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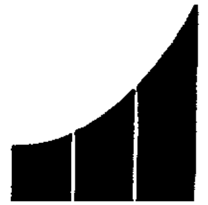

COLOMBIA: ECONOMIC TRENDS AND PERSPECTIVES

Exclusive Report for Interbanco

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LONG TERM TRENDS

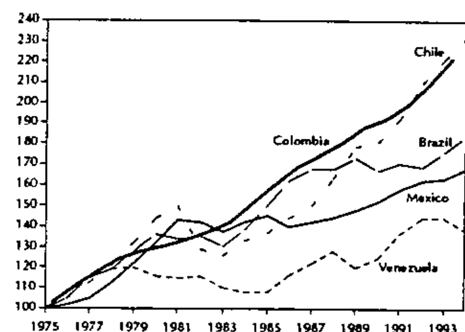
1. Economic Growth

Traditionally Colombia has not been affected by the great booms and recessions experienced by other Latin American countries. Through all of the post World War period Colombia has not shown an absolute drop of its GDP in any year, as has been the case in other countries. It achieved the highest percentage growth in Latin America between 1975 and 1991, and it is now surpassed only by Chile (Graph 1). Since 1980, per-capita GDP increased 21.2%, while it fell 2.4% in Latin America as a whole.

Due to the adjustment policies designed to fight inflation, and to the acceleration of the trade liberalization process, growth faltered in 1991 and 1992. However, during 1993 and 1994 the economy regained growth rates above 5%, and it is expected that in the medium term the indicators will continue on this path.

GDP is estimated at around US$66.5 billion in 1994 (US$1,810 per capita). The Colombian economy is well diversified, with agriculture, manufacturing and mining together contributing almost half of GDP. The major agricultural product is coffee, while manufacturing is concentrated in consumer goods and export industries (garments, paper products, chemicals). Mining activity is concentrated in petroleum, coal, nickel, emeralds, precious metals and iron ore. The mining sector is expected to gain importance in the next years with the coming on stream of the new oil fields of Cusiana and Cupiagua (with estimated reserves above 2 bn barrels).

GRAPH 1. GDP Growth Index for Some LA Countries



2. Inflation

Inflation figures in Colombia also stand out in comparison with most Latin American countries, even though inflation levels are higher than those prevailing in the developed world and in Asia's rapidly industrializing countries.

Between 1980 and 1993, average inflation in Colombia was 24.3%, peaking in 1990 (32.4%). It has gradually subsided since

TABLE 1.Colombia: Main Economic Indicators. 1980-1994.

	Real GDP Growth	Inflation Rate	Fiscal Balance	Foreing Debt			Foreing Debt			Service of the Debt
				Total	Public	Private	Total	Public	Private	
	%	%	% GDP	US$ millions	US$ millions	US$ millions	% GDP	% GDP	% GDP	% Exports
1980	4.1	25.9	-2.3	6601	4324	2277	19.8	12.9	6.8	18.9
1981	2.3	26.4	-5.5	8581	5708	2873	23.6	15.7	7.9	32.9
1982	0.9	24.0	-6.0	10273	6819	3454	26.4	17.5	8.9	42.1
1983	1.6	16.6	-7.4	11383	7780	3603	29.4	20.1	9.3	50.0
1984	3.4	18.3	-5.9	11123	7588	3535	29.1	19.8	9.2	45.4
1985	3.1	22.5	-4.4	14226	10811	3415	40.8	31.0	9.8	49.8
1986	5.8	20.9	-0.3	15680	12691	2989	44.9	36.3	8.6	42.6
1987	5.4	24.0	-1.9	17047	13947	3100	46.9	38.3	8.5	50.8
1988	4.1	28.1	-2.5	17359	14011	3348	44.3	35.7	8.5	57.7
1989	3.4	26.1	-2.4	17007	14071	2936	43.0	35.6	7.4	61.1
1990	4.3	32.4	-0.3	17556	14809	2747	43.6	36.8	6.8	52.8
1991	2.0	26.8	0.2	16975	14661	2314	39.9	34.4	5.4	49.8
1992	3.8	25.1	-0.3	16833	13831	3002	34.6	28.4	6.2	52.7
1993	5.3	22.6	0.3	18261	13350	4911	34.2	25.0	9.2	46.9
1994	5.7	22.6	2.6	21143	13088	8055	32.6	20.2	12.4	46.9

Soruce: Dane and Banco de la República.

then, falling to 22.6% in 1993 and 1994. By the end of 1994 the Government launched a «Social Pact» aimed at reducing inflation to 18% in 1995 by dismantling the main mechanisms of price indexation and reducing inflation expectations.

3. Fiscal Situation and External Debt

In the first half of the 80's, Colombia's fiscal deficit stayed close to 6% of GDP. During the second half of the eighties the deficit was corrected and since 1991 public finances have been near or above equilibrium. In 1994 the fiscal surplus including the privatizations reached 2.6% of GDP. The correction of previous fiscal imbalances has been mainly the result of a number of successful tax reforms, aimed at widening the tax base and modernizing the tax system. Greater control on the decentralized public sector has also helped to strengthen the fiscal situation.

Another area in which Colombia stands out in the regional context is that of foreign debt. It is mainly due to the growing strength of the foreign sector (see below), that Colombia has shown a constant improvement of its foreign debt indicators over

the past years. Total Colombia's foreign debt was equivalent to 40.8% of GDP in 1985, but this percentage has been decreasing in past years, to reach 32.5% in 1994, or US$21.1 bn. The role of the public government in these results is outstanding, whereas the public debt decreased from 31 to 20.1% of GDP in this same period.

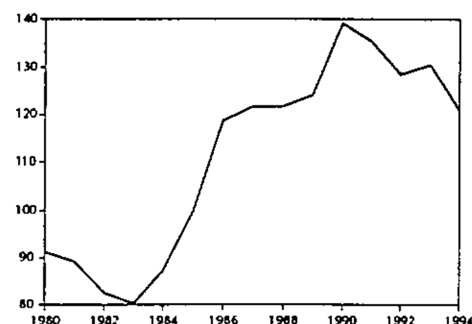
The total servicing of the debt has remained above the levels that were common until the early eighties. However, prepayment of foreign debt and substitution of debt with high interest rates for debt with more attractive interests through emission of bonds in the U.S., Japan and European stock markets, led to a reduction of public debt service as a proportion of exports during the last two years from 47.5% in 1992 to 28.6% in 1994.

It should be mentioned that Colombia was the only Latin American country which did not default on its payments or apply to renegotiate its foreign debt during the 80's.

4. Balance of Payments, Exchange Rate and International Reserves

Current account deficits as large as 7% of GDP occurred in Colombia in the early 80's. The country successfully undertook a comprehensive adjustment effort to deal with these imbalances. The fiscal deficit was severely reduced, and later eliminated, the exchange rate was devalued and a process of export diversification was actively pursued.

GRAPH 1. Colombia: Real Exchange Rate Index (1985 = 100)



Source: Banco de la República.

As recently as 1985, coffee sales accounted for 45% of total goods exported. The remainder was distributed among non-traditional exports of agriculture and manufactured products (30%), petroleum and its derivatives (11%), coal (3%), ferronickel (2%), and gold (10%). In the second half of the 80's, oil discoveries allowed Colombia to become a net exporter of hydrocarbons; exports of coal increased, and a boom in the non-traditional exports (agricultural and industrial) took place. As of 1993, coffee represented merely 15% of total goods exported, petroleum and its derivatives 18%, coal 8%, and non-traditional exports 54%. The average annual growth in the exports of petroleum and its derivatives was 27.9% from 1985 to 1993, while non-traditional exports showed an average rate of growth of 31.8%.

The expansion of the non-traditional exports since the mid-eighties had its roots in the stability of economic policies and, in particular, in a sustained favorable real exchange rate (Graph 2). A previous overvaluation of the peso was corrected between 1983 and 1986, when a real depreciation of 65% took place. An additional devaluation, which occurred until 1991, proved to be

TABLE 2. Colombia: Balance of Payments 1980-1994. selected years (Million of dollars)

	1980	1982	1985	1988	1990	1991	1992	1993	1994
Current Account	104	(2.885)	(1.586)	(216)	543	2.347	922	(2.242)	(3.037)
Trade Balance	13	(2.076)	109	827	1.972	2.959	1.234	(1.657)	(2.551)
Exports	4.296	3.282	3.782	5.343	7.079	7.507	7.263	7.429	8.545
Coffee	2.208	1.515	1.702	1.621	1.399	1.324	1.259	1.140	2.080
Oil	100	213	409	988	1.951	1.461	1.396	1.323	1.174
Coal, Nickel, Gold	320	183	546	,877	1065	1182	1044	981	928
Other	1.668	1.371	1.125	1.85	2.664	3.541	3.565	3.984	4.363
Imports	4.283	5.358	3.673	4.515	5.108	4.548	6.029	9.086	11.096
Services and Tranfers Balance	91	(809)	(1.695)	(1.043)	(1.428)	(613)	(312)	(585)	(486)
Capital Account	1.137	2.184	1.871	575	83	(468)	247	2.446	3.180
Direct and Portfolio Invesment	48	330	1.015	158	480	514	865	1.411	2.255
Other Long Term Finance	767	1286	1335	675	-283.8	-369.4	-634.6	-434.6	1754
Short term and errors	322	568	-479	-258	-113	-612	16	1470	-829
International Reserves	5419	4892	2312	3851.	4595	6500	7728	7932	8116

Source: Banco de la República.

unsustainable in the face of the large capital inflows of the following years. Thus, after an appreciation of nearly 13%, the real exchange rate is now back to levels close to that of 1986.

The growth of total imports which had been relatively low until 1991, 3.9% in dollar terms as an annual average between 1985 and 1991, has accelerated rapidly in the past three years, as a result of the trade liberalization policies the Government is committed to (see below), and of the recent real appreciation the peso has undergone. Imports grew 28% between 1991 and 1992, and 51% in 1993, spurred by imports in the areas of durable consumption goods, capital goods and transportation equipment.

The recent increase of imports of goods and services has led to a rapid decline of the current account. The huge surplus of 1991, equivalent to 5.5% of GDP, transformed itself into a deficit of 4.6% in 1994. Nonetheless, international reserves have remained at a high level, both in nominal terms and as months of imports, due to the inflow of direct foreign investment and other sources of long term finance. By the end of 1994, international reserves were US$8 bn, equivalent to 8.7 months of imports.

STRUCTURAL REFORMS

As other Latin American countries, in the early nineties Colombia undertook an ambitious program of structural reforms aimed at increasing productivity and reducing State intervention in economic activities. The core of the package of structural reforms was a program of trade liberalization, although ambitious structural reforms were also undertaken in areas such as foreign exchange operations, foreign investment, labor regime, financial legislation and tax regime.

1. Imports liberalization

Import liberalization began on February 1990, during Virgilio Barco's rule and was broadened and accelerated by the Gaviria Administration in 1990 and 1991. Import liberalization comprised the elimination of quantitative controls, which previously affected 60% of tariff positions and were administered on a case-by-case basis, and the reduction and harmonization of tariff rates. In 1990 there were 14 different tariff levels, rather spread apart, with an average tariff rate of almost 45% (including an across-the-board 8%). The resulting tariff structure consists of four basic tariff levels: 0% for raw materials, intermediate and capital goods not produced in Colombia; 5% and 10% for goods produced in the country; and 15% for final consumer goods. The 8% tariff surcharge remained until the beginning of 1992, when it was incorporated to the tariff structure (for that purpose, an additional tariff level of 20% was created). Apart from the five levels ranging from 0% to 20%, two additional levels (35% and 40%) apply only to automobiles. Agricultural products are subject to a variable tariff system, whereas the tariff may change to offset variations in international prices beyond a predetermined band.

As a result of these reforms the average tariff rate was reduced from 43.7% in December 1989 to 11.7% in March 1992, decreasing the total effective protection from 90.9% to 29.3% in the same period. Some minor reductions have taken place thereafter as a result of international trade agreements.

2. Trade Negotiations

In order to maximize the benefits of international trade, unilateral trade liberalization was complemented with a more active position in bilateral and multilateral negotiations.

Colombia has recently adopted a multi-tiered approach to trade negotiations. It has become more active in multilateral negotiations such as the GATT's Uruguay Round, while simultaneously pursuing its objectives through negotiations with the EU

and the US as well as signing several regional trade agreements. The latter is clearly justified by the large share of regional trade in total trade in Colombia (more than 60% of Colombian imports come from Latin America and the US, and more than 62% of the country's exports are destined to those areas).

With this strategy, Colombia has gained a privileged trade position:

- Thanks to recognition by the international community of the costs incurred by Colombia in its fight against drugs, it enjoys preferential access to the markets of US and the EU. Since November 1990 (and until 1996) the vast majority of Colombian products have free access to the European Union market. Since June 1992 through the Andean Trade Preference Act, ATPA, and for a 10-year period, nearly all trade barriers have been eliminated for 4,816 items (more than 78% of Colombian total tariff items) in the US market.

- Since January 1992 Colombia and Venezuela share a free trade area, and were joined by Ecuador and Bolivia in September 1992, thus creating a common market of more than 70 million people.

- Furthermore, in December 1993 Colombia and Chile signed a trade agreement to eliminate tariffs completely by 1999. In June 1994 Colombia, Venezuela and Mexico reached also an agreement to create a free trade area under the framework of G3 negotiations. Finally, Colombia and the Caribbean countries subscribed a trade agreement in July 1994. If negotiations with Central America and the Mercosur continue to develop, Colombia's trade position will become even more advantageous. These countries represent a market of more than 200 million people and more than half of Latin America's GNP and total exports.

3. Foreign Exchange Operations

The former foreign exchange regime, in force since 1967, was characterized by a strict and centralized control over all foreign exchange transactions. The main reforms introduced in 1991 were (1) granting amnesty to capital previously held abroad; (2) granting financial intermediaries and stock exchange commissioners permission to negotiate in foreign currency; (3) requiring exchange operations associated with the trade of goods or financial transactions to take place through the financial system; and (4) allowing currency originating in tourism, donations or services to be freely held.

Since 1994, the influence of the market forces is crucial in determining the exchange rate, as the Central Bank introduced a

managed float of the peso within a 14-point band. The Central Bank announces the upper and lower limits of the band and it may intervene in the market to smooth fluctuations or maintain a desired level of international reserves.

4. Foreign Investment

Until 1990, foreign investment was severely limited and regulated. The reforms introduced in this area were far reaching: (1) Equal conditions were granted for foreign and national investors, including free access to domestic credit, fiscal incentives and tax conditions. (2) Foreign investment was prohibited only in sectors of national interest, namely defense, processing, disposal and discharge of hazardous waste. In all other sectors, including the financial sector, free entry was allowed. (3) Free remittance of profits, as well as free remittance of capital, either partial or total, was permitted at any time. (4) The special surcharge for dividends or partnership profits received by nonresidents and for the remittance of commercial profits of branches of foreign companies or entities was reduced from 12% in 1993 to 10% in 1994, 8% in 1995 and 7% from 1996 onward. (5) Guarantees were established to provide stable conditions for foreign investment. Operation and profit remittance conditions cannot, therefore, become less favorable unless a foreign exchange crisis occurs.

5. The Labor and Social Security Regimes

The main purpose of the labor legislation reform was to eliminate a number of rigidities that were both hindering industrial restructuring and reducing workers stability. The main adjustments in force since 1991 were the elimination of retroactive severance payments and the 10-year stability clauses. In 1993 a substantial reform of the social security system was passed by the Congress.

Retroactive severance payments greatly increased the cost of stable labor. For workers hired after the approval of the law, it was determined that severance provisions («cesant_as») would be transferred annually to newly created severance funds, which would earn, at a minimum, the market interest rate. Previously hired workers were allowed to negotiate their change to the new regime with their employers. This process has been used widely to the benefit of both parties because current wages received by workers have increased, while provision requirements for the firms have been slimmed.

The 10-year stability clause prevented in practice to fire workers with more than 10 years of service. This clause was eliminated, although the indemnification fees for firing were raised.

A deep reform of the social security system was discussed at length in Congress and finally passed in December 1993. The reform enables private financial institutions to manage pension payment savings. Thus, employees may choose between the public Social Security Institute (ISS) or private funds. Pension collection rates are the same for the two systems (presently 12.5%, and 13.5% in 1996 and thereafter), but the conditions for receiving pension benefits differ between the two systems and among age groups. Employees and their families may also choose between alternative health institutions, under a two-tiered security system. Health contribution rates were increased from 7% to 12% (effective April, 1995).

6. Financial Sector Reforms

Structural changes in Colombia's financial system in the 1990s include four basic components: (1) more competition among financial intermediaries; (2) reduced reserve and obligatory investment requirements and increased reliance on market-base instruments of monetary control; (3) modernization of central banking legislation; and (4) a better regulatory framework.

To foster competition, Law 45 on the financial system, issued in 1990, authorized the ownership of financial institutions by foreign investors, permitted free entry into all segments of the market, subject only to prudential requirements; and made regulations more uniform among different types of institutions. With this law, intermediaries can expand the scope of their activities through the creation of subsidiaries and introduce innovations in their operations and services. The law defined explicit rules for the creation, functioning and restructuring of financial intermediaries. Law 35 of 1993 on financial activities defined a set of transparent regulations aimed at reducing market segmentation and fostering competition.

Privatization of public financial institutions has been part of the effort to promote competition in the financial sector. As of September 1994, the government had divested its equity holdings in the Banco de Colombia, Banco de Trabajadores, Banco de Tequendama, Banco de Comercio and the Corpavi financial corporation. The share of the public sector ownership in the financial sector fell from 72% at the end of 1990 to 24% as of mid-1994. The Banco Central Hipotecario was sold to the public pension fund (ISS) in exchange for central administration liabilities.

Forced investment requirements and monetary reserves for commercial banks and other intermediaries have been a key tool of financial intervention and monetary control in Colombia.

However, since 1990 forced investments are being phased out, the burden of obligatory investments has been reduced and been made to apply more uniformly, and the yield has been raised closer to market rates. The monetary average reserve requirements varies substantially among financial intermediaries: 25.5% for commercial banks (reflecting the 41% reserve ratio for demand deposits), 8.1% for savings and loan institutions, and 2.7% for development finance and commercial finance companies. The Central Bank is studying the possibility of reducing the dispersion of reserve requirements.

The Central Bank Law enacted in 1992 in development of the Constitution of 1991 provides for greater autonomy of the Central Bank, in part through the establishment of a governing board that includes five independent members in addition to the Minister of Finance (who presides as chairman) and the Central Bank General Manager (who is appointed by the board). The Central Bank is required to coordinate monetary and exchange rate policies with the Government's economic program, but its overriding objective is to seek price stability. The Central Bank charter prohibits the grating of credit to the Government, except for carrying out open market operations, unless the executive board gives its unanimous consent. The Central Bank may provide temporary liquidity to financial institutions, but overdrafts are not permitted. The Central Bank may impose credit controls or interest rate ceiling for periods not exceeding 120 days a year. The Central Bank is no longer authorized to require reserve-substituting investments, which were common in the past.

The regulatory framework of the financial system has been strengthened since 1990. The Superintendecy of Banks has been empowered to set requirements for ensuring that financial market participants will have the appropriate infrastructure to comply with financial and fiscal regulations. It has also been authorized to enforce antitrust law provisions in the financial sector. The law also establishes capital requirements for various types of intermediaries (for commercial banks it is set at 8% of total assets). In the area of financial sector regulation, the government is authorized to establish prudential portfolio and capital ratios to reduce risks. These ratios, which were originally set according to the Basilea Agreement, have been recently increased. The government is also authorized to limit or prohibit the extension of credit guarantees by financial entities, dictate norms for avoiding discriminatory practices and establish norms to facilitate mergers and acquisitions of financial entities and insurance companies.

7. Tax Reforms

Two major tax reforms have been passed by the Colombian Congress in the last four years. Approved in late 1990, the first

reform (1) granted amnesty to capitals held abroad before the implementation of the reform; (2) increased the value-added tax (VAT) rate from 10 to 12%; (3) extended the VAT to communications and personal services; and (4) granted tax exemptions to capital gains stemming from the sale of shares in the stock market. In addition, in 1991 the government imposed a 5% «war surtax» on the income of the large taxpayers and a «special contribution» to be paid by the oil companies.

Congress approved the second tax reform, aimed at offsetting the revenue loss by trade liberalization in July 1992. The reform seeks to (1) broaden the VAT base; (2) increase from 12% to 14% the VAT basic rate; (3) create a surcharge of 7.5 points on the income tax (thus increasing if from 30% to 37.5%); and (4) increase the ad-valorem gasoline tax and the «special contribution on hydrocarbons».

A new tax reform aimed at eliminating tax exemptions and simplifying most taxes is expected to be presented by the Government to the Congress in the next few weeks.

RECENT DEVELOPMENTS AND PERSPECTIVES

1. Adjustments to the Structural Reforms

The Samper Administration, inaugurated in August 1994, will deepen and consolidate most of the structural reforms described above. In particular, privatization will proceed apace. Between 1995 and 1998, the Samper government will sell most of the remaining public banks (the only important exception being Caja Agraria, a rural development bank), a number of other financial institutions, several electricity plants, a few hotels and 7 industrial firms partially owned by the Institute of Industrial Promotion (IFI). Together with revenues arising from concessions in utilities and transportation, the government is likely to raise US$3 billion over the period. The Samper Administration will most likely maintain the existing regimes of foreign exchange and foreign investment and will pursue the consolidation of the ambitious social security reforms passed by the Congress in late 1993.

The Samper government will probably take a less aggressive stance with respect to trade liberalization. The government has been concerned with the poor performance of the agriculture, textile and garment sectors, which were particularly hard hit by the reduction in tariffs, and has responded by providing financial assistance to these sectors and affording them a modestly higher level of tariff protection. The consolidation of the existing trade agreements and a unification of the Andean Pact and Mercosur are high on the agenda on the new administration.

The process of financial liberalization and development will also be deepened by the Samper government. In particular, special attention is being devoted to the design of new policies aimed at promoting the development of capital markets, and a technical mission has been set for that purpose. In order to reduce financial risks the government has increased capital ratios, introduced changes to the classification of overdue loans and established new methods of valuation of the investments of financial intermediaries.

The new administration will also deepen the process of tax reform by eliminating exemptions, increasing the VAT on a few luxury goods, lowering to 35% the income tax rate, lifting the «war tax» to new oil productions and improving the methods of collection of taxes.

2. Economic Growth

In 1994 growth was 5.7%, fueled by the boom of all types of domestic expenditure, both private and public. Over the 1995-98 period, the government aims to keep GDP growth above 5%. Although perspectives look promising, official projections are too optimistic. For 1995, GDP growth is likely to be 5.3% instead of 6%, and for 1996-1998 an average of 4.5% seems more reasonable than the 5.6% expected by the government. Growth will be supported by the expected expansion of investment in a variety of projects in oil and other infrastructure. The increase of oil exports will also provide a strong boost to economic activity. On the other hand, however, growth will be hindered by mounting labor costs and a less dynamic supply of domestic and external credits. The Central Bank is likely to maintain real interest rates high to restrain inflationary pressures, which will be fueled by more rapid devaluation rates.

TABLE 3. Colombia: Macroeconomic Projections

	1994	1995		1996	1997	1998
		Official	Fedesarrollo			
GDP growth (%)	5,7	6,0	5,3	4,0	4,8	4,6
Consumer prices (% change)	22,6	18,0	19,5	17,9	17,8	17,6
Peso devaluation rate (%) (peso vs U.S. dollar)	3,4	14,0	14,0	14,0	18,0	18,0
Real effective exchange rate (% change)	-7.3	0,0	-0,9	0,0	3,7	3,9
External current account (% of GDP)	-4,6	n.a	-5,3	-6,1	-5,1	-4,8
Total external debt (% of GDP)	31,4	n.a	28,0	29,3	31,1	32,3

Sources: National Planning Department and Fedesarrollo's projections.

3. Inflation

The government's inflation target of 18% by end-1995 seems out of reach and most likely inflation will close out the year at 19-20%. Although monthly inflation in January and February was relatively moderate (at 1.84% and 3.52%, respectively), the 12 month rate in February remained above 20%. A recent dry spell followed by freezing temperatures will most likely force foodstuffs prices up, as will a recent adjustment in gasoline prices.

The fight against inflation has historically been one of the least successful areas of Colombia's economic policy. This partly reflects the view within certain sectors of government that it is politically foolish to sacrifice economic growth —particularly in a country with low per capita income (US$1.800)— for a more aggressive reduction in the rate of inflation. As long as inflation remains stable, the argument goes, its disruptive impact is minimized. Though not in agreement with this view, the Central Bank seems to accept that reducing inflation is a gradual process. Thus, it is content with reducing the inflation rate by 3 or 4 percentage points per annum. But even this timid objective may prove difficult to reach if the rate of devaluation of the peso accelerates. It is not unlikely that devaluation reaches 14% in 1995 and 1996 and even more in the following years.

In the past couple of years, strong capital inflows have pressured the exchange rate band and caused the money supply to grow faster than planned. Thus, in 1994 the exchange rate increased only 3.4% and the supply of money grew 26.7% (or 32.6% on a 12-month average basis). This year, the central bank aims to keep money supply (m1) growth to 24.5%. That objective seems easily attainable, given the change in capital flows and the likely fall of international reserves (see below). To accommodate money demand the monetary authorities plan to use high real interest rates, currently in the 15% range, to help them reach their goals.

To boost the central bank's anti-inflation efforts, last December the government negotiated a Mexican-style tripartite price and wage pact, known as the Pacto Social, that marks an important departure from the traditional practice of indexing wages, rents, and other important prices to past inflation. Under the Pacto, labor agreed to accept a minimum wage increase of 20.5% in 1995, roughly equal to expected inflation plus likely productivity gains. Industry agreed to increase prices by 18% over the year, as did the government for most public sector prices, except gasoline, natural gas, and long-distance telephone rates which will rise by less than 18%. Significantly, the Pacto also committed the Samper govern-

ment to reduce import tariffs further to increase competition, marking an important departure from earlier government rhetoric.

The Pacto both facilitates the attainment of the inflation target and increases the pressure on the economic authorities to meet that target to build credibility for future Pactos. In this respect it might become more of a constraint of fiscal policy than the Samper government may originally have envisioned: should inflation fail to decelerate, there will be increased pressure on the finance ministry to scale back its ambitious spending plans to mitigate inflationary pressures and prevent an erosion of real wages. In fact, the authorities have very recently announced a US$380 million (0.5% of GDP) reduction in the 1995 budget to help with the deceleration of inflation.

4. Fiscal Accounts

Although the structure of the fiscal accounts will change significantly by 1998 as a result of the development plan «El Salto Social» proposed by the government and recently approved by Congress, the overall public sector will remain in balance over the period. If fully carried out, the Salto will push the central government on an aggressive expansion in real expenditures averaging 12.2% over the 1995-98 period, which will come on top of significant increases in justice and security expenditures under the previous administration. By 1998, central government expenditures will have reached 20.6% of GDP from 12.9% in 1991. Because the increase in central government expenditures will not be fully matched by increases in revenues, its financial position is expected to deteriorate over the next several years. The central government's deficits are expected to widen from 2.7% of GDP in 1995 to 4.0% of GDP in 1998. These figures include the likely proceeds from privatization, which in 1995 are expected to reach 0.6% of GDP as a result of the planned sale of two banks and the granting of various concessions. The authorities forecast that the deficits in the central government's accounts will be more than offset by surpluses in the other sectors of government such as Ecopetrol, the National Coffee Fund, and the Social Security Institute. As a result, the public sector as a whole is expected to post a surplus of 0.7% of GDP in 1995, and to stay basically in balance between 1996 and 1998. To minimize the impact of the central government's projected deficits on the local capital markets, the finance ministry is hoping to fund itself by placing bonds with those public-sector entities posting surpluses.

Broadly speaking, the government's forecasts seem plausible, although both government expenditures and public-entity surpluses may be somewhat overstated. The capacity of the central

TABLE 4. Colombia: Fiscal Accounts % of GDP

	1994	1995	1996	1997	1998
Central government					
Total revenue	17,0	14,7	16,1	16,3	16,6
Current revenue	14,4	14,1	15,1	15,5	16,1
Capital revenue	2,6	0,6	1,0	0,8	0,5
Total expenditure	16,2	17,3	19,5	20,0	20,6
Current expenditure	13,3	14,4	15,5	15,6	15,9
Interest payments	1,5	1,7	1,9	2,0	2,2
Capital expenditure	2,6	2,5	3,7	4,2	4,6
Net lending	0,3	0,4	0,3	0,3	0,1
Balance	0,8	-2,7	-3,4	-3,7	-4,0
Other public sector*					
Total revenue	15,8	17,1	16,9	16,8	17,1
Total expenditures	14,2	13,7	13,5	13,0	13,2
Interest payments	1,9	1,7	1,2	1,1	1,2
Balance	1,7	3,4	3,4	3,8	4,0
Public sector balance	2,5	0,7	0,1	0,1	0,0
Memo: Oil Stabilization Fund savings	0,0	0,0	0,1	0,4	0,7

* Includes Ecopetrol, the National Coffee Fund, states and municipalities, and the Social Security Institute; excludes the Oil Stabilization Fund.
Source: National Planning Department.

government to raise its spending may be lower than envisaged in the government's plans, while the surpluses forecasted for the National Coffee Fund and the Social Security Institute may be overly optimistic— in part due to the limits on price increases for public goods established in the Pacto. Nevertheless, the Salto is not likely to result in a substantive worsening in overall public-sector finances or in the debt burden. In fact, public-sector debt (foreign plus domestic) is likely to remain stable at about 40% of GDP through 1998.

5. External accounts

The country's external accounts are not expected to change dramatically over the next several years, although certain recent trends should begin to reverse themselves as of 1995. Following the apertura in 1991, Colombia's current account moved from a surplus in 1991 to a deficit equal to 4.6% of GDP in 1994. However, a surge in direct investments and long-term capital inflows permitted an expansion in international reserves from US$4.2 billion in 1990 to a historic high of US$8.1 billion in 1994, equal to 8.8 months of imports.

The widening of the current account deficit probably will continue until 1996 and then reverse course through 1998. Import growth is expected to remain strong in 1995 (18%) reflecting the expected strength in investment, but exports should also expand strongly (22%). A stable real exchange rate should prevent further

competitive pressures on non-traditional exports like agricultural goods, livestock, chemicals, textiles, leather goods, and apparel. But more importantly, oil exports will balloon as the Cusiana oil field comes on stream and it pushes oil revenues up by a forecasted 58% in 1995. As a result, the current account deficit is expected to reach at US$4 billion (5.3% of GDP) this year. However, the deficit will peak in 1996 at around US$5 billion (6.1% of GDP), partly as a result of a larger trade deficit, and partly due to higher net interest payments and remittances. In the following years, the current account deficit will stay around US$4.2-4.3 billion, as a result of a stronger trade balance and a larger service deficit.

While the projected current account deficit numbers are unquestionably large, they will be largely financed by foreign direct investment and other long-term capital, especially in 1995 and 1996. Large-scale investment projects in oil, electricity, and other infrastructure are expected to result in net foreign direct investment of US$2.7 billion in 1995 (fully 3.6% of GDP) and US$2.1 billion in 1996. Many of the investment projects are already under way, and there is little risk that foreign capital of this sort will not materialize. British Petroleum, Triton Energy Corporation, and Total are pouring significant sums of money into the Cusiana and Cupiagua oil fields, while a number of foreign companies are bidding for various concessions.

TABLE 5. Colombia: Balance of Payments (US$ millions)

	1994	1995	1996	1997	1998
Current Account	-2982	-4080	-4985	-4341	-4208
Trade balance	-2385	-2517	-2813	-1646	-650
Exports	8514	10371	10807	12077	13484
Oil	1326	2089	2395	2989	4170
Coffee	1897	2552	2175	2180	1884
Imports	10899	12889	13620	13723	14135
Services balance	-1442	-2453	-3098	-3665	-4573
Non financial	461	154	0	44	-165
Financial	-1903	-2607	-3098	-3709	-4408
Transfers	845	890	926	970	1015
Capital account	3107	3542	4013	4223	3296
Direct and portfolio investment	1538	2743	2100	1600	1450
Memo: International reserves	8013	7475	6503	6385	5473

Source: 1994- National Planning Department; 1995-8: Fedesarrollo.

As a result of the investment inflows, the country's net accumulation of foreign debt to cover the current account deficit will be limited in 1995 and 1996. Most likely, given the new post-Mexico international financial environment, the reliance on net new external debt may reach only US$1 billion in 1995 and US$2.5 billion in 1996. Depending on the magnitude of Colombian capital repatriation, reserves may decrease marginally, perhaps by US$0.5 billion in 1995 and US$1 billion in 1996.

Although foreign direct investment will most likely fall as of 1997, so will the current account deficit. Hence, net credits may stay around US$2.4 billion in order to maintain international reserves at a comfortable level, above US$5 billion. External debt ratios (public plus private sector) are expected to remain stable at very manageable levels over the period: gross external debt should remain at about 30% of GDP, while debt service is expected to remain at about 30% of exports.

CONCLUSION

Colombia stands out in the Latin American context as a very stable economy, free of the booms and busts typical of other countries. Though some macroeconomic imbalances appeared in the mid-80's, they were rapidly corrected with the adoption of fiscal adjustments and a substantial increase of the real exchange rate. As a result, Colombia was the only Latin American economy which did not renegotiate its foreign debt during the 80's. The country's record of steady economic growth, stable inflation and prudent macroeconomic management is acknowledged in the international financial markets. Colombia is one of only two countries in the region to enjoy an investment grade rating from Standard and Poor's (BBB-).

The structural reforms initiated in 1990 liberalized trade, granted access to foreign investors in all areas of economic activity, decentralized the foreign exchange regime and reduced State intervention. This process is unlikely to be reversed and, in the case of privatization, it will be deepened.

The recent deterioration of the international financial environment after the Mexican crisis will not cause a major change in growth perspectives in Colombia. Growth will remain above 4% in the next years, fueled by large investment projects, in the oil sector and elsewhere, and by social spending programs. A gradual process of disinflation will be pursued with the help of a tight monetary policy and forward-looking wage and price agreements. The country's external accounts will be managed in a manner consistent with the maintenance of a stable external burden.

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