Support for Adjustment in Colombia

In response to intense pressure on Colombia's balance of payments in 1981-84, and a threatened pullout by the country's commercial creditors, the Bank increased its assistance to Colombia. The main instruments were the $300 million Trade Policy and Export Diversification loan (TPED) and the $250 million Trade and Agricultural Policy loan (TAP). Despite their names, the loans were largely designed to support the Government's macroeconomic adjustment program which, unusually, was undertaken without the use of IMF resources, though it was closely monitored by the Fund. By responding to the concerns of commercial creditors, the loans played an important role in maintaining commercial lending.

As noted in OED's audit, all the main goals of the loans were met: better macroeconomic management, exchange rate policy, and coffee policy; avoidance of macroeconomic crisis, and resumption of growth. Colombia achieved the best economic growth record in the 1980s in Latin America. However, by replacing short-term Fund resources with long-term Bank resources in support of macroeconomic stabilization and adjustment, the loans created unrealistic expectations that the Bank would finance macroeconomic policy change even in normal economic times. The Bank took the view that further adjustment lending would need to be justified by significant reform in sectoral policies. It took several years, and a change in the Colombian administration, to resolve this difference in viewpoint.

Crisis and adjustment

Colombia's balance of payments crisis of the early 1980s had both internal and external causes. Lulled by the coffee boom of the later 1970s, the Government had allowed the exchange rate to appreciate significantly. With lax monetary policy, foreign exchange earnings translated into high money growth. A long, but limited and vacillating, movement to liberalize trade had not reduced vulnerability to the coffee price cycle.

Strong devaluations and economic contraction in Colombia's major Latin American trading partners reduced the country's export earnings. Debt problems in other Latin American countries also had an impact: by a process of association, international commercial banks reduced lending and hardened their terms for Colombia, despite the latter's relatively low foreign debt and traditionally prudent economic management.

Continuing a long tradition of influence in Colombia's economic policy making, the Bank advised on responses to the crisis. It accelerated disbursements of existing loans and designed new loans, subject to the Government's introduction of a macroeconomic adjustment program.

Agreement was reached (in April 1985) between the Bank, Fund, and commercial banks for a sui generis Monitoring Arrangement between the Fund and Colombia, under which the Fund would follow the development of the adjustment program as closely as it would have under a Stand-by Agreement, but there was to be no purchase of Fund resources.

The adjustment program called for:
- full correction of exchange rate overvaluation;
- limited trade liberalization; and
- scaling down of (global) external borrowing targets.

Two Bank loans

TPED

The Trade Policy and Export Diversification Loan (May 1985) was the first major Bank operation in the context of increased lending in conjunction with the IMF Monitoring Arrangement. Its conditions paralleled the agreements reached in the context of the Monitoring Arrangement, although they laid emphasis on more liberal trade. Despite its name, TPED was basically a structural adjustment loan.

This loan was a major success. The Government implemented the adjustment program agreed with the IMF and the Bank almost in its entirety. TPED was instrumental in persuading the commercial banks to continue long-term lending to Colombia. By providing foreign exchange for export-bound imported inputs, it allowed export growth to resume, preventing further deterioration of the balance of payments.

probable deep economic recession, and possible long-term retreat behind protectionist barriers. It also supported changes in administrative arrangements for imports and exports that increased efficiency.

TAP

Like the earlier loan, TPED, the Trade and Agricultural Policy Loan (May 1986) supported the macroeconomic adjustment program and financed imported inputs for exports, but with the added goal of modest changes in agricultural policy.

As with TPED, understandings not stated in the loan documents were important in the design of TAP; these were successfully acted upon. Several of the agricultural reform measures formally supported, however, appear not to have been implemented in time, either wholly or in part. Several of them were not spelled out clearly enough to be monitored and so it is difficult to determine how far the goals were achieved. Agricultural policy makers resisted having the Ministry of Finance change sectoral policies, in the context of a World Bank loan, without the long process of consensus-building characteristic of Colombian policy making.

Was TAP needed?

In retrospect, TAP exemplifies how changing circumstances may weaken the rationale for an otherwise well-conceived and carefully designed operation. Conceived with TPED in late 1984, TAP had been presented to Colombia's commercial creditors as part of a package with TPED, during the discussions leading to the 1985-86 agreements, and was also seen by the Fund as integral to the adjustment effort.

The trade and agricultural policy improvements contained in TAP's legal documents were very modest, and the justification of TAP thus rested largely on the same goals as those of the TPED: continued macroeconomic adjustment, in the absence of a formal standby agreement with the Fund, and continued facilitation of commercial bank credit flows.

But by 1986, when TAP was implemented, the economic situation had changed significantly. World coffee prices had risen sharply in 1985. The adjustment program was producing rapid results. Many of the quarterly targets agreed with the Fund were exceeded in 1985-86. The overall public sector deficit fell from 6.7 percent of GDP in 1984 to 4.2 percent in 1985; for 1986, no deficit was expected. Helped by higher coffee prices and higher exports of coal and petroleum, the balance of payments deficit on current account shrank fast and was in surplus by 1986.

Even the Colombian authorities debated whether to go ahead with TAP, in view of the resistance of affected parties to deepening structural reforms. By early 1986 it was becoming clear that the Government had no plans for the time being for major import liberalization or export promotion.

Outcomes and lessons

Moderate progress toward more liberal imports was achieved as agreed: quantitative restrictions and license controls were gradually lifted, though not enough to expose local producers to foreign competition. Given the dual focus of the two loans, on macroeconomic and sectoral policy measures, and the Government's overriding concern with macroeconomic matters, it would probably have been difficult for the Bank to obtain a real commitment to trade liberalization in the context of these two loans.

The adjustment program had a sustained effect. Colombia's GDP growth increased from 2.5 percent in 1983-84 to 4.5 percent in 1987-88, and unemployment fell from about 14 percent to about 10 percent. Public investment increased from 8.4 percent of GDP in 1983 to 9 percent in 1987, within a framework of careful monitoring of the rationale and profitability of new investment projects. By 1990, confident that a more open economic system could be sustained, the Government began pushing for a trade regime that would expose many local producers to serious foreign competition for the first time.

The Bank more than kept its commitment to increase lending to Colombia in line with that of the commercial banks. Its share of Colombia's long-term external debt rose from 17.4 percent in 1984 to 25.4 percent in 1988, limiting the scope for continued contributions to Colombia's development efforts over the ensuing few years.

Despite the overall success of the two loans, the relations between the Bank and Colombia subsequently deteriorated. One reason was the almost complete turnover of staff that took place in the Bank's 1987 reorganization, resulting in a change of perspective and the loss of many tacit understandings on policy change that had existed between Bank and Colombian counterpart staff.

A more enduring factor was that the loans had created expectations that the Bank could be a continuing source of lending to support macroeconomic adjustment. Having successfully substituted long-term Bank resources for shorter-term Fund resources, the Colombian authorities expected to be able to reproduce this pattern even in normal economic times. The Bank took the view that—especially in light of its increased exposure in Colombia—additional adjustment lending could only be justified by significant sectoral policy reform within the context of an adequate medium-term macroeconomic framework. The differences in viewpoint took several years, and a change in the Colombian administration, to resolve.