0.8	1.9	1.5
Fund credit outstanding						
In millions of SDRs	299.8	405.0	405.0	343.3	167.0	26.2
In millions of U.S. dollars	456.2	616.2	616.4	522.3	253.9	39.8
In percent of exports of goods and NFS	2.4	3.2	3.1	2.4	1.1	0.2
In percent of GDP	0.4	0.6	0.5	0.4	0.2	0.0
In percent of quota	38.7	52.3	52.3	44.4	21.6	3.4
In percent of overall debt service	3.1	4.6	4.6	3.4	1.6	0.2
In percent of gross foreign reserves	3.5	4.6	4.5	3.7	1.7	0.3
(In millions of U.S. dollars; unless otherwise stated)						
Memorandum items						
Exports of goods and NFS	18,984	19,550	19,725	21,426	23,228	25,625
Quota (millions of SDRs)	774	774	774	774	774	774
GDP	112,270	111,156	114,634	121,814	129,073	136,886
U.S. dollar per SDR (WEO projection)	1.522	1.522	1.522	1.521	1.520	1.519
Public sector external debt	24,825	24,486	25,034	25,323	25,739	26,340
Overall external debt service	14,492	13,347	13,528	15,168	15,939	17,192
Overall external debt	39,258	39,378	40,604	41,764	42,942	44,241
Gross foreign reserves	12,861	13,334	13,812	14,284	14,603	14,999

Source: Fund staff estimates.

1/ Projections assume that scheduled purchases under the proposed Stand-By Arrangement are made.

COLOMBIA: FUND RELATIONS

(As of February 28, 2005)

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	117.15	102.

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	April 14, 2005	1,548.00	0.00
EFF	Dec. 20, 1999	Dec. 19, 2002	1,957.00	0.00

VI. Projected Obligations to Fund (in SDR Million):

			Forthcoming		
Type	**20005**	**2006**	**2007**	**2008**	**2009**
Principal	0	0	0	0	0
Charges/Interest	0.01	0.01	0.01	0.01	0.01
Total	0.01	0.01	0.01	0.01	0.01

VII. Safeguards Assessments:

Under the safeguards policy, Colombia was 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, 2003. The assessment noted no significant vulnerabilities.

VIII. Exchange Rate Arrangement:

In September 1999 the Banco de la República floated the peso. The authorities accepted the obligations of Article VIII in August 2004. At end-February 2005, the exchange rate was Col$2,324 per U.S. dollar.

IX. Last Article IV Consultation:

The 2002 Article IV consultation was concluded on January 15, 2003.

X. FSAP Participation:

The Executive Board discussed the Financial Sector Stability Assessment (FSSA) in 1999.

XI. Statistics: Colombia subscribes to the SDDS.

XII. Recent Technical Assistance:

Dept.	**Purpose**	**Time of Delivery**
FAD	Advice on the reform of the budget code	March 2003
FAD	Follow-up on the reform of the budget code	November 2003
MFD	Inflation forecast under inflation target framework	May 2004
FAD	Assessment of fiscal decentralization	May 2004

XIII. Resident Representative: None.

XIV. Fourth Amendment: Colombia has accepted this amendment.

COLOMBIA: WORLD BANK RELATIONS[7]

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 (WBG's) strategy seeks to support Colombia's quest for development and peace. The Country Assistance Strategy (CAS) for Colombia was discussed by the Bank's Board in January 2003 and since then, Colombia has received US$1.5 billion in loans to date. Between 50–60 percent of the lending program would consist of fast-disbursing operations. A CAS Progress Report will be prepared for July 2005.

The World Bank Program for FY 2005–06

In line with the CAS, since June 2004, the IBRD has continued the preparation of adjustment loans to support fiscal adjustment, financial sector adjustment, the labor and social sector reform, and environmental management. Labor and social sector reforms are being supported by a technical assistance loan that aims at improving knowledge, developing effective instruments, and strengthening ability to carry out such reforms. The environment adjustment loan is being complemented by a technical assistance loan to support the inclusion of environmental and social policies in government programs and to strengthen the capacity of the major relevant institutions.

The IBRD will also support a program in the infrastructure sector, covering water supply and sanitation services and a project to reduce Colombia's vulnerability to natural disasters in terms of state fiscal liability. IFC focuses on supporting new forms of public-private partnership. MIGA focuses 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.

Bank-Fund Collaboration in Specific Areas

The WBG 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.

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[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 (IBRD/IDA and grants)
As of March 1, 2005
(In millions of U.S. dollars)

Closed Projects	**163**
Active Projects	**15**
IBRD/IDA *	
Total Disbursed (Active)	303.4
Of which has been repaid	0.0
Total Disbursed (Closed)	10,045.1
Of which has been repaid	8,423.8
Total Disbursed (Active + Closed)	10,348.5
Of which has been repaid	8,423.8
Total Undisbursed (Active)	674.9
Total Undisbursed (Closed)	0.3
Total Undisbursed (Active + Closed)	675.2

Loan Information (IBRD)
As of March 1, 2005
(In millions of U.S. dollars)

Fiscal Year*	2001	2002	2003	2004	2005
Total disbursements	264	369	948	491	403
Repayment amount	225	243	223	205	156
Net disbursements	39	126	725	286	247

* Fiscal Year: July 1–June 30.

IFC Operations
As of January 1, 2005
(In millions of U.S. dollars)

	Loans	**Equity (+Quasi)**	**Participation**	**Total**
Total commitments	299.6	129.0	117.2	545.8
Total undisbursed	102.2	19.8	95.2	217.2

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

(As of February 25, 2005)

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: (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. These objectives constitute the framework for the Bank activities in Colombia.

To help **reinvigorate the economy** the Bank will foster competitiveness and will 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 social protection systems and will promote the coverage, quality, and efficiency of essential social services. In the **governance and modernization of the State** area the Bank will support national public sector reforms and local governments management capacity building, moreover, the Bank will promote initiatives to foster transparency and combat corruption, and will support judicial branch reforms.

From the Bank's standpoint, the implementation of the strategy is constrained by the country's fiscal deficit and the armed conflict. Both constraints have implications for the size of the lending program, the mix of lending and non-lending products, and the prospects for achieving the strategy objectives.

II. LENDING

As of February 25, 2005 the country's portfolio consists of 26 loans an amount equivalent to US$1,901 million. These resources are distributed among 24 investment loans (US$ 901 million) and two policy-based loans (US$1,000 million). In addition, the country portfolio with Colombia includes 45 non-reimbursable technical cooperation (US$25,7 million) and four small projects (US$1.67 million). Through the Multilateral Investment Fund (MIF), which finances private sector investment projects, Colombia has 30 non-reimbursable operations (US$18.3 million).

In 2004 six loans for US$737 million were approved. These operations include policy-based loans to support the Public Utilities Reform (US$600 million). In 2005, the Bank estimates the approval of seven investment loans by US$ 626.1 million (in the areas of transportation, health, citizens security, energy and agriculture) and a policy-based loan by US$ 400 million to support the Country's Competitiveness Strategy.

[1] **Prepared by IADB staff. Questions may be addressed to Mr. Luis Giorgio, Country Officer, at (202) 623-1663 or giorgio@iadb.org.**

COLOMBIA: FINANCIAL RELATIONS WITH THE INTER-AMERICAN DEVELOPMENT BANK
(As of February 28, 2005)

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

	Commitments	Disbursements	Undisbursed amounts
Agricultural and rural development	92.1	83.1	9.0
Modernization of State	692.7	248.8	443.9
Social Investment	312.2	218.8	93.4
Education	26.0	13.9	12.1
Health	472.0	265.0	207.0
Sanitation	49.4	31.3	18.1
Natural resource management	55.4	30.4	25.0
Urban development and household	180.0	14.8	165.2
Transportation	21.7	14.3	7.4
Grand total	**1,901.5**	**920.4**	**981.2**

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

	1998	1999	2000	2001	2002	2003	2004*	2005**
Gross disbursement	412.9	952.4	241.2	785.3	151.8	2,011.7	332.0	835.2
Amortization, interest and contributions	369.1	445.8	473.2	408.2	819.4	1,017.5	648.6	534.1
Net cash flow	43.8	506.6	-232.0	377.1	-667.6	994.2	-316.6	301.1

(*) Preliminary.
(**) Projections.

Source: IADB.

COLOMBIA: WORK PROGRAM

Mission to conduct first review of SBA program.	July 2005.
Board discussion of First review.	September 2005.

COLOMBIA: STAND-BY ARRANGEMENT

Attached hereto is a letter (the "Letter"), with an annexed Memorandum of Economic Policies (the "Memorandum") and a Technical Memorandum of Understanding (the "Technical Memorandum"), dated April 13, 2005, from the Minister of Finance and Public Credit and the General Manager of the Bank of the Republic requesting a Stand-By Arrangement and setting forth:

(a) the objectives and policies that the authorities of Colombia intend to pursue for the period of this Stand-By Arrangement; and

(b) understandings of Colombia with the Fund regarding reviews that will be made of progress in realizing the objectives of the program, and of the policies and measures that the authorities of Colombia will pursue for the remaining period of this Stand-By Arrangement.

To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period from May 2, 2005 to November 2, 2006, Colombia will have the right to make purchases from the Fund in an amount equivalent to SDR 405 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. (a) Purchases under this Stand-By Arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 193.5 million until September 15, 2005, the equivalent of SDR 235.8 million until December 15, 2005, the equivalent of SDR 278.1 million until March 15, 2006, the equivalent of SDR 320.4 million until June 15, 2006 and the equivalent of SDR 362.7 million until September 15, 2006.

(b) None of the limits in (a) above shall apply to a purchase under this Stand-By Arrangement that would not increase the Fund's holdings of Colombia's currency subject to repurchase beyond 25 percent of quota.

3. Colombia will not make purchases under this Stand-By Arrangement that would increase the Fund's holdings of Colombia's currency subject to repurchase beyond 25 percent of quota:

(a) during any period in which the data at the end of the preceding period indicate that:

(i) the ceiling on the overall deficit of the combined public sector, or

(ii) the floor on the net international reserves of the central bank, or

(iii) the ceiling on the net disbursement of short-term external debt of the Public Sector, or as specified in Table 3 of the Memorandum and as further specified, respectively, in Section IV.A, Section VI.A, and Section VI.C of the Technical Memorandum is not observed; or

(b) until Colombia has consulted with the Fund as provided for in Section V of the Technical Memorandum; or

(c) until Colombia has consulted with the Fund as provided for in Section VI.A of the Technical Memorandum; or

(d) if Colombia fails to carry out its intentions with respect to the following structural performance criteria:

(i) By June 30, 2005 approve the changes to the budget law as specified in Table 4 of the Memorandum, or

(ii) By July 31, 2005, submit to Congress a 2006 budget as specified in Table 4 of the Memorandum; or

(e) after September 14, 2005, March 14, 2006 and September 14, 2006, until the reviews contemplated in paragraph 75 of the Memorandum are completed; or

(f) if at any time during the period of the Stand-By Arrangement, Colombia

(i) imposes or intensifies restrictions on the making of payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements that are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons, or

When Colombia is prevented from purchasing under this Stand-By Arrangement because of this paragraph 3, purchases will be resumed only after consultation has taken place between the Fund and Colombia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

4. Colombia will not make purchases under this Stand-By Arrangement during any period in which Colombia: (i) has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation (a) in respect of a noncomplying purchase pursuant to Decision No. 7842-(84/165) on the Guidelines on Corrective Action, or (b) in respect of a purchase in support of debt and debt service reduction operations pursuant to Decision No. 9931-(89/167), or (c) pursuant to subparagraph 17 and 31 of Decision No. 8955-(88/126) on

the Compensatory Financing Facility, or (d) in respect of a purchase under Decision No. 11627-(97/123) SRF on the Supplemental Reserve Facility and Contingent Credit Lines, or (e) pursuant to paragraph 1(b) of Decision No. 5703-(78/39) or paragraph 10(a) of decision No. 4377-(74/114); or (ii) is failing to meet a repayment obligation to the PRGF Trust established by Decision No. 8759-(87/176) PRGF, or a repayment expectation to that Trust pursuant to the provisions of Appendix I to the PRGF Trust Instrument.

5. Colombia's right to engage in transactions covered by this Stand-By Arrangement can be suspended only with respect to requests received by the Fund after: (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or limit the eligibility of Colombia. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Colombia and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this Stand-By Arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, unless, at the request of Colombia, the Fund agrees to provide SDRs at the time of the purchase.

7. Colombia shall pay a charge for this Stand-By Arrangement in accordance with the decisions of the Fund.

8. (a) Colombia shall repurchase the amount of its currency that results from a purchase under this Stand-By Arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Colombia's balance of payments and reserve position improves.

(b) Any reductions in Colombia's currency held by the Fund shall reduce the amount subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of reduction.

9. During the period of the Stand-By Arrangement Colombia shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Colombia or of representatives of Colombia to the Fund. Colombia shall provide the Fund, with such information as the Fund requests in connection with the progress of Colombia in achieving the objectives and policies set forth in the attached Letter and annexed memoranda.

10. In accordance with paragraph 76 of the Memorandum, Colombia will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government or whenever the Managing Director requests consultation because of the criteria in paragraph 3 above have not been observed or because the Managing Director considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Colombia has outstanding purchases in the upper credit tranches, the government

will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Colombia's balance of payments policies.

Attachment

Bogotá, Colombia
April 13, 2005

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Rato:

The government remains fully committed to promoting faster sustainable and equitable economic growth through the implementation of a strong economic program in 2005 and 2006, which is explained in the attached Memorandum of Economic Policies and Technical Memorandum of Understanding.

We are requesting the Fund's support for this program through a new 18-month Stand-By Arrangement (SBA) in the amount of SDR 405 million (35 percent of quota on an annual basis), with these resources to become available on a quarterly basis. The government will treat the new arrangement as precautionary. We would also like to cancel the SBA that expires on May 14, 2005 simultaneously with the approval of the new program.

We are also requesting completion of the final review under the current Stand-By Arrangement. All quantitative performance criteria at end-2004 have been observed and most structural benchmarks have been met (Tables 1 and 2). In this regard, we are requesting a waiver of the condition for the completion of the fourth review calling for congressional approval of the revised budget code. We will strive to have this legislation approved by Congress by June 2005, which will be a structural performance criterion under the new arrangement. We are also requesting a waiver for the nonobservance of the performance criterion on the nonintroduction of a multiple currency practice, which was created by the subsidies for banana and flower exports introduced in December 2004. The deadline for applying for these subsidies was February 28, 2005. Now no one is eligible for these subsidies.

Sincerely yours,

/S/	/S/
Alberto Carrasquilla Minister of Finance and Public Credit	Gerardo Hernandez Acting General Manager Banco de la República

Annexes

MEMORANDUM OF ECONOMIC POLICIES

Introduction

48. When it took office in August 2002, this government embarked on a medium-term strategy to foster steady economic growth by reducing the vulnerability of the economy. As a result, real economic growth rose from 1.9 percent in 2002 to 4 percent a year (about 2½ percent a year in per capita terms) in 2003–04. The urban unemployment rate declined from17.6 percent at end-2002 to 15.4 percent at end-2004. Inflation declined from 7 percent during 2002 to 5.5 percent during 2004, as targeted. The external current account deficit fell to about 1 percent of GDP in 2004, aided by high world prices of oil and coal and a recovery in exports to Venezuela. At the same time, net capital inflows picked up sharply to 3.3 percent of GDP in 2004. To reduce the external vulnerability of the economy and to limit the upward pressures on the peso, the Banco de la República made significant purchases of foreign exchange, raising net international reserves to US$13.2 billion (123 percent of short-term debt on a remaining maturity basis).

49. Economic reforms—centered on fiscal discipline—were an essential component of this strategy. Congress approved a number of the government's initiatives to strengthen the medium-term sustainability of the fiscal position, with a view to reducing public debt to less than 45 percent of GDP by 2010. Through revenue enhancements as well as improved administration, tax revenues rose from 19.2 percent of GDP in 2002 to 20.3 percent of GDP in 2004. Pension reforms in December 2002 and May 2003 helped lower the actuarial deficit of the pension system from 207 percent of GDP to 187 percent of GDP. At the same time, the central government continued to exercise expenditure restraint, while local and regional governments—benefiting from several laws adopted earlier this decade that strengthened Colombia's system of decentralization—continued to run moderate surpluses.

50. In 2004, the combined public sector (CPS) deficit experienced an unusually sharp decline to 1.3 percent of GDP, compared with an adjusted program target of 2.1 percent of GDP[8] and a deficit of 3.7 percent of GDP in 2002 (Table 3). The central government (which comprises the central administration, social security and decentralized agencies) performed broadly as expected, registering a deficit of 3.7 percent of GDP. This unusually low CPS deficit in 2004 reflects several temporary factors. Local and regional governments spent considerably less than budgeted, and ran exceptionally large surpluses. Also, the operating surplus of Ecopetrol (the state petroleum enterprise) was unusually high, as the average export price of Colombia's oil rose to US$36 per barrel.This fiscal consolidation, together with the real appreciation of the peso, helped reduce total public debt from 60 percent of

[8] According to the program, the fiscal deficit target for 2004 was reduced by 130 percent of the increase of deposits of the Oil Stabilization Fund (FAEP), which capture part of the windfall arising from higher than expected world oil prices.

GDP at end-2002 to 53 percent of GDP by end-2004.[9] Also public sector deposits rose from about 8 percent of GDP at end-2002 to 10 ½ percent of GDP by end-2004, and public debt net of deposits fell from 52 percent of GDP to 43 percent of GDP in this period.

51. Since August 2002, the government's program to modernize public administration has limited the growth in public spending. These efforts have resulted in the closing of 33 public entities and the restructuring of several others, leading to the elimination of about 27,000 positions. Other important steps include modifying the labor regime of the Social Security Institute (ISS), restructuring the state telecommunications company, public hospitals and health clinics and public electricity companies, and introducing on-line procurement systems.

52. The Banco de la República used its inflation targeting framework effectively in a challenging environment. In 2003, it reduced inflation through increases in its policy interest rate complemented by well-timed and moderate foreign exchange sales designed to calm expectations, following the sharp depreciation of the peso vis-à-vis the U.S. dollar between mid-2002 and early 2003. In 2004, the Banco de la República met its inflation target, while mitigating the strong upward pressures on the peso. The amount of the foreign exchange purchases were consistent with the inflation target.

53. The financial system has strengthened. The solvency and profitability of the banking system has recovered, reflecting economic growth, a successful recapitalization scheme, and improved supervision. Nonperforming loans declined to about 4 percent of total loans by end-2004 and are fully covered by provisions. Some of the funds lent for bank recapitalization by the Deposit Insurance Fund (FOGAFIN) have been prepaid. Several smaller banks intervened in 1999 were sold in 2004 and in early 2005. Progress has continued in implementing the risk-based financial supervision, valuation mechanisms have been introduced to unify application of mark-to-market regulations, and actions to combat money laundering have continued.

54. The government's democratic security policy also was an integral part of the strategy. There are many signs—such as a reduction in guerilla attacks, kidnappings, increased road travel and fewer incidents of economic sabotage—that the security situation has improved considerably since 2002. This helped strengthen confidence, which in turn encouraged investment and economic growth.

Economic Program for 2005–06

55. The government's economic strategy will continue to aim at supporting steady economic growth over the medium term, which will help reduce unemployment and poverty

[9] The IMF definition of public debt differs from data published by the Colombian government, which is net of the public sector's external financial assets.

further. Fiscal consolidation will remain at the center of this strategy, as further declines in the public debt burden will support growth by strengthening confidence and lowering interest rates.

Macroeconomic Framework: Main Elements 2003-10

	2003	2004		Projection			
		Rev. Prog.	Rev.	2005	2006	2007	2010
	(Annual percentage change)						
Real growth	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Inflation 1/	6.5	5.5	5.5	5.0	4.5	3.5	3.0
	(In percent of GDP)						
External current account balance	-1.5	-2.2	-1.0	-2.8	-2.6	-2.7	-2.5
NFPS primary balance 2/	1.7	2.5	2.7	2.7	2.7	2.7	2.7
Combined public sector balance 2/ 3/	-2.7	-2.5	-1.3	-2.5	-2.0	-1.8	-1.4
Total public debt	56.0	52.1	52.9	50.4	49.8	48.2	42.7
Public deposits	8.6	…	10.6	…	…	…	…
	(In billions of U.S. dollars)						
Net international reserves 4/	10.5	10.4	13.2	12.3	12.7	13.1	14.9
	(In U.S. dollars per barrel)						
Crude oil, spot price 5/	28.9	....	37.8	40.5	38.0	36.0	34.0

1/ For 2007 and beyond, inflation projection consistent with achieving medium-term inflation target of 2-4 percent a year
2/ At projected WEO price of oil in 2005-06, adjusted to reflect Colombia export price.
3/ Excludes the effect of the program adjustor for any oil windfall.
4/ Takes into account the prepayment of the IDB loan in 2005.
5/ Petroleum price is average of spot prices for UK Brent, Dubai, and West Texas Intermediate.

56. For 2005–06, economic policies have been designed to support real GDP growth of 4 percent a year and to reduce inflation to a range of 4½ to 5½ percent during 2005 and to a point within the range of 3–5 percent in 2006. The external current account deficit is projected to rise to close to 3 percent of GDP in 2005–06, reflecting falling volumes of oil exports, the effect of slower global growth and a return to more normal expansion in exports to Venezuela. Net capital inflows are expected to stay at around 3 percent of GDP in each year. Net international reserves are projected to stay at US$12.2 billion by end-2005 (107 percent of short-term debt on a remaining maturity basis), reflecting the recent purchase by the government of US$1.25 billion to prepay an emergency loan from the Inter-American Development Bank. The quarterly targets for net international reserves (with an adjustor for sales of foreign exchange of up to US$2 billion) are presented in the TMU.

Fiscal policy

57. The medium-term fiscal framework that was presented to Congress in June 2004 (in accordance with the Fiscal Responsibility Law approved in 2003) aims to reduce net public debt to 38 percent of GDP by 2015. It added that the combined public sector would need to raise its primary surplus to 2½ to 3 percent of GDP starting in 2005 to reach this objective.

58. The program fiscal targets are consistent with this framework. These targets assume that spending by local and regional governments will return to normal levels following a sharp and unexpected decline in 2004. In this context, the combined public sector deficit (CPS) will amount to 2.5 percent of GDP in 2005 (Table 3). The central government stands ready to adjust its spending if necessary to achieve the program target, and if spending by local and regional governments turns out lower than expected, there will be scope for enhanced investment in high quality projects by the central government. In 2006, the CPS deficit would decline further to 2.0 percent of GDP. By July 2005, the government will present a 2006 budget to Congress that is consistent with this objective, which will be a structural performance criterion. In 2006, the primary surplus would reach 2.7 percent of GDP, which—together with a reduction of public sector deposits to more normal levels—would lower public debt to below 50 percent of GDP by end-2006.

59. The government needs to ensure that spending stays on a sustainable path, even if world prices of oil reach unusually high levels. The 2005 fiscal target is based on an average export price of Colombia's oil of US$31 per barrel and the underlying average export price of oil in 2006 will be based on an independent estimate of the long-term world price of oil. To ensure that the public sector saves a significant share of any oil windfall, the targets for the CPS deficits for 2005–06 will be adjusted downward as explained in the TMU when the average export price of oil exceeds these baseline prices.

60. The government will seek to continue reducing the vulnerability of the public finances to exchange rate fluctuations. In 2005, it will seek to limit net foreign currency financing to minus 0.3 percent of GDP, in line with the indicative quarterly limits presented in the TMU. The government has also begun to manage its exchange rate risk more actively. It has already issued US$825 million through a global peso-denominated bond, with the investor bearing the exchange risk. It has also begun to conduct forward transactions in foreign exchange. The government will provide a transparent accounting of the stock of all its foreign currency derivative transactions and positions, including an estimate of the possible fiscal impact of adverse movements in the exchange rate. To continue to ensure that these operations are consistent with monetary and exchange rate policy, the government will provide the Banco de la República with a schedule of its planned forward operations. The government will limit the stock of its net forward sales of foreign exchange to no more than US$100 million.

61. In 2005, public revenues are projected to decline slightly to 31 ¼ percent of GDP. Tax revenues will remain broadly stable at close to 21 percent of GDP, reflecting the buoyancy of tax revenues and the success of our tax administration efforts. Also, the government will continue to scale back the subsidies for domestic prices of gasoline and diesel, which cost over 1 percent of GDP in foregone revenue in 2004. This will help offset the revenue impact of the continued decline in Ecopetrol's oil production.

62. Total public expenditure is expected to rise to 33.7 percent of GDP in 2005. The government will restrain the growth in spending on wages and goods and services, but will remain under pressure from rising pension costs. In December 2004, the government granted

export subsidies for exporters of bananas and flowers that hedge their exchange rate risk, with an estimated fiscal cost of less than 0.1 percent of GDP. The eligibility period for this subsidy expired on February 28, 2005. After this date, the government will not grant any further export subsidies but may seek other options to assist the agricultural sector within its budget constraint.

63. The government believes public investment, especially in infrastructure, plays an important role in the growth process. The government will continue to strengthen the quality of investment by increasing the commercial orientation of public enterprises and by relying, where possible, on projects carried out by public-private partnerships (PPPs). The government will complete the valuation of contingent liabilities arising from PPPs by including all past liabilities, in particular those stemming from infrastructure investment, and will present this valuation in the medium-term fiscal framework for the 2006 budget. It will also set up a pilot program to assess the results of a group of completed investment projects, with a view to establishing over time a centralized system for project evaluation.

64. The deficit of the central government—which comprises the central administration, social security and the decentralized agencies—would rise moderately to 4.0 percent of GDP in 2005 and to 4.3 percent of GDP in 2006. Total revenues would remain broadly stable at about 23.0 percent of GDP, while total expenditures would rise slightly in relation to GDP reflecting increased pension payments.

65. For 2005–06, we intend to press ahead with the following structural fiscal reforms (Table 4):

- ***Budget code.*** Congress is currently considering the reform of the budget code, which seeks to reduce expenditure rigidities by scaling back revenue earmarking (which amounts to 50 percent of tax revenues), budgetary carryovers, and multi-year spending commitments. Building on the fact that the reform was already voted upon favorably at the House committee level, we will make every effort to secure approval of the revised code by June 2005, and this action will be a structural performance criterion. Once approved, we will enact the necessary regulations to implement this reform as quickly as possible and no later than December 2005. We will also strive to continue to reduce remaining expenditure rigidities.

- ***Pension reform.*** In spite of the steps that have already been taken, the actuarial deficit of the pension system remains very high at almost 190 percent of GDP, partly because the constitutional court ruled against the transition rules that had been approved in December 2002. Also, the pension reserves of ISS were depleted in 2004, placing an extra burden on transfers from the central administration. To continue to press ahead with this reform, in July 2004, the government submitted a constitutional amendment that proposed to eliminate all special pension regimes and the 14^{th} monthly pension payment for new retirees and to set a cap on the maximum pension. These reforms will yield crucial benefits for the long term by reducing the actuarial deficit of the pension system to about 160 percent of GDP. The elimination of the 14^{th}

monthly pension payment for new retirees will yield moderate fiscal savings starting in 2006. The proposed amendment also clarifies the interpretation of acquired rights, a critical element for any future changes to the regime's parameters. The government will press hard to secure congressional approval of its proposed reform by June 2005. The government recognizes that additional reforms will be needed over the medium term to reduce the actuarial deficit further.

- *Privatization.* The government intends to bring Ecogas, which operates the country's natural gas pipelines, to the point of sale in 2005. It will hire an investment bank to begin to prepare to bring several regional electricity firms (Empresa de Energía de Cundinamarca, Electrificadora del Meta, Empresa de Energía de Boyaca, Electrificadora de Santander and Centrales Eléctricas del Norte de Santander SA) to the point of sale by June 2006. Together these public enterprises have an estimated value of about 0.8 percent of GDP.

- *Improving information on operations of all levels of government.* More complete, up-to-date information on the operations of all levels of government will allow for better monitoring of the fiscal position and for better coordination of monetary and fiscal policy. By June 2005, the government will review the quality of the information on the local and regional governments provided by the Contaduria. By September 2005, the government will issue the regulations needed to improve the quality of the information reported on the operations of the local and regional governments. The progress in improving the quality of this information will be discussed in the context of the first program review. By December 2005, the government will publish the upgraded information on the operations of all levels of government.

66. After 2006, the public sector will continue to face important challenges in its efforts to reduce public debt further. For this reason, this government will begin to lay the foundation for crucial medium-term reforms, especially in the areas of tax policy, subsidies, and revenue sharing. A more efficient tax system—with a simplified structure of VAT rates and a much broader VAT base and no distortionary taxes such as the financial transactions tax and the bank stamp tax—would support faster economic growth. Since 1991, Colombia has developed an extensive network of subsidies that has helped improved the quality of life for the most vulnerable members of the population, yet poverty remains too high. The government will seek to find more effective ways to target these subsidies to the poor, and there may be some scope to trim the cost of the subsidies that tend to benefit the middle and upper classes. The current mechanism for setting domestic prices of gasoline and diesel creates an implicit subsidy that implies a revenue loss for the public sector, especially Ecopetrol, and the government intends to liberalize domestic fuel prices over the medium term. The mechanism for transferring revenues to local and regional governments presents a potential risk to the finances of the central government, starting in 2009. By December 2005, the government will publish a report that evaluates the current system of sharing revenues with local and regional governments.

Monetary and exchange rate policy

67. The Banco de la República is fully committed to reducing inflation to a range of 4½ to 5½ percent during 2005, within the inflation targeting framework adopted in the late 1990s. In December 2004, in light of evidence that inflationary pressures had eased, the central bank relaxed the stance of monetary policy by reducing its repo interest rate and closing its window for contractionary monetary operations. If necessary to meet the inflation target, the Banco de la República will tighten monetary policy by raising its repo interest rate and re-opening the window for contractionary operations.

68. The Banco de la República remains committed to a flexible exchange rate regime, which is helpful for the economy to adjust to shifts in external conditions. Since 2004, the exchange rate regime could be characterized as a managed float, as the central bank stepped up its intervention to limit the speed and depth of the appreciation of the peso. However, the Banco de la República will continue to attach top priority to achieving its inflation target.

Financial sector

69. Colombia is pioneering a new risk-based approach to credit risk regulation and supervision. Banks are making good progress in developing models for their risk assessment, which will be used to determine capital adequacy and provisioning requirements in accordance with the Basle II capital principles. The new capital and provisioning standards will be implemented gradually over the next several years. In this context, the government will ensure that the Superintendency of Financial Institutions will have sufficient resources to hire the qualified technical staff that it needs to implement this new system.

70. The quality of the mortgage loan portfolio is improving gradually as the economy and housing prices recover further. Some banks with significant amounts of mortgages will continue to operate under restructuring, which—if necessary—could call for increases in provisioning and capital.

71. The Superintendency of Financial Institutions will advance in designing the framework for consolidated supervision of financial conglomerates. The government is in the process of unifying the supervisory framework of financial institutions, currently under responsibility of the Superintendency of Financial Institutions and the Superintendency of Securities. This will allow for a more effective monitoring of the financial system and limit the possibilities for regulatory arbitrage.

72. The government has made important strides in resolving the situation of the distressed banks following the crisis of 1999. Since then, FOGAFIN (Financial Institution Guarantee Fund) has spent considerable effort in liquidating six of these banks, merging two and selling another four. Last year, the auction of Banco Aliadas earned 1.7 times the bank's book value. The government remains fully committed to divesting the financial institutions that were intervened in 1999 and remain under the control of FOGAFIN. To this end, it has begun the privatization process of Granahorrar which will be brought to the point of sale by December 2005 (a structural benchmark). Regarding Bancafé, after the failed privatization process

implemented in early 2004, the government initiated a thorough restructuring program with the aim of improving the bank´s efficiency and bringing performance indicators in line with its private sector peers. Under this program, the bank closed 40 of its 278 branches in 2004, reduced staff from 4,100 to 3,550 and cut operating expenses substantially. In March 2005, the staff was reduced further to 3,200 and a process of restructuring began to lower labor costs further, with a view to eventually bringing this institution to the point of sale. In the meantime, the government wants to ensure that the new Bancafé and the other public bank—Banco Agrario—will continue to be managed efficiently. Therefore, the government will establish by September 2005 a corporate governance framework for the new Bancafé and Banco Agrario. In this regard, the authorities have requested technical assistance from the Monetary and Financial Systems Department from the Fund.

73. The government will seek congressional approval of the new securities law by June 2005. This law will help modernize local capital markets by clarifying the principle of finality in securities trading, reducing counter-party risk in securities transactions, and facilitating the establishment of centralized clearing and settlement systems for both exchange rate and fixed income derivatives markets.

74. The government will continue to foster the development of hedging instruments to strengthen risk management in the financial system. For this purpose, we will request technical assistance from the Fund to establish the road map for developing hedging instruments.

Other Issues

75. This program would have semi-annual reviews, which would be completed by September 2005, March 2006, and September 2006. The first review will evaluate the progress under the program so far, and will look at the pace of spending by local and regional governments. The second review will focus on reaching detailed understandings on policies for 2006, including specific plans for structural reforms during 2006. The third review will concentrate on economic performance in 2006 under the program.

76. The government believes that the policies set forth in this Memorandum of Economic and Financial Policies (MEFP) are adequate to achieve the objectives of its program, and as usual we will maintain a close policy dialogue with the Fund. We stand ready to take additional measures, as necessary, to achieve the objectives of the program. The Fund's management or the authorities can request a consultation on the stance of policies when appropriate.

Table 1. Colombia: Performance Criteria Under 2003-2004 Program 1/

	Performance Criteria	2004 Performance Criteria			
	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					
Ceiling 2/	-6,375	-1,178	-1,460	-1,462	-5,394
Outturn	-6,225	-956	-64	1,713	-3,447
Margin (+) or shortfall (-)	150	222	1,396	3,175	1,947
	Inflation rate 3/ (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	6.5	6.2	6.1	6.0	5.5
	(In millions of U.S. dollars)				
Net international reserves of the Banco de la Republica					
Floor 4/	10,202	9,902	10,300	10,400	10,540
Outturn	10,524	11,019	11,379	11,929	13,197
Margin (+) or shortfall (-)	322	1,117	1,079	1,529	2,657
	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	716	26	-237	-735	-289
Margin (+) or shortfall (-)	1,134	774	1,537	2,485	2,089
Change in the outstanding stock of short-term external debt of the public sector					
Ceiling	100	200	200	200	200
Outturn	-274	-81	-65	102	167
Margin (+) or shortfall (-)	374	281	265	98	33

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/ The ceiling has been adjusted downward by 130 percent of the gross deposits to the Petroleum Stabilization Fund. This adjustment is Col$22.1 billion in March, Col$189.97 billion in June, and Col$387.6 billion in September, and Col$705.6 billion in December.

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

4/ Floor for December 2003 and March 2004 adjusted downward by US$338 million, the accumulated foreign exchange sales through the options intervention mechanism.

Table 2. Colombia: Structural Performance Criteria and Benchmarks Under 2003-2004 Program		
	Structural Performance Criteria	**Status**
October 31, 2003	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 international 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 midyear budget report to Congress.	Was structural performance criterion for end-October 2003. Done Dec.16, 2003. Waiver approved.
July 31, 2004	The 2005 budget submitted to Congress will provide for a CPS deficit of 2 to 2½ percent of GDP and will include a presentation of expenditure according to a standard international classification system.	Done.
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 midyear 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.	Not met.
	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 with a delay in July 2002. Done 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. Congressional approval of the modifications of Law 80 to improve management of government contracts. Bring Bancafé to point of sale.	Done October 2003. Not met. Done with a delay in February 2004. No bids received.

Structural Benchmarks		
March 31, 2004	Completion of a CONPES document to strengthen the government's legal defense service to take effect by 2005.	Done November 2003.
June 30, 2004	The government will issue a plan to improve the statistical reporting system for the financing of the nonfinancial public sector deficit.	Done.
	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.	Done.
July 31, 2004	Submit to Congress a constitutional amendment to eliminate special pension regimes, end 14th monthly pension and cap maximum pension at no more than 25 minimum salaries.	Done.
September 30, 2004	Full implementation of CONPES plan to eliminate the deficit of the ISS health system by 2007.	Done.
	Implementation of the plan to strengthen the governments' legal defense services.	Done.
	CONPES will publish a strategy for strengthening the current system of fiscal decentralization.	Not met. By December 2005 government will publish study that evaluates revenue sharing system.
	Adoption of the following measures to improve tax administration: (i) establish an integrated taxpayers' current account, which records all of a taxpayer's payments in a single account; (ii) begin to close enterprises that evade taxes; and (iii) begin to report persons with tax arrears to credit bureaus.	Done.
December 31, 2004	FOGAFIN will announce auction for Granahorrar.	December 2005.
	Restructuring of Bancafé will be completed.	Done with delay in March 2005.
	Implement plan to improve reporting of financing of public sector.	Done with delay. Prior action for new program adopted in March 2005.
	Resubmit to Congress the modifications to Law 80 to improve management of government contracts.	Done.

Table 3. Colombia: Performance Criteria for 2005-2006 Program 1/

	Outturn	2005 Indicative Targets	2005 Performance Criteria		
	Dec. 31, 2004	Mar. 31	Jun. 30	Sept. 30	Dec. 31
I. Performance Criteria					
Cumulative flows from beginning of calendar year (In billions of Colombian pesos)					
Overall balance of the combined public sector					
Ceiling 2/	…	-1,606	-1,514	-3,403	-6,890
Outturn	-3,447	…	…	…	…
Margin (+) or shortfall (-)	…	…	…	…	…
Inflation rate 3/ (12-month inflation rate)					
Inflation - Consultation band					
Upper limit	…	6.5	6.3	6.2	6.0
Target	…	5.5	5.3	5.2	5.0
Lower limit	…	4.5	4.3	4.2	4.0
Outturn	5.5	5.0	…	…	...
(In millions of U.S. dollars)					
Net international reserves of the Banco de la Republica					
Floor	…	12,215	12,215	12,215	12,215
Outturn	13,195	…	…	…	…
Margin (+) or shortfall (-)	…	…	…	…	…
Change in the outstanding stock of short-term external debt of the public sector					
Ceiling	…	200	200	200	200
Outturn	…	…	…	…	…
Margin (+) or shortfall (-)	…	…	…	…	…
II. Indicative Targets					
Cumulative net disbursement from beginning of calendar year (In millions of U.S. dollars)					
Net disbursement of foreign currency debt to the public sector					
Ceiling	...	300	-800	-650	-750
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 (TMU) attached to the staff report for Colombia's request for a Stand-by Arrangement (EBS/05/---).

2/ The ceiling for December 2004 has been adjusted downward by Col$994 billion, 130 percent of the gross deposits to the Petroleum Stabilization Fund during 2004.

3/ Deviations from the quarterly path for inflation will trigger consultations with the Fund, as set out in the TMU.

Table 4. Colombia: Structural Conditionality Under the 2005-2006 Program SBA

	Prior Action	Status
	Issue circular that requires banks to treat the annexes pertaining to their operations with the nonfinancial public sector as part of their reports on their balance sheets.	Done.
	Structural Performance Criteria	
June 30, 2005	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.	Approval was a condition for completion of final review under previous program.
July, 31 2005	Submission to Congress of 2006 budget consistent with combined public sector deficit of 2.0 percent of GDP in 2006.	
Structural Benchmarks		
June 30, 2005	Congressional approval of a constitutional amendment to eliminate special pension regimes, end 14th monthly pension and cap maximum pension at no more than 25 minimum salaries. Congressional approval of new securities law.	
September 30, 2005	Issue the regulations needed to improve the quality of information reported for the operations of local and regional governments.	
December 31, 2005	Publish a report evaluating the current system of sharing revenue among the different levels of government. Issue regulations to implement the revised budget code. Bring Granahorrar to the point of sale.	
March 30, 2006		
June 30, 2006		

COLOMBIA—TECHNICAL MEMORANDUM OF UNDERSTANDING

1. This Technical Memorandum of Understanding (TMU) presents the concepts, specific performance criteria, and the format for periodic reporting to the Fund, as well as the assumptions that apply under the program supported by the stand-by arrangement.

IV. FISCAL TARGETS

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

	Ceiling (In Billions of Colombian Pesos)
Overall deficit of the combined public sector	
From January 1, 2005 to:	
March 31, 2005 (indicative target)	1,606
June 30, 2005 (performance criterion)	1,514
September 30, 2005 (performance criterion)	3,403
December 31, 2005 (performance criterion)	6,890

[1] As measured by the net financing defined in the text below. The combined public sector is defined in the text below.

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

The Combined Public Sector

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

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

3. For any given calendar quarter, the overall **CPS balance** is measured, in Colombian pesos, as the sum of: (i) its net domestic financing; (ii) its net external financing; and (iii) privatization proceeds, as defined below.

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

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

6. The **CPS net external financing** is defined as the sum of (i) disbursements of grants and project and nonproject loans, including securitization (*titularización*) of public sector export receipts; (ii) proceeds from bonds issues to nonresidents (issued or guaranteed by any CPS entity) denominated in domestic or foreign currency or indexed to any foreign currency; (iii) the net changes in short-term external debt including prepayment of exports; and (iv) any change in arrears on external interest payments; minus (v) net increase in the financial assets held abroad by the CPS; (vi) cash payments of principal on current maturities for bonds and loans; (vii) cash payment to settle any external arrears; (viii) any prepayment of external debt; and (ix) the value of any new leasing contracts entered into by the public sector during

the program period, which is defined as the present value at the commercial interest reference rate (CIRR) (at the inception of the lease) of all lease payments expected to be made during the period of the lease contract excluding those that cover the operation, repair, or maintenance of the property.

7. **Privatization** proceeds are defined as the cash payments received by the CPS from the sale of the government's ownership stake in enterprises. Nonrecurrent fees (e.g., prepayments) received by the CPS for concessions to operate public services, such as in the telecommunications sector, are treated as privatization proceeds. For purposes of the program, such fees will be accounted for over the concession period, distributed in equal quarterly amounts. Proceeds from the the sales of the government's shares in public enterprises will be considered as privatization. To the extent that the purchasers of public enterprises assume their debts, the net financing used by these enterprises during the program period until their sale will be deducted from the net financing of the CPS; if the CPS assumes the debt, the net financing used by the enterprise during the program period before the sale will remain outstanding as part of the financing of the CPS.

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

9. **Adjustment**

(i) The quarterly ceilings on the combined public sector deficit will be adjusted upward (larger deficit), and the indicative target on net disbursements of public sector foreign currency and foreign currency indexed debt (see below) will be adjusted upward by the value of the grant element of any concessional loan disbursements or the full value of grants up to a maximum of 0.5 percent of GDP or US$500 million for 2005 as a whole, in support of the government's projects related to post-conflict, which include support for refugees ("*desplazados*") and programs to reincorporate former insurgents ("*reinsertados*") into civilian life. The program does not envisage any concessional financing for this purpose. 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. The value grant element of the loan will equal the grant element in percentage terms multiplied by the total value of the disbursements in U.S. dollars during the period.

(ii) The cumulative quarterly ceilings on the combined public sector deficit will be adjusted downward by the net oil export revenues in excess of the baseline set out in the table below, net of additional royalties relative to the baseline and net of the net financial costs of export coverage. Net oil export revenues are defined to include proceeds from exports of crude oil and petroleum derivatives minus the value of domestic purchases and imports of crude oil. The net financial costs of export hedging apply to oil sold as part of one-year contracts, and refers to the difference between the contractual price and the actual spot price. The baseline for net oil export revenues and royalties are specified in U.S. dollars, but all amounts in this adjustor will be valued in pesos at the following average exchange rates: Col$2,596 per U.S. dollar for the first quarter of 2005; Col$2,620 per U.S. dollar for the second quarter of 2005; Col$2,643 pesos per U.S. dollar for the third quarter of 2005; and Col$2,668 per U.S. dollar for the fourth quarter of 2005. All adjustments will be made within a quarter, which means that the ceiling on the cumulative CPS deficit in a quarter will be adjusted downward by the amount of the windfall in the same quarter. There will be no upward adjustment to the ceiling on the CPS deficit.

Baseline Assumption for Oil Windfall

	Net export revenue (In millions of U.S. dollars)	Royalties (In millions of U.S. dollars)
From January 1, 2005 to March 31, 2005	321.4	221.5
From January 1, 2005 to June 30, 2005	603.2	436.4
From January 1, 2005 to September 30, 2005	926.0	635.9
From January 1, 2005 to December 31, 2005	1287.0	831.9

10. **Exchange rate conversion.** (i) For the CPS balance, all revenue, expenditure and financing items denominated in foreign currency will be converted into Colombian pesos at the average exchange rate prevailing in the month when the transaction took place.

V. Monetary Targets

11. Reflecting the BR's inflation targeting framework for monetary policy, quarterly targets for 2005 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 year-on-year rate of inflation at the end of each quarter were to deviate from the programmed quarterly baseline target by 1 percentage point or more, as set out in the table below. The BR will provide Fund staff with monthly information and analysis of inflationary developments including inflation forecasts, and keep the staff informed of all policy actions taken to achieve the inflation objectives of the program.

Performance Criterion on Inflation[1]	
	Inflation (12-Month Percentage Change)
March 31, 2005 (indicative target)	5.5
June 30, 2005 (performance criterion)	5.3
September 30, 2005 (performance criterion)	5.2
December 31, 2005 (performance criterions)	5.0

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

VI. External Targets

A. Performance Criterion on NIR of the BR

	Target[1] (In Millions of U.S. Dollars)
Outstanding stock as of:	
March 31, 2005 (indicative target)	12,215
June 30, 2005 (performance criterion)	12,215
September 30, 2005 (performance criterion)	12,215
December 31, 2005 (performance criterion)[3]	12,215

[1] These performance criteria are explained in Table 1 of the TMU. NIR is defined in paragraph 13.

12. The **NIR** of the BR (*reservas de caja*) are equal to the U.S. dollar value of gross foreign reserves of the BR minus gross foreign reserve liabilities.

13. **Gross foreign reserves** of the BR comprise (i) gold; (ii) holdings of SDRs; (iii) the reserve positions in the FLAR and the Fund; and (iv) all foreign currency-denominated claims of the BR on nonresident entities excluding accrued, but unpaid, interest on reserve assets and valuations. Gross foreign reserves exclude capital participation in international financial institutions (including Corporación Andina de Fomento (CAF), IDB, IBRD, IDA, BCIE, and the Caribbean Development Bank), the holdings of nonconvertible currencies, and holdings of precious metals other than gold. The *pesos andinos* are considered to be part of Colombia’s gross foreign reserves.

14. **Gross foreign reserve liabilities** of the BR are defined as the sum of (i) all foreign currency-denominated liabilities of the BR with an original maturity of one year or less excluding accrued, but unpaid, interest on liabilities (*causaciones*); (ii) liabilities to the Fund,

(iii) any position in derivatives that represent a claim on gross foreign reserves; (iv) any purchases from the Latin American Reserve Fund (FLAR); (v) any increase in medium- and long-term external debt of the BR over and above US$2.6 million, which is the level of the outstanding debt on December 31, 2004; and (vi) any foreign currency liabilities of the BR to residents, including financial institutions.

15. **The government's exposure in derivative markets.** The ministry of finance and public credit will publish on a weekly basis the gross and net operations in futures, forwards and other derivative contracts (involving the Colombian *peso*, vis-à-vis a foreign currency) as well as its cash position in foreign exchange.

16. **Adjustment.** The quarterly NIR targets may be adjusted downward by up to US$2.0 billion in the event of central bank for foreign exchange intervention. In the event that NIR declines by US$1.0 billion during any 30-day period through foreign exchange intervention, the authorities will complete consultations with the Fund (Executive Board) on the proposed policy response before requesting purchases from the Fund.

B. Indicative target on the Net Disbursement of Public Sector Foreign Currency Debt[1]

	Ceiling (In millions of U.S. dollars)
Cumulative net disbursement of public sector foreign currency debt sector from January 1, 2005 to:	
March 31, 2005	300
June 30, 2005	-800
September 30, 2005	-650
December 31, 2005	-750

[1] The public sector includes the CPS as defined above and the financial public sector, including second-tier banks. In calculating compliance with the ceiling, the reduction/accumulation of the public sector's U.S. dollar assets in both spot and derivative markets will raise/lower net disbursements. Debt is defined in point 9 of the Guidelines on Performance Criteria with respect to foreign debt (Executive Board Decision No. 12274–00/85, August 24, 2000).

17. This ceiling applies to the net disbursement (gross disbursement minus amortization/redemptions) of foreign currency and foreign currency indexed public sector (financial and nonfinancial) debt. It does not apply to debt in foreign currency that is indexed to the peso.

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

19. **Exchange rate conversion.** (i) changes in the foreign currency debt will be valued in U.S. dollars at the exchange rate of that currency with respect to the U.S. dollar prevailing at the time of each transaction; (ii) the net international reserves at end-2004 are valued at

cross-exchange rates prevailing at end-2004 and reserves held in interest-bearing securities are valued at market prices prevailing at end-2004; any accumulation of reserves after end-2004 will be accounted for at the U.S. dollar value at the time of acquisition; (iii) all references of foreign currency debt to GDP in relation to GDP are calculated at the end-period exchange rate of the Colombian peso with respect to the U.S. dollar.

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, 2004 to December 31, 2004 (performance criterion)	13
Cumulative net disbursement of short-term external debt of the public sector from January 1, 2005 to:	
March 31, 2005 (indicative target)	200
June 30, 2005 (performance criterion)	200
September 30, 2005 (performance criterion)	200
December 31, 2005 (performance criterion)	200

[1] Short-term debt defined as all debt with an original maturity of one year or less, excluding normal trade financing. Public sector includes the PS as defined above and the financial public sector except transactions that affect the reserve liabilities of the BR. The term "debt" has the meaning set forth in point 9 of the Guidelines on Performance Criteria with respect to Foreign Debt (Decision No. 12274-00/85, August 24, 2000).

IV. Reporting Under The Program

The regular reporting will include the following:

Monthly reporting

(i) Financial sector

(a) Monthly inflation report (within 15 days following presentation to the Board of Directors of the Banco de la Republica)

(b) Banco de la República intervention in the foreign exchange market in the preceding month (within 15 days).

(ii) Fiscal sector (within 6 weeks)

(a) Net borrowing of the central administration.

(b) Cash operations of the treasury (which includes floating debt).

(c) Operations of the Central Administration including transfers.

Quarterly reporting

(i) Performance criteria: Definitive information on the observance of the program targets not later than 7 weeks after the end of the quarter.

(ii) Fiscal Net Borrowing on the combined public sector deficit, distinguishing between external financing, domestic financing, the financial system, and privatization receipts, not later than 7 weeks after the end of the quarter. This will include data on privatization revenue, which will include gross receipts, costs of privatization and the resulting cash receipts received by the treasury and the assumption of debts by the government in connection with the privatization.

Colombia: Quantitative Indicator on Net Public Financing in Foreign Currency or Indexed to Foreign Currency

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

		Q1		Q2		Q3		Q4	
		Proj.	Actual	*Proj.*	Actual	*Proj.*	Actual	Proj.	Actual
	Net accumulation foreign currency debt	**-245**		**-1057**		**-816**		**-937**	
+	Net foreign currency financing	639		-864		-465		-695	
	Non-financial public sector	644		-844		-444		-662	
	Disbursements	1006		1537		2311		3080	
	Amortization	362		2381		2755		3742	
	Financial public sector	-5		-20		-21		-33	
	Disbursements	1		1		3		4	
	Amortization	6		21		24		37	
+	Disbursements in Colombian pesos indexed to foreign currency	0		0		0		0	
	Non-financial public sector	0		0		0		0	
	Financial public sector	0		0		0		0	
-	Disbursements in foreign currency indexed to the Colombian peso	450		450		450		450	
	Non-financial public sector	450		450		450		450	
	Financial public sector	0		0		0		0	
-	Net accumulation of foreign currency assets in spot markets	314		-257		-99		-1458	
	Non-financial public sector	314		-257		-99		-1458	
	Financial public sector	0		0		0		0	
-	Net accumulation of foreign currency assets in derivative markets	120		0		0		0	
	Non-financial public sector	120		0		0		0	
	Financial public sector	0		0		0		0	
	Program target (ceiling)	**300**		**-800**		**-650**		**-750**	
	Margin	***545***		***257***		***166***		***187***	

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FOR IMMEDIATE RELEASE
April 29, 2003

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$ 613 million Stand-By Arrangement for Colombia

The Executive Board of the International Monetary Fund (IMF) approved today an 18-month, SDR 403 million (about US$ 613 million) Stand-By Arrangement to support Colombia's economic program through November 2006. An amount equivalent to SDR 193.5 (about US$292.2 million) will be made immediately available, with the remaining balance distributed in five equal installments of SDR 42.3 million (about US$ 64 million). However, the authorities intend to treat the arrangement as precautionary, and therefore do not intend to draw on the credit available.

The Board has also completed the fourth and final review under an SDR 1.55 billion (about US$2.34 billion) Stand-By Arrangement that was approved on January 15, 2003 (see Press Release No. 03/04), and which will end effective May 2, 2005 at the authorities' request. In completing the review, the Board approved Colombia's request for waivers of the non-observance of two performance criteria. No drawings were made under the expiring arrangement either.

Following the Executive Board's discussion of Colombia, Anne O. Krueger, First Managing Director and Acting Chair, made the following statement:

"Colombia's economic performance continued to improve during 2004, reflecting strong policy implementation as well as the favorable external environment. Economic activity showed solid growth, unemployment and poverty fell, and inflation declined to the lowest level in decades. The external sector strengthened, aided by broad-based export growth as well as sizable net capital inflows. The combined public sector deficit fell sharply in 2004, supported by unexpectedly high world oil prices as well as a large surplus of the autonomous local and regional governments. This helped reduce the public debt further.

"For 2005-06, economic policies seek to sustain this strong performance. The successor 18-month Fund arrangement will allow for a gradual exit from Fund financial support. Fiscal policy continues to aim at reducing the public debt. In line with this objective, the government is targeting a decline in the combined public sector deficits in 2005 and 2006, based on prudent assumptions about the world oil price and the overall balance of the local and regional governments. The authorities also intend to save most of any oil price windfall. Monetary policy will target a gradual decline in inflation in 2005-06, in the context of a managed float exchange rate policy.

"Structural reforms continue to advance. The authorities intend to press for congressional approval by June 2005 of the revised budget code, the constitutional amendment for pension reform, and the new securities market law. The authorities are continuing to strengthen the financial system. In particular, one state-owned bank was restructured in March 2005, and another one will be brought to the point of sale by end-2005. The government intends to continue building political support for key medium-term reforms, such as strengthening tax policy and improving the system of revenue sharing. These policies will help lay the foundation for continued growth with stable prices over the medium term", Ms. Krueger said.

Program Summary

Colombia performed very well under the program approved in January 2003. The authorities' sound policy implementation continued to reduce vulnerabilities and foster economic growth. Real GDP increased steadily in 2003-04, helping reduce unemployment. Inflation declined to the lowest level in decades and the external sector strengthened, with a low current account deficit and strong capital inflows in 2004. Fiscal consolidation, together with the real appreciation of the peso, lowered gross public debt from about 60 percent of GDP at end-2002 to about 53 percent by end- 2004, together with a sizable increase in public deposits. Likewise, the financial sector continued to perform well.

The new program seeks to support the authorities' macroeconomic framework–especially with regard to fiscal policy and public debt reduction-during the upcoming transition to a new government to take office in August 2006. By maintaining sound economic policies in the coming 18 months, the country will strengthen its credibility further and continue to reduce economic vulnerabilities, which are crucial to achieve sustained economic growth.

The program envisages real GDP to rise by 4 percent a year in 2005-6, while inflation would decline to 5 percent in 2005 and to 3-5 percent in 2006. Net international reserves are projected to stay at around US$ 12.2 billion by end-2005.

Fiscal policy in 2005-06 will stay on the path to reduce public debt to close to 40 percent of GDP by 2010. The fiscal targets assume that spending by local and regional governments will return to normal levels following a sharp and unexpected decline in 2004. The combined public sector deficit would amount to 2.5 percent of GDP in 2005 and decline to 2.0 percent in 2006. As a result, public debt would decline to about 50 percent of GDP by end- 2006. These targets will be reduced by a significant share of any price windfall, lowering public debt further.

The government intends to continue to advance key structural fiscal reforms, which include a constitutional amendment to the pension regime, a new securities law, and a reform of the budget code. The government will bring the state-owned bank Granahorrar to the point of sale, and will also try to privatize some small electricity firms with an estimated book value of 0.8 percent of GDP.

Colombia is an original member of the IMF; its quota is SDR 774 million (about US$1.17 billion); and it has no outstanding use of IMF credit.

Colombia: Selected Economic Indicators

	2000	2001	2002	2003	Prel. 2004	Proj. 2005
(Annual percentage change, unless otherwise indicated)						
National income and prices						
Real GDP	2.9	1.5	1.9	4.0	4.0	4.0
Consumer prices (end-of-period)	8.7	7.6	7.0	6.5	5.5	5.0
Nominal exchange rate (end-of-period, depreciation +)	19.0	2.8	25.0	-3.0	-14.0	...
Real effective exchange rate (depreciation-)	-2.6	1.5	-17.4	-5.2	11.4	...
Money and credit 1/						
Broad money	-2.1	7.0	5.3	6.5	16.7	11.1
Credit to the private sector	-8.6	1.7	4.0	9.2	12.2	14.6
Real interest rate (90-day time deposits; percent per year)	4.2	3.6	0.7	1.4	2.2	...
(In percent of GDP, unless otherwise indicated)						
External sector						
Current account (deficit-)	0.9	-1.4	-1.7	-1.5	-1.0	-2.8
External debt	46.1	47.5	52.3	46.0	37.1	35.9
Of which: public sector	26.3	28.5	31.9	29.6	24.1	22.7
Net official reserves (in months of imports of goods and services)	6.6	7.8	7.6	6.5	7.1	6.5
Savings and investment						
Gross domestic investment	13.7	14.5	14.2	14.9	14.0	15.3
Gross national savings	14.6	13.2	12.6	13.5	12.9	12.5
Public finances						
Combined public sector balance	-3.4	-3.2	-3.7	-2.7	-1.3	-2.5
Nonfinancial public sector balance	-3.5	-3.5	-4.2	-3.2	-1.7	-2.5
Central administration balance	-5.7	-5.7	-6.4	-5.4	-5.5	-6.1
Public sector debt 2/ 3/	47.7	51.8	60.2	56.0	52.9	50.4

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

Statement by Roberto Steiner, Alternate Executive Director for Colombia
April 29, 2005

1. On behalf of my authorities I would like to thank management and staff for the continued support and advice they have provided Colombia. My authorities broadly agree with the staff's medium-term views expressed in the Article IV papers and appreciate several suggestions included in the FSSA. Colombia has comfortably complied with all quantitative performance criteria as well as with most structural measures. The few structural issues that have not been implemented on a timely basis are part of the new program.

2. Since taking office in late 2002, the government has made significant progress in re-establishing macroeconomic stability, fostering broad-based private sector led growth, and reverting the deteriorating trend in most social indicators. Strong program implementation has allowed for a reduction in the fiscal deficit and in the debt burden, a gradual and continued decline in inflation, a replenishment of NIR, the strengthening of the financial system, and the streamlining of state institutions. Timely policies have been supported by ample liquidity in global financial markets since 2003 and more recently by a favorable evolution of the terms of trade. These positive external shocks, however, have to be contrasted with an unsettled regional political situation and with the need to garner political and financial backing for the government's internal democratic security strategy. My authorities believe that, progress notwithstanding, continued Fund support will be important in the midst of the upcoming political transition. The new program, which should facilitate Colombia´s exit from Fund supported arrangements, will once again be treated as precautionary.

Growth and unemployment

3. Over the last two years GDP growth averaged 4 percent. This is Colombia's best performance in a decade. In 2004, growth was broad-based. While construction (up 10.7 percent) and manufacturing (4.8 percent) were among the most dynamic sectors, no sector grew less than 2.1 percent. Domestic demand was up 5.4 percent, and the investment to GDP ratio reached its highest level in six years. In dollar terms exports advanced 31 percent, with robust growth in both traditional and non-traditional components. Growth is being supported by ample credit, low and stable interest rates, and an improved business environment. Consumer and investor confidence surveys indicate that growth should remain reasonably strong in 2005. Notably, investor perceptions are at their highest level in twelve years. Colombia has made important progress in improving its business environment. According to the World Bank's *Doing Business in 2005*, during the latest year for which information is available, Colombia was the second most successful reformer in a ranking of 145 countries.

4. Unemployment has gone down significantly –from 20 percent in 2000 to 12 percent in 2004-- but remains high. My authorities concur with staff that the 2002 reforms made the labor market more flexible, while protecting vulnerable segments of the population. Formal employment has expanded, underemployment has declined, the share of workers receiving social security benefits has gone up, and the duration of unemployment has shortened. Still, non-wage labor costs are high; the minimum wage is biased upward because of a

Constitutional Court decision mandating yearly hikes equivalent to no less than previous year inflation; there is a mismatch between abundant workers with low skills and the rapid pace of technological change in an increasingly open economy; and the security situation, though improving, has displaced hundreds of thousands of low-skilled agricultural workers to urban areas. The agenda going forward includes further efforts to enhance human capital, garner social consensus for reducing non-wage labor costs, and continue to improve security.

5. With growth having stabilized around potential, the challenge is to increase the latter. This will require attention along several dimensions. First, recent achievements in restoring macro stability have to be consolidated. Second, several structural impediments to growth have to be removed. Third, further improvements in security are needed. Finally, progress is being achieved in negotiating a free trade agreement with the United States. The new Fund arrangement aims squarely at further enhancing macroeconomic stability, and also deals with some structural issues impeding growth –including a new securities law.

Fiscal policy

6. Colombia´s fiscal position has improved markedly since 2002. The CPS deficit declined from 3.7 percent of GDP in 2002 to 1.3 percent in 2004, while the gross debt to GDP ratio of the non-financial public sector went from 60.2 to 52.9 during the same period. External public debt as a proportion of total debt declined from 53 to 45.6 percent. Recently, Colombia successfully placed a global bond denominated in pesos, to an extent not matched by any other sovereign at this stage. The deficit target for 2005 (2.5 percent of GDP) takes into account the fact that the recent over-performance of local governments is not sustainable and that the price of oil has been budgeted to decline in 2005. The improvement in the fiscal position has required action in the revenue as well as in the expenditure fronts. A series of reforms increased tax revenue by slightly more than 1 percentage point of GDP. Expenditure restraint has been more elusive; the bulk of outlays –social security, transfers to territorial entities, and debt service—is inflexible, while military expenditure had to be increased.

7. While the government has been able to raise the tax burden, the tax code remains distorted. Income rates are high, there are several VAT rates applied to a narrow base, and wealth and financial transaction taxes do not favor savings or financial intermediation. Government efforts to broaden the VAT base have been supported by the Congress but turned down by the Constitutional Court on grounds that they do not pass the test of equity. The government agrees with staff that a major overhaul of the tax code is needed, but believes this politically challenging endeavor does not appear feasible in the near term.

8. With regard to expenditure, the government has concentrated efforts in three areas: pensions, reforming state institutions, and approving a new budget code within the scope of the fiscal responsibility law. As to pensions, important reforms were passed in 2002 and 2003. Unfortunately, the Constitutional Court reversed some of the changes, including its decision to go back to the transition period approved in 1993 on grounds that the government cannot take away an acquired right. As a result, the government decided to introduce in 2004 a constitutional amendment to cap pensions at no more than 25 minimum wages, do away with one monthly pension payment for new retirees, bring forward the full transition to the new regime from 2014 to 2008, and clearly define the concept of acquired rights. This

reform, which requires eight votes in Congress, received four in the previous legislature and a fifth vote last week, albeit postponing the transition to 2010. It should be approved by June.

9. Reforming state institutions has been a priority of this administration. Ministries have been merged, redundant institutions suppressed, and no less than 27 thousand positions eliminated. The reform of over 150 government institutions has produced savings of no less than 10 percent of GDP in NPV terms. While the government has been unable to garner congressional support for amending the procurement law, through administrative decisions it has introduced meaningful changes to enhance the transparency and efficiency of how the government undertakes business with the private sector. Likewise, important measures have been taken to enhance the government's legal defense capabilities, which should provide important fiscal savings by reducing the costs of lawsuits brought against the government.

10. A key component of the reform of state institutions is the creation of a national hydrocarbon agency (ANH), outside of the state-owned oil company (Ecopetrol). ANH sets policy, while Ecopetrol competes in a level playing field with private operators. ANH has reformed contracts with foreign operators, significantly reducing "government take" in the oil business. As a result, exploration has increased rapidly, and in probabilistic terms it is now expected that the decline in oil production will cease after 2007. Efforts to make Ecopetrol a commercially run enterprise include the politically charged decision of reducing subsidies to gasoline and diesel. At the retail level, gasoline prices are now similar to those in the U.S., something not typical of an oil exporting country. My authorities see merit in staff's proposal to deregulate gasoline prices in the medium term. In the meantime, they remain committed to continue reducing subsidies. Telecom, the state communications company also went through a major re-structuring operation. The new concern (Coltel) is profitable, following changes that implied fiscal savings of more than 8 percent of GDP in NPV terms.

11. Colombia's budget is inflexible. Since early 2004 the government submitted to Congress a draft legislation to reduce earmarking and restrict the ability to make multi-year spending commitments. The reform has received one positive vote in the lower house. It is expected that it will receive the required additional three during this legislature.

12. Looking ahead, further reforming the rules governing decentralization constitutes a major challenge. Transfers from the central government to territorial entities, which used to be linked to the growth of current revenue, are now linked to inflation plus a real increase of 2 percent a year. Unfortunately, the law calls for going back to the previous scheme in 2009. The government, analysts, and broad segments of congress believe that reverting to the previous scheme would be a mistake. The government has expressed publicly that the best alternative is to cap transfers in real terms at the level reached by 2008. This charged public debate should eventually lead to the introduction of legislation on this critical matter, and for that purpose the government has agreed to publish by December 2005 a report evaluating the current revenue sharing system.

13. Important steps have been taken to improve macroeconomic management at the regional level. In 2000 a law was passed limiting operating expenses to a percentage of revenue and establishing corrective adjustment programs with the Ministry of Finance for governments not complying with the ceilings. A 2003 law requires all levels of government

to present each year a consistent 10-year macroeconomic framework, and establishes that at the sub-national level the primary surplus has to ensure debt sustainability. As a result, the overall balance of sub-national governments has improved, and in 2004 the surplus at the regional level explains in part the over-performance of the consolidated public sector.

14. Progress notwithstanding, the decentralization scheme has problems –in addition to those related to revenue sharing. Coordination mechanisms among levels of government should be strengthened, and reporting and monitoring of sub-national governments must be improved. Also, clearer distribution of expenditure responsibilities to avoid duplication would be helpful. The staff finds the sectoral distribution of transfers too rigid, leaving minimal discretion to local governments. While my authorities see merit in this point, it is also the case that health and education needs are prevalent throughout the country, so that earmarking, while diminishing flexibility, facilitates the achievement of shared social goals. Finally, my authorities agree with the staff that transfers could be re-designed in order to provide better incentives at the local level, but do not agree that there is evidence that the transfer system *discourages* local tax collection. Empirical research on the relationship between transfers and taxes show that at the Department level the evidence is mixed, while at the Municipal level taxes (particularly on real estate) have *increased* together with transfers.

Monetary and exchange rate policy

15. It was only a few years ago that Colombia was dubbed by Dornbusch and Fischer as "the moderate inflation country *par excellence*". In 2004, inflation was 5.5 percent, the target established by the central bank. Colombia is well on its way to achieving in a few year´s time the goal of stabilizing inflation in a range of 2-4 percent, similar to that of its trading partners. The inflation targeting framework has served Colombia well, and the central bank is convinced of the benefits of a floating exchange rate regime.

16. In 2004, Colombia was confronted with sizable capital inflows, and observed appreciation pressures unlike any other emerging market. Notwithstanding the fact that the central bank intervened in the foreign exchange market, the peso appreciated 14 percent against the U.S. dollar. Intervention allowed the central bank to increase its level of reserves from $10.5 to $13.2 billion, further strengthening the economy's resilience to shocks. Foreign exchange intervention has been partially sterilized, as my authorities are of the view that there has been an increase in money demand, and that inflation is not in jeopardy if this enhanced demand is accommodated. In 2004, monetary policy was further eased with three reductions in the policy interest rates totaling 75 bps and with the closing of the window for contractionary operations later in the year.

17. The central bank's March inflation report supports the view that the recent monetary easing has been fully consistent with the established inflation target for 2005 and with a further gradual reduction in inflation in 2006. First, the output gap continues to be positive. Second, expectations from surveys and those implicit in financial instruments are consistent with the 5 percent target. Third, there is no pressure coming from wages, with 2/3 of wage negotiations implying wage increases of between 5 and 6 percent in 2005. Fourth, non-traded goods inflation is currently very near the established target for the year. Finally, the exchange rate is expected to remain stable. The central bank has announced that it will continue

intervening in the foreign exchange market as necessary and that its contractionary window will for now remain closed. The bank is confident with the consistency of its policy stance, and has agreed to narrow the inflation consultation band under the new arrangement. In March y-o-y inflation was 5 percent, the established target for end 2005.

18. In late 2004, the government decided that the unstable nature of portfolio investments from abroad could jeopardize the stability of the financial system. It introduced a requirement for portfolio investments to remain in Colombia for at least one year. Interest payments, capital gains, and dividends can be transferred abroad without penalty. The government has recently announced that it will soon eliminate this restriction, whose temporary nature is justified as a means to deal with what is seen as an essentially temporary phenomenon.

Financial sector

19. Following a profound crisis in 1999, Colombia´s financial sector has improved quite remarkably. Banks are well-capitalized and profitable, non-performing loans have decreased significantly, provisions surpass 100 percent of NPLs, and credit to the private sector is increasing at a healthy pace. While the recovery of the financial sector to a certain extent reflects the cyclical position of the economy, policy actions have played a critical role as well. The government's opportune intervention and management of distressed institutions has allowed for the prompt recovery of those that were viable, and the closing of those that were not. Several private institutions that received public sector support have been able to prepay their obligations, while many of the institutions that were taken over by the government have been re-privatized. Colombia has pioneered a risk-based provisioning system (SARC) and is gradually taking the steps necessary to adopt Basel II.

20. My authorities see the need of further reducing public sector participation in the financial sector. In 2004 they unsuccessfully attempted to privatize Bancafe, and remain committed to bringing it to the point of sale. For that purpose, a restructuring program is underway which, by removing labor and pension liabilities, should make the new bank (Granbanco-Bancafe) attractive to potential buyers. The reform of Granahorrar is well on its way, and it should be brought to the point of sale later in the year. In the meantime, the government is devoted to enhancing governance practices in the new Granbanco-Bancafe as well as in Banagrario, and for that purpose has requested technical assistance from the Fund.

21. The updated FSSA has provided valuable information and policy recommendations. The report rightly notes that, recent progress notwithstanding, problems remain in a few institutions, particularly among mortgage banks. My authorities agree with staff that it is important to enhance the technical capability of the supervisor, particularly in the area of risk evaluation. My authorities reminded staff that it had unsuccessfully tried to advance in Congress the principles of enhancing the independence of the supervisory agency and of granting immunity to supervisors. My authorities have a different view regarding staff's claim that assets are over-valued, a statement that fails to recognize important recent advances in valuation mechanisms both by the supervisory agency and by the central bank. Finally, my authorities believe that stress tests undertaken by staff involve scenarios that are too extreme, not supported by Colombia's historical financial developments.

Vulnerabilities and risks

22. My authorities commend staff for an excellent paper on balance sheet mismatches, noting, however, that it uses data up to 2003, and all indications are that vulnerabilities declined significantly in 2004 --public debt went down, its currency composition improved, the currency strengthened, and interest rates declined. The paper shows that while public debt remains high, albeit declining, corporate vulnerabilities have receded and households have build up a sizable net financial position. The financial sector is less exposed to currency risk through the household and corporate sectors, but its exposure to the sovereign has increased. Staff argues for more asset diversification on the part of non-bank financial institutions, and my authorities believe that the securities reform being considered by Congress is a step in that direction, as it will facilitate the diversification of corporate financing sources, including by fostering the issuance of equity. Staff provides interesting suggestions as to how to further promote hedging mechanisms and my authorities have requested technical assistance from the Fund in order to move from the diagnosis to the implementation stage.

23. According to staff, downside risks include a public debt level that is still high; a faster than anticipated decline in the surplus of local governments; a deterioration in security; a deterioration in the external environment; and expenditure pressures due to the electoral cycle. These points are well-taken, and the government is working on those areas that are under its control. In particular, continued fiscal consolidation is the cornerstone of the new arrangement. With regard to security, the notable issue is not so much whether it is “good” or “bad”, but rather whether it is improving or not. All indicators suggest that not only has security increased markedly, but also that all key actors have internalized the importance of enhancing it. What used to be the agenda of the government has now become the agenda of the Colombian people. In terms of security, if anything, risks are on the upside. Finally, it is evident that the external situation has been good and that it is bound to eventually deteriorate somewhat. My authorities are aware of this and have taken measures to strengthen the fiscal position, improve the currency composition of debt, increase the NIR position, and, more importantly, continue with the remarkable diversification of the economy. In a country where not long ago coffee represented around 50 percent of exports, oil –at current high prices—is now the largest export item, accounting for less than 25 percent of total exports.

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IMF Executive Board Concludes 2005 Article IV Consultation with Colombia

On April 29, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Colombia.[1]

Background

Since 1999 Colombia's economic policies have sought to strengthen the economy in the aftermath of the country's worst economic crisis in 30 years. The strategy focused on fiscal consolidation, lowering inflation, and strengthening the financial system. The government that took office in August 2002 improved the fiscal position through several revenue measures (a one-time wealth tax, an income tax surcharge, and a broadening of the VAT base) and expenditure restraint. Two pension reforms were also adopted, reducing the actuarial deficit of the pension system from 207 percent of GDP to 187 percent of GDP. Other reforms focused on restructuring and downsizing the nonfinancial public sector, improving financial supervision, and privatizing or liquidating the remaining public banks. Congress also approved in December 2002 a labor market reform to encourage employment in the formal sector. In addition, this administration established a policy known as democratic security to try to resolve the civil strife.

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

Initially the recovery proceeded slowly but in 2003–04 economic performance improved significantly:

- Real economic growth recovered to 4 percent a year in 2003–04. The national unemployment rate declined from 20 percent at end-2000 to 12 percent at end-2004, while the poverty rate declined from almost 60 percent in 1999 to 52 percent in 2003.

- The combined public sector deficit was reduced from 3.4 percent of GDP in 2000 to an unexpectedly low 1.3 percent of GDP in 2004, reflecting an unanticipated rise in the export price of oil to US$36 per barrel and an unusually large surplus of the autonomous local and regional governments. This outturn—together with the real appreciation of the peso during 2004—helped reduce public debt to 53 percent of GDP by end-2004. Also, public sector deposits reached 10.5 percent of GDP by end-2004.

- Inflation declined to 5.5 percent during 2004—the lowest level in decades—owing to the effective implementation of the inflation targeting framework.

- The external sector strengthened, led by sustained growth in exports and a recovery in capital inflows. During 2004, the peso appreciated by 11 percent in real effective terms, prompting the central bank to purchase US$2.9 billion (about one-third of the stock of base money) to limit the appreciation. By end-2004, net international reserves reached US$13.2 billion (123 percent of short-term external debt on a remaining maturity basis).

- The health of the financial system continued to improve. The solvency and profitability of the banking system have recovered, reflecting economic growth, a successful recapitalization scheme, and improved supervision. Nonperforming loans declined to 3.6 percent of total loans by late 2004 and were fully covered by provisions. The bank restructuring agency (FOGAFIN) continued to trim the government's participation in the banking system by selling several banks that were intervened in 1999. Progress continued in implementing risk-based financial supervision and actions to combat money laundering.

Executive Board Assessment

Executive Directors commended the authorities' pursuit of sound macroeconomic policies and structural reforms in recent years, which has contributed to a significant improvement in Colombia's macroeconomic performance and social indicators despite a difficult security environment. Economic growth has rebounded; inflation, unemployment, and the public debt have declined; the balance of payments position has improved, in part because of buoyant export growth; and confidence in the economy has strengthened, as reflected in increased capital inflows, the appreciation of the domestic currency, and a lowered country risk premium.

At the same time, Directors noted that unemployment, poverty, and the public debt remain high. In addition, while welcoming the reduction in the foreign currency component of the public debt through the issuance of peso-denominated bonds in international capital markets, Directors emphasized that external vulnerabilities still loom large due to rollover and foreign exchange risks. They therefore welcomed the authorities' intention to maintain the strategy of fiscal consolidation and steadfast pursuit of structural reform in the coming years, in order to strengthen the foundations for economic growth and to further reduce inflation and the ratio of public debt to GDP.

Directors agreed that the authorities' main challenge in implementing the economic strategy will be to maintain the pace of fiscal reforms. They considered the reforms currently before Congress—the revised budget code and the pension reform—to be important for containing expenditure growth and increasing the flexibility of expenditure management. However, they stressed that several other reforms will be needed over the medium term, on both revenue and expenditure.

On revenue, Directors welcomed the authorities' intention to continue to build support for a more efficient tax system while broadening the tax base and improving tax administration. They encouraged the authorities to slow the increases in revenue transfers from the central administration to subnational governments, and to strengthen fiscal coordination among the different levels of government. On expenditure, Directors called for a streamlining of current expenditure to make room for more productive capital expenditure. They welcomed efforts to increase the effectiveness of social spending through better targeting of subsidies to the poor. They also urged additional pension reform to limit the expected rapid rise in net pension costs, and gradual deregulation of the domestic prices of gasoline and diesel over the medium term. Directors encouraged further improvements in debt management, especially by increasing reliance on domestic currency borrowing, to reduce vulnerabilities.

Directors commended the prudent conduct of monetary policy. They noted that the inflation targeting framework has helped lower inflation expectations, and welcomed the authorities' commitment to reduce inflation to the range of 2–4 percent a year over the medium term. Directors considered that the flexible exchange rate regime has served Colombia well. It has helped maintain Colombia's external competitiveness, as evidenced by the broad-based growth of exports and the sustainable level of the external current account deficit. Most Directors urged the authorities to guard against excessive foreign exchange intervention aimed at curbing the appreciation of the currency, as this could create uncertainty regarding the objective of monetary policy, generate inflationary pressures, and raise quasi-fiscal costs through sterilization operations. They encouraged the authorities to phase out, as planned, the temporary capital controls instituted in December

2004. Directors welcomed the improved management of foreign exchange risk by the private sector, and encouraged the authorities to continue to facilitate the development of market-based hedging mechanisms.

Directors commended the government's financial restructuring operations, which have helped strengthen the financial system since 1999. They encouraged continued efforts to improve financial supervision, as recommended in the Financial System Stability Assessment Report. Key measures would include provision of sufficient autonomy to the Superintendency of Banks and adoption of risk-based regulations in line with the Basel II core principles. Directors encouraged the authorities to continue to reduce the role of the public sector in the banking system, and, in this regard, commended the decision to divest one large state-owned bank and to consider the divestment of another state-owned bank. They considered the new securities market law to be an important step toward deepening the domestic capital market, and urged the phase-out of the financial transactions tax and the bank stamp tax to promote financial intermediation.

Directors welcomed Colombia's acceptance of the obligations of Article VIII, Sections 2, 3, and 4. They urged the authorities to establish a timetable for removing two remaining exchange restrictions.

Colombia: Selected Economic Indicators

	2000	2001	2002	2003	Prel. 2004	Proj. 2005
(Annual percentage change, unless otherwise indicated)						
National income and prices						
Real GDP	2.9	1.5	1.9	4.0	4.0	4.0
Consumer prices (end-of-period)	8.7	7.6	7.0	6.5	5.5	5.0
Nominal exchange rate (depreciation+, end of period)	19.0	2.8	25.0	-3.0	-14.0	...
Real effective exchange rate (depreciation-)	-2.6	1.5	-17.4	-5.2	11.4	...
Money and credit 1/						
Broad money	-2.1	7.0	5.3	6.5	16.7	11.1
Credit to the private sector	-8.6	1.7	4.0	9.2	12.2	14.6
Real interest rate (90-day time deposits; percent per year)	4.2	3.6	0.7	1.4	2.2	...
(In percent of GDP, unless otherwise indicated)						
External sector						
Current account (deficit-)	0.9	-1.4	-1.7	-1.5	-1.0	-2.8
External debt	46.1	47.5	52.3	46.0	37.1	35.9
Of which: public sector	26.3	28.5	31.9	29.6	24.1	22.7
Net official reserves (in months of imports of goods and services)	6.6	7.8	7.6	6.5	7.1	6.5
Savings and investment						
Gross domestic investment	13.7	14.5	14.2	14.9	14.0	15.3
Gross national savings	14.6	13.2	12.6	13.5	12.9	12.5
Public finances						
Combined public sector balance	-3.4	-3.2	-3.7	-2.7	-1.3	-2.5
Nonfinancial public sector balance	-3.5	-3.5	-4.2	-3.2	-1.7	-2.5
Central administration balance	-5.7	-5.7	-6.4	-5.4	-5.5	-6.1
Public sector debt 2/ 3/	47.7	51.8	60.2	56.0	52.9	50.4

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

1/ All annual changes in foreign currency stocks valued at constant exchange rate.
2/ Includes bonds issued to recapitalize financial institutions.
3/ Program definition. Assumes no purchases under the current SBA. Includes valuation changes.