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THE BOARD OF DIRECTORS REPORT  
TO THE CONGRESS OF COLOMBIA

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MARCH, 2001

BANCO DE LA REPÚBLICA

(THE CENTRAL BANK)

**BOARD OF DIRECTORS**

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*Santafé de Bogotá, C.D. March 29, 2001*

*Honorable Chairmen and Members  
Third Standing Constitutional Committees of the  
Senate and The House of Representatives  
Bogotá*

*Dear Sirs:*

*The Board of Directors of the Banco de la República, pursuant to the provisions of article 5 of Law 31 of 1992, hereby submits to the Congress of the Republic a report setting forth the macroeconomic results of year 2000 and those during 2001 to date. Similarly, the goals adopted by The Board of Directors for the current year are set forth herein as well as the different perspectives for various macroeconomic variables. The last section is intended to provide information for the Congress regarding the structuring of international reserves and the projection of the financial situation of the Banco de la República for the year 2001.*

*Yours truly,*



Miguel Urrutia Montoya  
Governor

## INTRODUCTION

During 2000 Colombian economy began a process of economic recovery recording a Gross Domestic Product (GDP) growth rate of 2,81% within a framework of inflation rate drop. Although it represents an average growth under the historical average, the sources of this growth lay down the bases for recovery of the economic activity, which started during 2000, and strengthens and consolidates towards the future. The macroeconomic handling and its adequate coordination bear the responsibility of ensuring that this be attained, through coherent monetary, fiscal and external policies, which deepen the progress obtained and guarantee growth sustainability and the reduction of unemployment rate in the near future.

A careful analysis of the economic results for year 2000 allow identifying the bases upon which the economic recovery could be accelerated and to consolidate price stability. This is the core topic of this Board of Directors Report to the Honorable Congress of Colombia.

The second section of this Report examines the results of the economic activity during 2000 and the perspectives for 2001. Sources of growth are discussed in this section, both from the supply and demand points of view, and an evaluation of unemployment is performed, as the main problem affecting Colombian economy. It is worth highlighting the fact that economic recovery is being generated by a greater dynamics of private productive activity. As pointed out by DANE (National Administrative Department of Statistics), the private sector GDP grew 3,58% during 2000, while the public sector GDP showed a contraction of 1,16%. Industry, agriculture and commerce were the main productive sectors responsible for the recovery. On their part, private consumption, none traditional exports and private investment accounted for the origin of a greater demand. This is the profile of an economy undergoing recovery as responding to correct policies and incentives. On one hand, it reflects the effects of the fiscal adjustment effort that allowed reducing the public non-financial sector deficit from 6,1% of the GDP in 1999 to 3,6% of GDP in 2000. On the other hand, it shows that reduction of real interest rates and an attainable competitive real exchange rate have been successful to stimulate private initiative, encourage household consumption and strengthen exports. Recovery based on these characteristics has the advantage of being sustainable, while progressing towards fiscal clearance and provides appropriate incentives so that the private incentive becomes the growth propeller.

Identification of the positive aspects of the growth origin is in contrast with the unemployment rate, which undoubtedly constitutes the most serious problem of Colombian economy. Current unemployment is linked to the lower growth of economic activity during the latest years. However, the determining factors of unemployment are far more complex than the mere economic deceleration.

Inflexibility of the labor market is related to, among others, increased real labor costs, an addition of an important number of women and youngsters to the labor market searching for a supplement to family income, the low educational level of the population and the weakening of intensive hand labor sectors, such as the construction sector. The foregoing and other aspects of unemployment origin are studied later, in an effort to present a more comprehensive context for evaluating macroeconomic policy. From such analysis it may be concluded that only if the ongoing recovery of economic activity is supplemented with policies tending to improve the operation of the labor market, it will be possible to observe important reductions in the unemployment rate during the next few years.

The third section of the Report examines different aspects of macroeconomic policy in year 2000 and perspectives for 2001. The section relating to economic policy explains the new strategy adopted by the Board and describes the actions undertaken through the year. The process of monetary intervention through open market transactions (OMA) is analyzed in detail. The difficulties for providing liquidity to a fragmented financial market can then be clearly observed, being such market subject to substantial changes in connection with the public, induced by the tax upon financial transactions and by the drop in interest rates. The description of the monetary events during 2000 allows an adequate understanding of the policy decisions and of the advantages of the new monetary strategy. By allowing more flexibility in the handling of monetary aggregates, the new strategy pursues a greater stability in the interbank interest rate, without compromising the achievement of the inflation target.

The report continues to review the financial system situation. This is one of the sectors where the cycle of recovery of Colombian economy is best observed. Various indicators show improvement in the public financial sector as well as in the private financial sector. In fact, the current solvency of the system is at the same level it was before the crisis, the percentage of unproductive assets decreased, the level of coverage protects half of the overdue portfolio and the assets profitability shows a significant improvement as compared to 1999. Even though such profitability is still negative due to the effort of portfolio procurement, the banking private sector recovery is evident.

A description of the foreign exchange policy is shown, examining the market foreign currency purchase options by the Banco de la República and the behavior of the relevant premiums and amounts. Similarly, the main decisions are explained regarding foreign exchange regulation adopted by the Board during 2000.

The result of the balance of payments during 2000 is of relevant importance as the basis for recovery, since the balance of trade represented surplus and the balance of current account presented equilibrium. This section examines the main determinant factors for attaining this result, were the good performance of exports stands out, which reached a growth rate of 12,7% Dollars and a share of 15,8% of the GDP, the highest ever since 1970. Not only the oil exports were responsible for this result, but the non-traditional exports also contributed, - including industrial exports - which showed growth rates of 17% and 21% respectively, thus stimulating the industrial activity recovery.

Progress in public finances clearance in 2000 and its improvement during the current year, constitute essential requirements for the sustainability of economic recovery. The Report examines progress attained in the fiscal aspect, which allowed reducing the national government deficit from 7,5% of the GDP in 1999 to 6,0% of the GDP in 2000. Similarly, it analyzes the factors that made it possible to increase the surplus for the rest of the public sector from 1,4% to 2,4% of the GDP during the same period. The main legal amendments have also been commented upon, which were enacted during 2000, and which will provide continuity to the fiscal adjustment and perspectives for the year 2001 are submitted to discussion. This section concludes with a reflection on the matter of territorial finances unbalances, based on the result of research carried out within the Banco de la República.

The fourth section of the Report presents the results of inflation and its basic trends. In this regard, the Board stresses the fact that through achieving the inflation target in 2000, Colombian economy is firmly positioned among the group of countries with one digit inflation rate. The inflation rate reduction from 9,2% in 1999 to 8,7% in 2000 was achieved in the context of an economy under recovery, thus weakening the announcements of those who expected that the reestablishment of growth would revive inflation. The results achieved during 2000, and the favorable performance continued to be shown by inflation during 2001, and confirm the confidence of the monetary authority on the fulfillment of the 8,0% target set for the present year and 6% for 2002.

The Report concludes with the presentation of the financial situation of the Banco de la República. It highlights the profits obtained during 2000, amounting to \$ 1,45 billion, which, according to governing law will be delivered to the Government prior to the end of the month of March 2001. The profit will contribute substantially for financing the National Government activities during the current year.

## COLOMBIAN ECONOMY UNDER RECOVERY PROCESS

### A. FOUNDATIONS OF THE RECOVERY

The recovery of the economy during the year 2000 was carried out within macroeconomic stabilization, lower inflation, adjustment of public finances and equilibrium of the current account of the balance of payments.

The most outstanding fact is having achieved an economic recovery, while the process of inflation reduction consolidated. During year 2000, an additional reduction of one half point was obtained in the inflation rate, with respect to 1999, and the economy grew at a rate close to 2,8%. In general, this result is accounted for as fulfillment of the targets established in the macroeconomic program outlined for the year 2000. This program combined adequately the monetary, foreign exchange and credit policy instruments together with the fiscal and foreign policies, which allowed a better space for private activity.

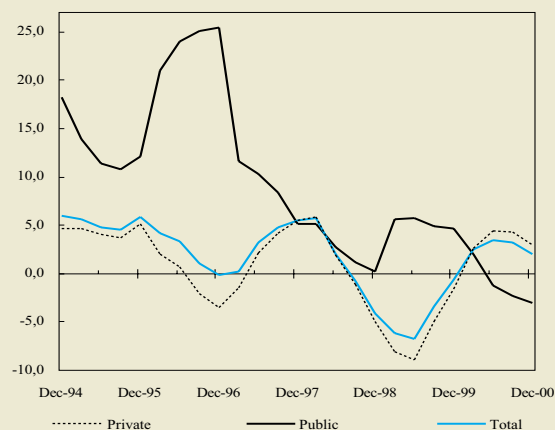
The fulfillment of the macroeconomic program has led to revitalizing aggregate demand, strengthening the financial system and stabilizing the public debt indicators. Additionally, the foreign exchange market maintained the foreign exchange rate at a competitive level, while interest rates decreased. These factors have increased the public confidence on the economy, while the risk perception of international markets has diminished.

As a consequence, private consumption, private investment and non-traditional exports have begun to recover, being the main growth sources for 2000, while public investment and expenditure showed a

decreasing trend throughout the year, fulfilling the fiscal adjustment goals. This means that economic recovery has been generated completely by the private sector activity. In fact, if the GDP is shown in terms of the public and private sectors, it may be seen that the first grew 3,03% during the last quarter, while the second decreased 2,99% with respect to the same quarter of the previous year. (Figure 1).

Despite the economic reactivation during 2000, the high unemployment rate continues to be one of the main problems of the country. As it is discussed in this chapter, economic circumstantial factors, such as economic growth deceleration, increase in labor supply, and structural factors as an increase in the global participation rate and changes in the structure of labor demand, explain the increased unemployment during the nineties decade.

FIGURE 1.  
ANNUAL GROWTH RATE OF THE  
PUBLIC, PRIVATE AND TOTAL QUARTERLY GDP  
(PERCENTAGE)



Source: National Administrative Department of Statistics (DANE).



## B. ECONOMIC GROWTH DURING 2000

### 1. Supply Analysis

According to preliminary estimates from the National Administrative Department of Statistics (DANE), the GDP annual growth rate was 2,8% during 2000; greater than in prior years (0,56% in 1998 and -4,3% in 1999). Specifically, during the first quarter of 2000 the economy grew 2,5%; 3,5% during the second quarter, 3,2% during the third quarter and 2,1% during the fourth quarter of 2000, with respect to each of the quarters of the previous year. (Figure 2).

The economic growth was led by the good performance of the industrial sector, which changed from a 12,5% decrease in 1999 to a 9,7% growth in 2000, consolidating its recovery after six quarters of continuous drop<sup>1</sup>.

The positive performance of the industrial activity was due to the dynamism of external demand and to a competitive real exchange rate, which led to 21,7% growth of the dollar value of industrial exports between 1999 and 2000. Among the group

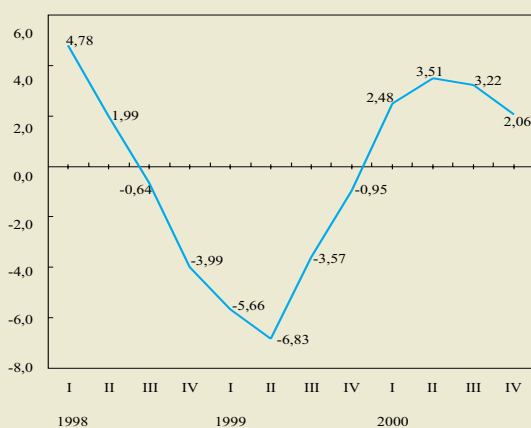
of goods, the outstanding exports were those of transportation materials, wood, leather, common metals and machinery and equipment. (Figure 3).

Similarly, after six quarters of negative growth, the commerce sector showed considerable recovery during 2000, by changing from an 8,9% decrease in 1999 to a 5,3% increase for the whole year. This recovery is explained by the good performance of "tradable" supply reflected in an increase in agricultural and industrial production and an increase in imports, as well as in hotel and restaurant services which changed from -4,6% in 1999 to 3,3% in 2000. This performance is reflected through the retail sale index by commerce, which during 2000 showed positive growth rates (Figure 4).

The Agricultural and Livestock sector grew 5,3% mainly due to a greater coffee production (7,4%)<sup>2</sup> and to crops different from coffee, which grew 6,5%, including permanent crops such as flowers, African palm, and sugar cane. The growth of this sector was favored by: associative credit flow, granted by the agricultural sector support programs, the high level of the real exchange rate and favorable climatic conditions.

The construction sector had a lesser drop during 2000 (-0,9%) as compared to (-24,6%) in 1999. For the first time after ten quarters of continuous drop, the construction sector showed positive growth rates during the last two quarters of the year, 2,8% and 6,8% respectively. This favorable trend was due mostly to the dynamism of building construction, which recovered during the year, reaching positive growth rates during the second semester of 2000.

FIGURE 2.  
ANNUAL GROWTH RATE OF THE QUARTERLY GDP  
(PERCENTAGE)



Source: National Administrative Department of Statistics (DANE) and Ministry of Finance and Public Credit.

<sup>1</sup> Particularly, the manufacturing industry presented 8,8% growth during the first quarter, 11,8% during the second quarter, 13,2% during the third quarter and 6,1% during the fourth quarter.

<sup>2</sup> The coffee GDP growth figures in real terms are consistent with the drop in real revenues of the sector which occurred as a consequence of the poor performance of international coffee prices.

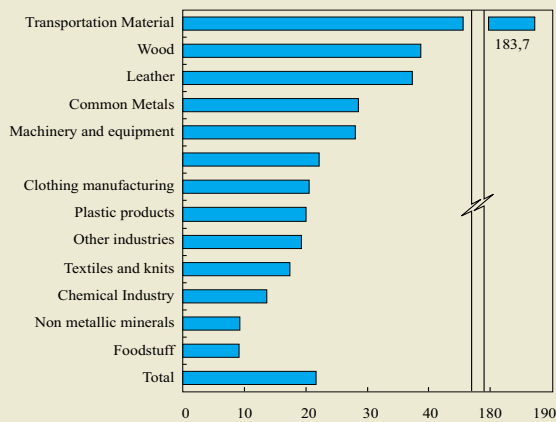
Civil engineering works showed recovery by growing 1,5% during 2000, after having decreased 12,1% in 1999.

The DANE census for buildings confirms construction reactivation. As it may be observed in Figure 5, the new construction works grew nearly 40% during the fourth quarter of 2000, as compared to the same period in 1999, while the stayed works

decreased in more than 30,0% during 2000. Such recovery can also be seen in the increase of the number of approved construction licenses and areas. (Figure 6).

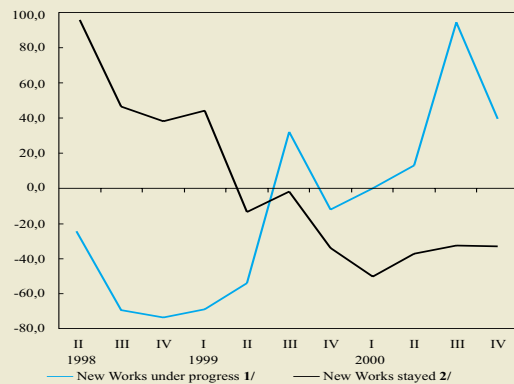
With regards to the issue of financing construction, a recovery of the credit directed towards the construction of social housing was observed, fact that reflects the emphasis that the government has

**FIGURE 3.**  
NON TRADITIONAL INDUSTRIAL EXPORTS  
DURING 2000  
(ANNUAL GROWTH IN DOLLARS)



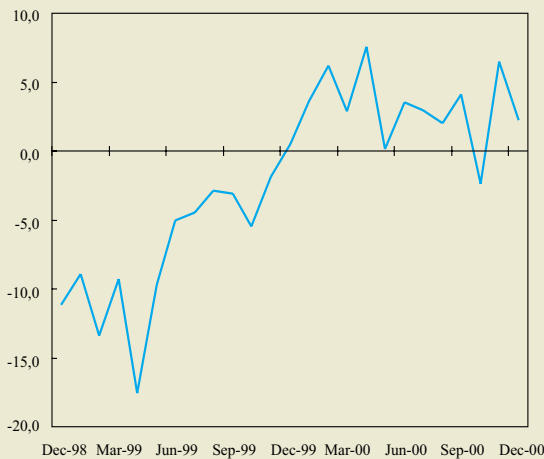
Source: Banco de la República.

**FIGURE 5.**  
BUILDINGS CENSUS - TOTAL IN SIX AREAS  
(ANNUAL GROWTH OF CONSTRUCTED AREA IN  
SQUARE METERS)



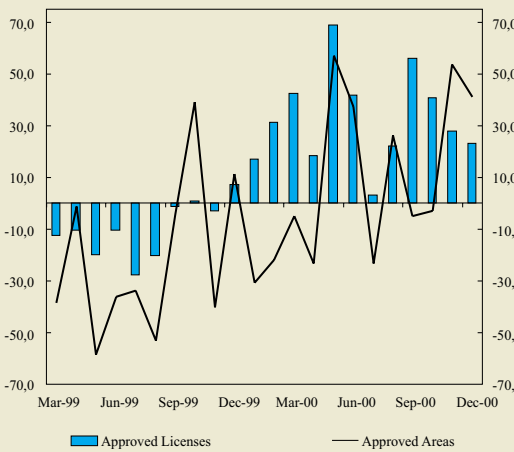
1/ Refers to construction area initiated during the census period.  
2/ Includes the construction area initiated and stayed during the reference quarter and the areas whose work was under progress in previous periods becomes inactive in the current period.  
Source: DANE.

**FIGURE 4.**  
REAL SALES OF RETAIL TRADE NOT  
INCLUDING FUEL  
(ANNUAL GROWTH )



Source: DANE.

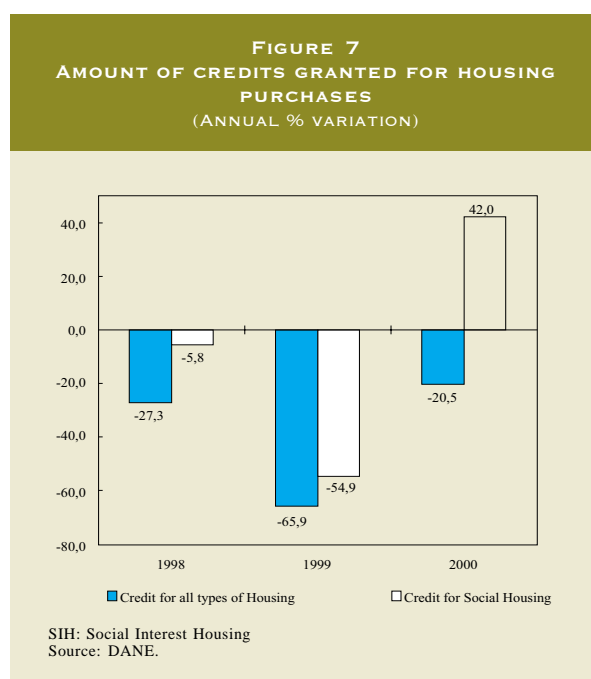
**FIGURE 6.**  
APPROVED LICENSES AND AREAS FOR TOTAL  
CONSTRUCTION  
(ANNUAL GROWTH )



Source: DANE.

applied to this type of housing construction, as a part of its strategies for generating employment. (Figure 7).

Despite the recovery evidenced by most of the economic sectors during 2000, a drawback in



production of sectors such as mining and social services was observed, which showed contractions of -5,7% and -1,1% respectively, upon having been the only sectors that had grown during 1999, at growth rates of 4,7% and 3,9% respectively. The former is explained mainly by the decrease of oil production (15,7%) due to the decline in production of the main oil wells existing in the country and the latter by the reduction of the leisure services and government services.

Thus, the results of the economic activity during 2000 showed a positive balance for most sectors, as it is indicated by the high growth rates of industry, commerce and agriculture. On the contrary, a moderate drop compared with previous years in the construction occurred, as well as a deceleration of the mining exploitation sector and of the government services (Table 1).

## 2 Analysis of Demand

Analyzing GDP growth from the expenditure point of view, final consumption contributed to economy growth in 2000 with nearly 1,8 percentage points.

**TABLE 1**  
**GROSS DOMESTIC PRODUCT (GDP) BY ACTIVITY SECTOR (1994=100)**  
(ANNUAL GROWTH %)  
(UNSEASONALIZED SERIES)

Economic Activity Sector	1999 (e)	2000 (e)					2001 (proj.)
		I	II	III	IV	Total	
Agriculture and Livestock, Forestry, Hunting and Fishing	(0,04)	2,2	7,0	3,6	7,2	5,3	4,4
Mining and Quarrying	4,7	0,2	(8,4)	(12,7)	(6,4)	(5,7)	(0,1)
Electric power, Gas and Water	(3,5)	4,2	2,5	1,2	3,1	2,7	3,8
Manufacturing Industry	(12,5)	8,8	11,8	13,2	6,1	9,7	7,0
Construction	(24,6)	(10,0)	(2,4)	2,8	6,8	(0,9)	6,1
Commerce, repairs, restaurants and hotels	(8,9)	4,0	7,3	6,4	3,4	5,3	4,6
Transportation and Communications	(3,0)	3,3	3,8	4,1	3,2	3,7	4,8
Financial Establishments, real estate and services to enterprises	(6,4)	(1,7)	(0,4)	1,4	(0,3)	(0,2)	3,1
Social Services, Community and Personal Services	3,9	1,1	(1,2)	(1,8)	(2,4)	(1,1)	(1,1)
<b>Gross Domestic Product</b>	<b>(4,3)</b>	<b>2,5</b>	<b>3,5</b>	<b>3,2</b>	<b>2,1</b>	<b>2,8</b>	<b>3,8</b>

(e) estimated

(proj.) projected.

Source: (1999) DANE, (2000) Ministry of Finance and Public Credit, General Directorate of Macroeconomic Policy (DGPM), (2001) National Planning Department (DNP) - Economic Studies Directorate (DEE).

This growth was mainly due to the positive household behavior, which grew 3,2% throughout the year, contributing with nearly 2,1 percentage points to the total economy growth and thus compensating the -1,3% drop of public administration consumption<sup>3</sup> (Table 2).

The positive behavior of household consumption explains the internal demand recovery during 2000 as compared to 1999, year in which the household consumption dropped 5,1%. Hence, final consumption showed positive growth rates after six quarters of continuous drop, even accounting for consumption reduction by the government. Recovery in household consumption is due to the increase in real salaries, increase of the number of occupied population, the decrease of interest rates and the reduction of household indebtedness. A greater consumption is reflected upon an increase in the demand of durable goods (11,5%), semi-durable goods (8,2%) and non-durable goods (2,5%) (Table 3).

One of the factors that affected demand dynamism was the historically low levels of the average real interest rates (Figure 8), which allowed an increase of durable goods consumption. This fact is reflected on the increase of credit card financed sales (Figure 9), and the recovery of the consumption credit during 2000 (Figure 10).

Demand recovery was not only present on the side of consumption but also on the total investment, while changing from decreasing 32,1% in 1999 to a growth of 13,4% during 2000. This result is explained mainly by an increase of 47,8% of private investment. Despite this fact, its does not reach the level present in 1998. Private investment growth was attained thanks to an increase in the gross formation of fixed private capital (25,1%) and to the recovery of inventory variation, which changed from de-accumulating nearly 0,61% of

<sup>3</sup> Since DANE has not provided GDP growth in terms of expenditure, the numbers estimated by the Ministry of Finance and Public Credit have been used.

**TABLE 2**  
GDP BY COMPONENTS OF EXPENDITURE (MILLION PESOS 1994) ANNUAL GROWTH (%)  
(UNSEASONALIZED SERIES)

	1999	2000 (e)	2001 (proj.)
<b>Total consumption</b>	(3,0)	2,0	2,3
Household consumption	(5,1)	3,2	3,6
Public Administration consumption	3,6	(1,3)	(1,7)
<b>Total investment</b>	(32,1)	13,4	13,6
Private investment	(56,5)	47,8	27,9
Public investment	1,1	(7,0)	0,3
Gross fixed capital formation	(23,8)	4,6	10,8
Private	(47,0)	25,1	24,1
Pública	5,4	(9,4)	(0,8)
Changes in stocks	n.c.	n.c.	n.c.
<b>Final Internal Demand</b>	(8,4)	3,6	4,0
Exports	5,7	1,2	3,8
Imports	(16,6)	5,5	4,7
<b>Gross Domestic Product</b>	(4,3)	2,8	3,8

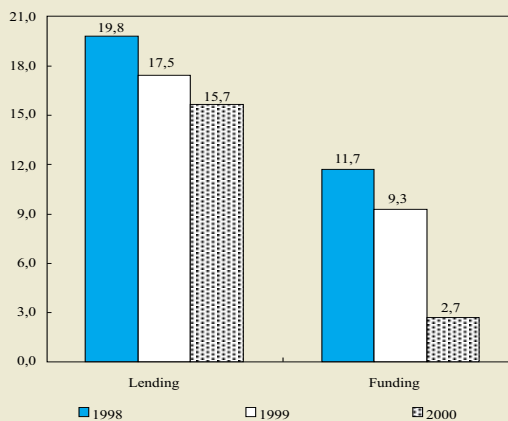
(e) estimated.

(proj.) Projected.

n.c. Non computable. As a percentage of the GDP the variation of existences changed from -0,61% in 1999 to 0,58% in 2000 and it is expected to reach historical levels of 1,0% for 2001.

Source: Ministry of Finance and Public Credit, General Directorate of Macroeconomic Policy (DGPM).

**FIGURE 8**  
REAL INTEREST RATES  
(ANNUAL AVERAGE - PERCENT)



Source: Banco de la República.

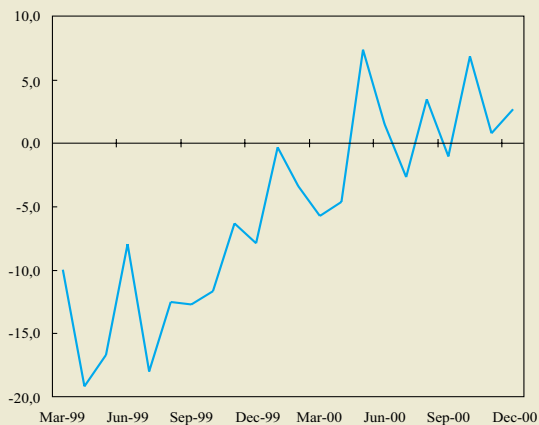
**TABLE 3**  
**GDP BY DISTRIBUTION OF EXPENDITURE (1994=100)**  
**ANNUAL GROWTH (%)**  
 (UNSEASONALIZED SERIES)

Economic Activity Sector	1999 (e)	2000 (e)				
		I	II	III	IV	Total
<b>Final consumption</b>	(3,0)	2,6	2,6	2,0	1,0	2,0
Household	(5,1)	3,0	4,3	4,0	1,6	3,2
Non-durable	(5,8)	3,9	3,1	3,8	(0,9)	2,5
Semi-durable	(6,1)	7,6	9,0	7,8	8,3	8,2
Services	(0,9)	1,2	2,0	2,1	1,5	1,7
Durable	(24,1)	1,0	23,4	14,8	8,2	11,5
Government	3,5	1,3	(2,2)	(3,5)	(0,9)	(1,3)
<b>Gross Capital Formation</b>	(32,1)	7,6	18,5	17,1	11,2	13,4
Gross fixed capital formation	(23,8)	(0,5)	5,1	6,8	7,1	4,6
Machinery and equipment	(21,3)	11,0	14,6	15,5	14,6	13,9
Equipment of transportation	(32,8)	6,8	9,6	(5,1)	(6,0)	1,4
Buildings	(35,5)	(15,7)	(9,6)	15,8	1,0	(2,3)
Civil Works	(11,0)	(1,9)	5,5	(4,4)	8,4	1,9
Changes in stocks	n.c.	n.c.	n.c.	n.c.	n.c.	n.c.
<b>Final Internal Demand</b>	(8,4)	3,3	4,7	4,1	2,5	3,6
<b>Total Exports</b>	5,6	2,4	0,6	4,6	(2,9)	1,2
<b>Total Imports</b>	(16,6)	7,1	7,6	9,9	(1,8)	5,5
<b>Gross Domestic Product</b>	(4,3)	2,5	3,5	3,2	2,1	2,8

(e) estimated  
 n.c. Non computable.

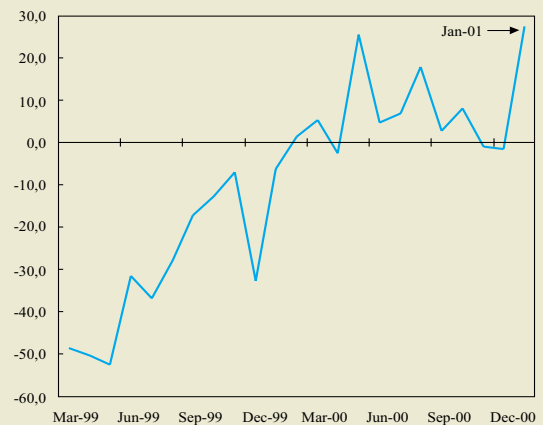
Source: Ministry of Finance and Public Credit, General Directorate of Macroeconomic Policy (DGPM).

**FIGURE 9**  
**CREDIT CARD SALES**  
**TOTAL SYSTEM**  
 (REAL ANNUAL GROWTH RATE)



Source: "Red Multicolor", Calculations by Banco de la República, Economical Studies Division (SGEE)

**FIGURE 10**  
**CONSUMPTION CREDIT DISBURSEMENTS IN REAL**  
**TERMS TOTAL FINANCIAL SYSTEM**  
 (VARIATION VIS A VIS THE SAME PERIOD OF THE PREVIOUS YEAR)



Source: Banking Superintendency, Calculations by Banco de la República, Economical Studies Division (SGEE)

the GDP to accumulate nearly 0,58% of the GDP, representing a contribution of 1,26 percentage points to economy growth during 2000. This accumulation of stocks after a recession period, as the one present in Colombian economy during 1999, is an indication of recovery at the sales level, and thus, of the economic activity<sup>4</sup>. On the contrary, public investment had a 7,0% contraction during 2000.

The increase of the total gross fixed capital formation (4,6%) is explained mainly by the increase of 13,9% of investment in machinery and equipment during 2000 as compared to a decrease of 21,3% in 1999; similarly, investment in transportation equipment, buildings and civil works recovered throughout 2000. However, this recovery of investment is not as solid, since the investment in transportation equipment, while presenting positive growth rates during the first two quarters of the year (6,8% and 9,6% respectively), continued to decrease during the second semester of 2000 (Table 3).

Thus, in 2000 the growth sources for the economy were mainly the components of private demand, consumption and investment, and an increase of exports, while the public expenditure components decreased, fulfilling with the fiscal adjustment. It should be highlighted that the greater dynamism of the private investment and consumption is due, among other causes, to lesser interest rates and a greater confidence of the public in the Colombian economy. In general, the greater internal and external demand was satisfied by the

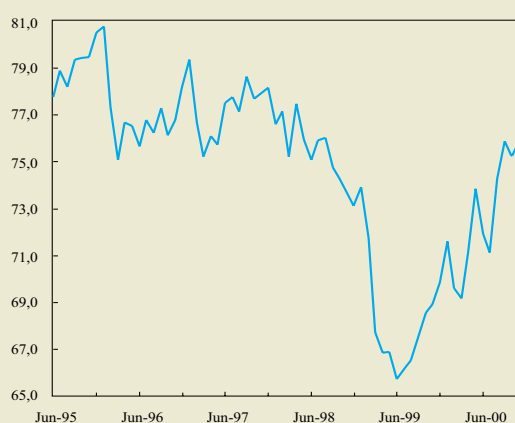
<sup>4</sup> See Concha Alvaro, (2000), "The result of existences variation in Colombia, 1999", working paper of the Ministry of Finance and Public Credit, National Directorate of Macroeconomic Policy (DGPM).

<sup>5</sup> The original series of use of installed capacity shows the lowest level throughout the year in December, which is due to the existence of seasonality in each series, which makes it necessary to soften it, in order to make an analysis without including these type of effects. However, the level of utilization observed in December, 2000 (69,3%) was greater than that observed during December of the previous year (69,0%).

enterprises with a greater use of the installed capacity<sup>5</sup> (Figure 11).

Notwithstanding the fact that the Colombian economy was reactivated during 2000, it is still below the average growth in Latin America (4,0%). However, for 2001 a growth similar to the growth of the set of countries of the region is expected, countries which started their recovery phase during 2000 (Table 4).

FIGURE 11  
UTILIZATION OF THE INSTALLED CAPACITY  
ACCORDING TO THE ANDI  
(SMOOTHENED SERIES)



Source: ANDI.

TABLE 4  
ANNUAL GROWTH RATE OBSERVED  
AND FORECASTED FOR SOME LATIN AMERICAN  
COUNTRIES

	1999	2000 (*)	2001 (*)
Argentina	(3,4)	(0,5)	2,0
Brazil	0,9	4,0	4,0
Chile	(1,1)	5,7	4,7
Ecuador	(7,3)	2,6	4,1
Perú	1,4	3,7	0,3
Venezuela	(6,1)	3,2	4,8
México	3,7	7,3	3,2
Latin America	0,3	4,0	3,4
<b>Colombia</b>	<b>(4,3)</b>	<b>2,8</b>	<b>3,8</b>

(\*) Forecast as of December.

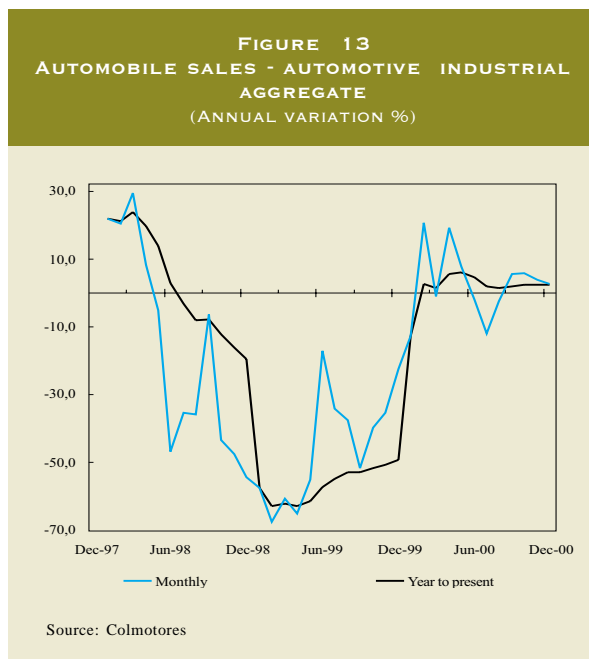
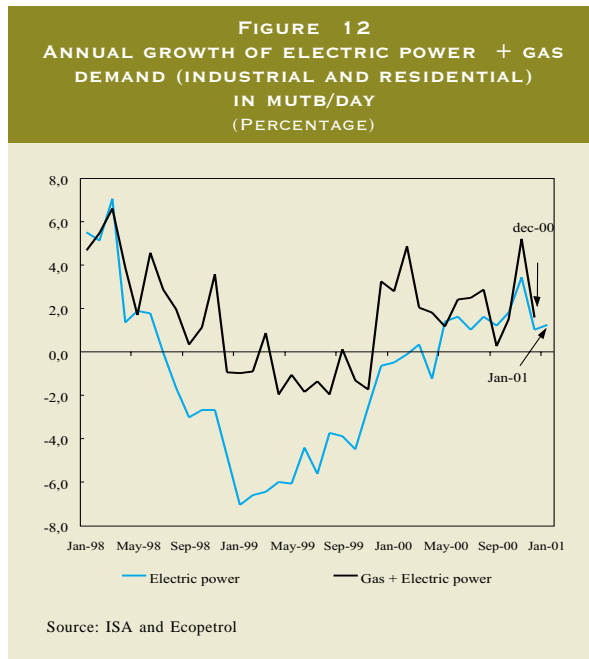
Source: CEPAL and J.P. Morgan

Other statistics also confirm economic reactivation. For example, indicators such as the monthly consumption of electric power plus gas, and automobile sales continue to show positive signs on industrial production and internal consumption of durable goods respectively (Figures 12 and 13).

Moreover, the Entrepreneurial Opinion Survey of December 2000, carried out upon the industrial sector by Fedesarrollo, shows that economic dynamics

may continue during 2001 as it is shown by the current economical indicator and by the level of orders for the industry, which show a growing trend, while the existences level show historical low levels (Figures 14 and 15).

Similarly, short and medium term economical situation expectations continue to be optimistic as pointed out by the high level of the business climate (Figure 16). At the same time the risk perception





that the international markets have upon the Colombian economy has decreased (Figure 17) making available access to external financing and motivating foreign investment.

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### C. GROWTH PERSPECTIVES FOR 2001

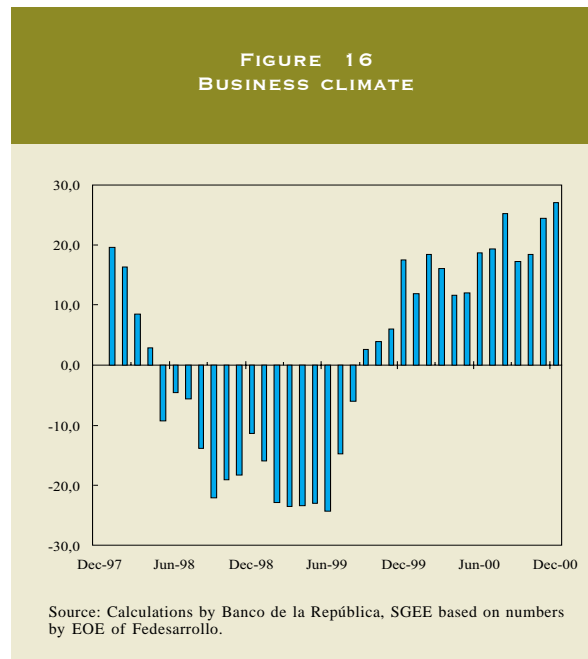
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The consolidation of the economic recovery during 2001 shall depend on compliance of the fiscal goals by the government, the existence of low real interest rates, and the continuity of expansion of exports. Growth shall be sustainable as long as the private investment rates continue to be high, for which it is essential to provide a coherent macroeconomical policy, a recovery of confidence in the country, an improvement of the public order situation and the approval of the structural amendments of the public sector.

It is expected that the growth for 2001 (3,8%) will be led by private consumption and investment, as well as by exports, while the government keeps its adjustment process on the expenditure side. According to the projections of the Ministry of Finance and Public Credit, it is estimated that consumption and investment grow 2,3% and 13,6% respectively, and that imports and exports increase 4,7% and 3,8% respectively (Table 2).

Industrial dynamics during 2001 will depend mainly on the behavior shown by exports and imports. While the former stimulates industrial production via a greater external demand, the latter achieves it through internal demand. According to estimates by the National Planning Department (DNP), it is

<sup>6</sup> The growth projections of the Ministry of Finance and Public Credit for 2001 are based upon an exercise of requirements to reach 3,8% expected for the present year. In this way, with the information available on the demand side coming from the balance of payments and the cash flows from the government, according to the Superior Council of Fiscal Policy (Confis), the growth of private investment is determined by remainder.



expected that the industry grows 7,0% during 2001. (Table 1)

Reactivation of the construction sector (6,1%) will be partially subject to the recovery of credit destined to housing and to its legal certainty, and that a fiscal adjustment is carried out mainly on operational expenditures more than on investment in public works. A slight recovery of this sector can already be seen thanks to a larger construction



volume of social interest housing, which is reflected in the good performance of the cement production and of industries related to construction (Figure 18).

The mining sector on its part, will continue to be affected by the normal reduction of production of the important oil fields in the country and by the terrorist attacks to the oil infrastructure.

The growth of the economy during 2001 is liable to changes in the economic conditions of the main trade partners namely the United States, Venezuela and the Andean Community (Table 5). It will also depend on variations of the international oil price and of the exchange rate, which has been favorable to Colombian sales abroad up to date.

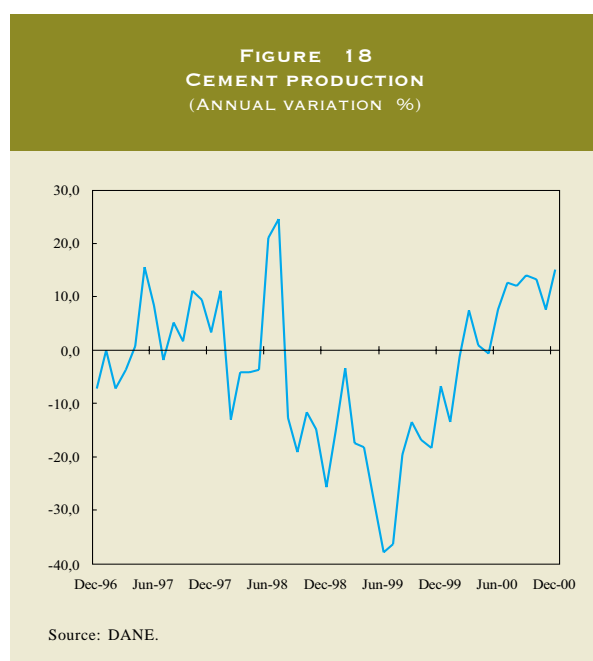
Particularly, the United States continues to present signs of economical deceleration whose magnitude is difficult to forecast. During February, a growth of 1,6% was projected towards the end of 2001, which compared to a 5,0% reached in 2000, could affect negatively Colombian exports. Facing this new macroeconomic environment, the Federal Reserve Bank (Fed) has reacted rapidly, decreasing the interest rate from 6,5% to 5,5%. Additionally, the latest statement by the monetary authority

shows slight inflationary fears, which may suggest another decrease of the interest rate. Such a decrease in the Fed's interest rate could help stabilizing the spreads of the sovereign debt to 10 and 30 years during 2001 and thus stimulate capital flows towards Latin America and Colombia.

Latin American economy has behaved satisfactorily in the last months and it is expected that the economic expansion cycle continue. It is foreseeable, however, that some economies show a lesser growth, due to persisting political problems and due to less favorable global conditions. The external vulnerability of the region is less than the one present in former periods, greatly due to the implementation of coherent macroeconomic policies. Thus, it is foreseen that the region would reach a real growth of 3,4% by the end of 2001, which is a positive factor for Colombian exports (Tables 4 and 5).

Finally it is expected that for 2001 the international oil price continue to decrease as shown during the past December. This price had shown a significant rebound up to November, which showed great uncertainty of economic agents upon the availability of crude. However, this uncertainty has given way to reflecting lesser prices of the future contracts for one, six and 12 months. Thus for 2001, the market expects lower prices (an average of US\$25,2 per barrel) from those observed during a great portion of 2000 (in average US\$28,8 per barrel)<sup>7</sup>, with a possible negative effect on the fiscal revenues of the country.

On the other hand, it is expected that the coffee crisis, which began in 1999, continues during 2001, due to the excess supply existing at a worldwide level. This is due mainly to a greater production in Vietnam which in 2000 exceeded Colombian



<sup>7</sup> Corresponds to export prices of the Colombian blend. For 2001 a projection is made taking as reference the information from World Economic Outlook (WEO), prepared by the FMI, which corresponds to an average price UK Brent, Dubai and West Texas Intermediate (WTI).

**TABLE 5**  
**EXPORTS, ACCORDING TO DESTINATION AND GROWTH - MAIN TRADE PARTNERS**

Destination	Exports in 2000 1/				Economic Growth (%)	
	Participación		Crecimiento %		2000	2001 (proj.)
	Total	Non-Traditional	Total	Non-Traditional		
United States	50,7	32,6	14,4	10,0	5,0	1,6
Andean Community 2/	16,6	31,9	32,3	34,0	4,8	3,1
Venezuela	9,9	20,4	41,3	41,4	3,2	4,8
Aladi 2/	22,5	41,0	32,2	33,7	4,1	3,5
European Community	12,4	9,6	(10,1)	(5,9)	3,2	2,4
Japan	1,8	0,7	(6,1)	21,8	1,3	0,8
Remainder	12,6	16,1	7,8	12,1	n.a.	n.a.
Total 3/	100,0	100,0	12,7	17,1	n.a.	n.a.

(proj.) Projected.

n.a. not applicable

1/ Information up to December 2000, provisional figures.

2/ Not including Colombia.

3/ 100% Participation is attained without the Andean Community and Venezuela, since they are included in Aladi.

Source: Banco de la República and J.P. Morgan

production, producing an accumulation of stocks in the consuming countries such as the United States and Germany, and thus, a drop in coffee international prices (ex - dock), that after an average price of US\$1,19 per pound in 1999, dropped to US\$1.02 per pound in 2000 and a price of US\$ 0,98 per pound is projected for 2001.

#### D. THE UNEMPLOYMENT PROBLEM

##### 1. Behavior of the unemployment rate and its determinants

The unemployment<sup>8</sup> rate in Colombia changed from an average of 9,0% between 1990 and 1995 to 16,0% between 1996 and 2000. In a recent study, Hugo López (2001)<sup>9</sup> identifies several causes that explain this behavior, in their order, the economical recession, the increase of labor costs and greater labor force participation. Another factor that became a cause of unemployment was the change

of composition of labor demand toward better qualified workers, whose availability has been scarce during the last 10 years.

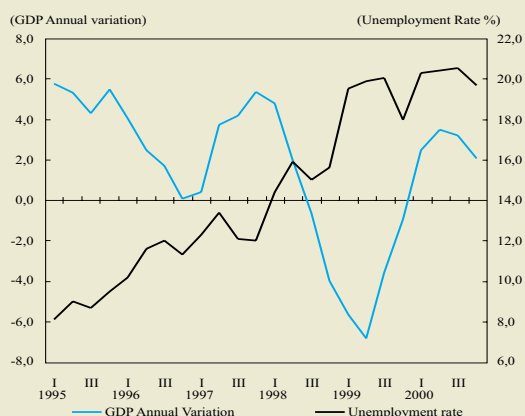
As it may be observed in Figure 19, the unemployment rate has shown a growth trend since 1995, year in which the first symptoms of economic deceleration and a drop in investment were evidenced. Specifically, it may be observed that during 1995 and 1996 a lesser economic growth occurred along with an important increase in the unemployment rate.

This growing trend could not be stopped despite the slight recovery of the economy between 1997 and the first quarter of 1998. The accelerated drop of the GDP between 1998 and 1999 generated a

<sup>8</sup> Rate of unemployment for seven metropolitan areas.

<sup>9</sup> López, Hugo (2001) "Characteristics and Determinants of the Colombian labor supply and its relation with the dynamics of unemployment: Theoretical and political dissertations". CIDE, Medellín.

**FIGURE 19**  
**GDP ANNUAL GROWTH**  
**AND UNEMPLOYMENT RATE**



Source: DANE.

fast growth in unemployment, reaching maximum historical levels, which have persisted, in spite of the economic reactivation during 2000.

Although the unemployment rate during 2000 was at the high levels of 20,0%, its growing trend started

to give in<sup>10</sup>. This behavior was due to a greater dynamism of sectors such as industry and commerce and to the recovery of construction observed during the last quarters of 2000 (Table 6). Hence, the number of occupied people increased an average of 212.493 during each of the quarters of 2000<sup>11</sup>.

The industry, besides leading the GDP growth, contributed with greater employment generation during 2000. On its part, the commerce sector has shown an increase in the occupation level since 1999 (Figure 20). However, this behavior corresponds to an increase of the number of independent

<sup>10</sup> This rate corresponds to seven of the metropolitan areas, in accordance with the National Household Survey (ENH) performed by DANE, that is carried out quarterly. Recently, DANE published the Continuous Household Survey which is performed on a monthly basis and covers 13 main cities and their metropolitan areas. Pursuant to this latest survey, unemployment rate during January 2001 was 20,5%.

<sup>11</sup> For each quarter, the number of occupied people grew 263.513 during the first quarter, 237.334 during the second, 269.016 during the third and 80.107 during the fourth quarter.

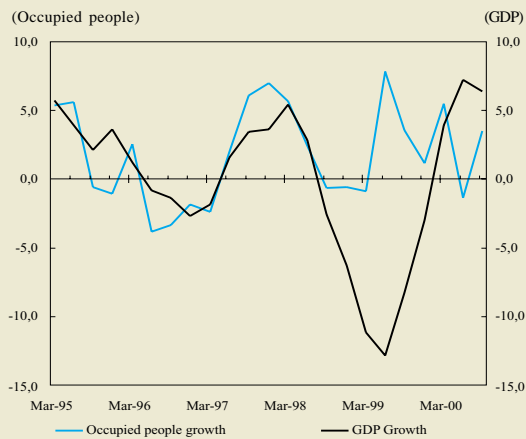
**TABLE 6**  
**ANNUAL GROWTH OF OCCUPIED POPULATION, BY ECONOMIC SECTOR**  
**TOTAL FOR SEVEN METROPOLITAN AREAS**  
**(PERCENTAGE)**

Activity	1998				1999				2000			
	I	II	III	IV	I	II	III	IV	I	II	III	IV
Industry	8,0	5,3	(4,7)	(3,9)	(15,6)	(11,8)	(5,4)	(1,4)	7,2	8,1	14,9	n.d.
Commerce	5,7	2,4	(0,6)	(0,6)	(0,9)	7,8	3,6	1,1	5,5	(1,4)	3,5	n.d.
Community, Social and												
Personal Services	9,3	8,4	5,7	8,9	0,2	(0,5)	3,0	0,8	7,6	7,4	7,4	n.d.
Financial Services	2,5	(9,9)	(1,7)	(1,1)	4,3	(0,2)	(3,7)	8,8	(6,8)	(1,7)	(3,7)	n.d.
Construction	5,3	0,2	0,6	0,8	(17,3)	(16,3)	(23,5)	(13,5)	1,4	(3,6)	(1,5)	n.d.
Transportation	8,1	13,8	(1,1)	(5,0)	(7,4)	(7,1)	7,4	2,5	7,1	12,7	(9,0)	n.d.
Agriculture, Mining,												
Electricity, Gas & Water	(6,3)	(18,8)	(6,6)	(3,5)	14,0	0,1	7,0	8,1	(12,5)	20,5	1,9	n.d.
<b>Total</b>	<b>6,7</b>	<b>3,6</b>	<b>(0,0)</b>	<b>1,0</b>	<b>(4,3)</b>	<b>(2,2)</b>	<b>(0,3)</b>	<b>0,6</b>	<b>4,8</b>	<b>4,3</b>	<b>4,8</b>	<b>1,4</b>

n.d. not available

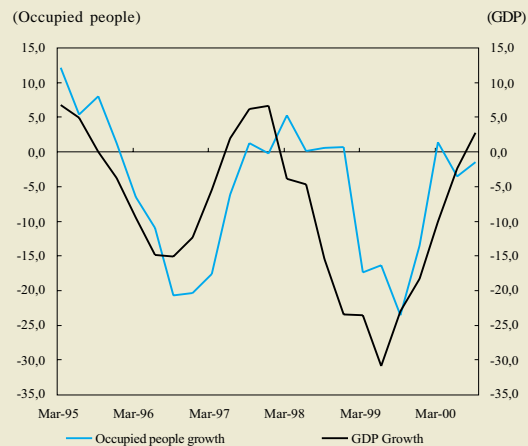
Source: DANE National Household Survey (ENH) January, 2001

**FIGURE 20**  
**TRADE SECTOR:**  
**GDP ANNUAL GROWTH AND NUMBER OF**  
**OCCUPIED PEOPLE 1/**  
**(PERCENTAGE)**



1/ Numbers as to September 2000  
 Source: DANE.

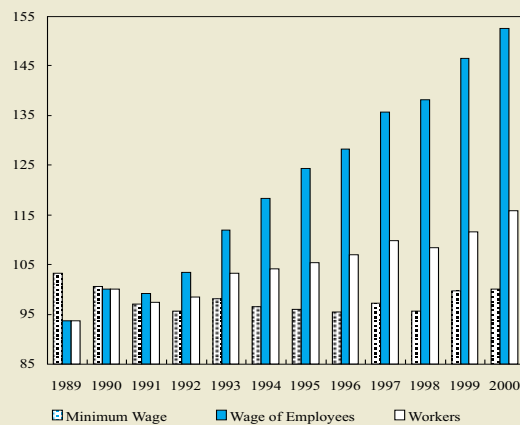
**FIGURE 21**  
**CONSTRUCTION SECTOR:**  
**GDP ANNUAL GROWTH AND NUMBER OF**  
**OCCUPIED PEOPLE 1/**  
**(PERCENTAGE)**



1/ Numbers as to September 2000  
 Source: DANE.

workers<sup>12</sup>, which has been reflected through an increase in the rate of informality (ratio between informal and total occupation) in the seven metropolitan areas, changing from 52,5% in 1996 to 60,0% during 2000. Similarly, construction, one of the sectors most affected by the economic crisis, reverses its decreasing trend, both in its production as well as in the number of occupied people during 2000 (Figure 21). The unemployment growth in Colombia has obeyed, partially, to an increase in labor costs. As shown by H. López (2001), the increase in real salaries, yet not being the factor that triggered unemployment, did affect negatively the dynamism of the occupation level between 1991 and 1997, and worsened unemployment between 1998 and 2000. Specifically, the wages pressure on unemployment has been occurring due to an increase of the cost of qualified work, more than for the non-qualified work, as it may be seen in the index of real salaries of the manufacturing industry (Figure 22).

**FIGURE 22**  
**INDEXES OF REAL SALARIES OF THE**  
**MANUFACTURING SECTOR**  
**(ANNUAL AVERAGE)**



Source: DANE, Banco de la República

An increase of para-fiscal costs of the labor hiring, as a consequence of greater contributions to social security as from Law 100, 1993, is added to higher costs of real wages.

An increase in salaries over inflation during the past years, due to the inertial behavior of inflation expectations and greater para-fiscal costs, led to a significant increase in labor costs. This fact, that coincided with a negative external shock and a

<sup>12</sup> Occupied people classified within the informal sector are those workers with salaries and employers belonging to companies with less than 10 workers, those independent workers who are not professional or technicians and family or household workers. This definition pretends to identify the segment of the labor market in which it is easier to fail to comply with labor, taxes, trade legislation etc., by virtue of a reduced scale of operation.

weakening of the effective demand, generated a reduction of the wage earning worker's employment and an increase of informal employment. As a matter of fact, during 2000 the wage earning worker's employment decreased at a rate of 7,5%, as an inverse behavior was observed in the number of independent workers, family workers and household workers (Table 7).

Moreover, in 1996, 37,7% of the informal employment was constituted by salary paid work by small enterprises ("micro-enterprises": less than 10 workers) and 43,8% by independent workers. However, in June 2000 the salary paid employment had dropped to 31,0% of the informal occupation, while the independent work had increased to represent 49,2% of the informal occupation. Thus

the rate of informality (work in small enterprises, independent work and household work) of the seven main metropolitan areas of the country changed from 52,7% in 1996 to 60,3% in 2000.

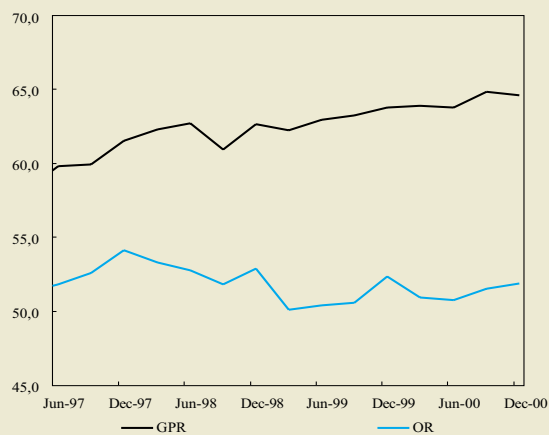
The growing labor participation has been another determinant factor of unemployment during recent years. During 2000, the global participation rate (GPT= Economically Active Population (PEA) / population with working age), common indicator of the labor supply, was, in average, 64,3%, greater than in 1997 by 4,3 percentage points (Figure 23). The increase in GPT is due, partially to the deterioration of the family household income, caused by the economic deceleration, that induced members of the household unit to join the labor supply and that were not part of the PEA before.

**TABLE 7**  
**URBAN EMPLOYMENT GROWTH, ACCORDING TO OCCUPATIONAL POSITION**  
**SEVEN METROPOLITAN AREAS**  
**(PERCENTAGE)**

	1994	1996	1998	2000	% Occupied 2000
<b>A. Wage Earning Workers</b>	5,0	3,7	(1,3)	(7,5)	54,6
1. Micro-enterprises	2,2	5,4	(0,6)	(0,9)	18,4
2. Medium and Large enterprises	8,9	3,5	(4,6)	(8,4)	29,3
3. Government	(3,5)	0,2	11,3	(18,5)	6,9
<b>B. Independent Workers</b>	8,0	2,4	16,0	16,1	38,6
1. On their own	9,6	8,0	15,4	22,1	32,7
a. No professional & Non-technician	8,4	8,7	13,9	23,8	29,6
b. Professional & Technician	21,7	1,4	29,7	7,6	3,1
2. Employers	3,1	(16,3)	18,5	(9,1)	5,8
a. Micro-enterprises	3,5	(18,5)	17,0	(3,9)	5,1
b. Medium and Large enterprises	0,6	(1,9)	26,5	(34,6)	0,7
<b>C. Other employment</b>	(25,1)	(13,4)	37,4	17,8	6,8
1. Household work	(14,4)	(12,9)	26,8	22,8	5,3
2. Household helpers	(19,5)	(15,3)	79,5	3,9	1,6
<b>Total informal sector</b>	0,9	2,0	10,6	11,9	60,0
<b>Total formal sector</b>	6,8	2,7	0,5	(9,9)	40,0
<b>Total occupied population</b>	3,6	2,4	5,8	2,0	100,0

Source: DANE, Calculations based on ENH, June 2000.

**FIGURE 23**  
**GLOBAL PARTICIPATION RATE (GPR) AND**  
**OCCUPATION RATE (OR),**  
**SEVEN METROPOLITAN AREAS**  
**(PERCENTAGE)**



Source: DANE, ENH.

This phenomenon was particularly noticeable in 2000 when, according to the new household<sup>13</sup> survey the PEA increased from 61,6% in January 2000 to 64,8% in January 2001. The increase in labor participation was reflected through an increase in the unemployment rate from 17,6% to 20,5 during this period, according to said survey. This occurred despite an increase in the occupation rate (OR = Occupied population / population with working age) of 50,8% in January 2000 as compared to 51,5% in January 2001 due to an increase of 3,9% of the number of occupied people during this period. Hence, despite the fact this rate has been relatively high, generation of new employment was insufficient to compensate the increased growth of the labor supply.

## 2 Characteristics of the unemployed

The urban unemployment has affected young people, women and workers of lower income and low qualification levels to a greater extent. Similarly, unemployment growth embraced different family members, as the participation of single members and spouses in the labor supply increased.

<sup>13</sup> The continuous Household Survey covers 13 main cities of the country and is performed on a monthly basis.

Youngsters have been most affected by unemployment. As a matter of fact, in average 60,0% of the non-occupied population includes people between 12 and 24 years old. In September 2000 the unemployment rate of the group whose ages were between 12 and 17 was 44,7% and 34,8% for the following group of ages between 18 and 24. (Table 8). The importance of achieving a greater educational level in this population group arises therefrom.

Growth of unemployment among youngsters suggests that the total unemployment is not due to layoffs but to lack of stimulus to hire new workers. This reaffirms the need of a labor amendment to diminish contracting costs, including costs of future layoffs.

The female unemployment rate has been greater than the male unemployment rate, and it has grown faster within the younger group. Thus the rate of unemployment for women was 24,5% while men unemployment rate reached 16,9% in September 2000 (Table 8). The increase of the gap between these unemployment rates was mainly stressed in the range of 12 to 17 years old, changing from 3 to 12 percentage points between 1991 and 2000.

Relating to income level, it may be observed that between 1992 and 1996 the unemployment rate remained relatively stable, except for those whose income is located at the first income decile. However, between 1996 and 2000 unemployment extended to people belonging to all income levels, although the most affected continued to be those with lowest income. (Figure 24)

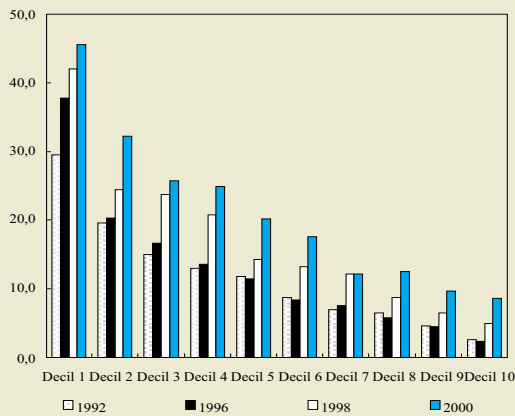
People with lesser qualifications, those with primary or secondary educational level, constitute, in average 80% of the non-occupied population in 2000. (Figure 25), with unemployment rates of 16,6% and 23,7% respectively. Nonetheless, the group having a greater educational level, has shown the greatest relative growth in unemployment through the nineties decade. (Table 9).

**TABLE 8**  
**UNEMPLOYMENT RATES BY AGE AND SEX GROUPS**  
**SEVEN METROPOLITAN AREAS**  
 (PERCENTAGE)

Age Groups	1991	1996	1998	2000
<b>Total</b>	9,8	12,0	15,0	20,5
12-17	23,8	31,8	33,3	44,7
18-24	18,4	22,0	29,2	34,8
25-55	7,0	8,8	11,1	16,0
56 and over	3,9	4,6	9,2	14,1
<b>Total Men</b> 7,4	9,6	12,5	16,9	
12-17	22,3	29,0	29,6	39,8
18-24	15,0	18,6	25,3	30,2
25-55	5,0	6,7	9,0	12,5
56 and over	4,1	5,6	10,3	14,4
<b>Total Women</b>	13,1	15,1	18,0	24,5
12-17	25,6	35,8	37,9	51,9
18-24	21,9	25,8	33,1	39,1
25-55	9,8	11,6	13,6	19,8
56 and over	2,9	2,1	6,5	13,4

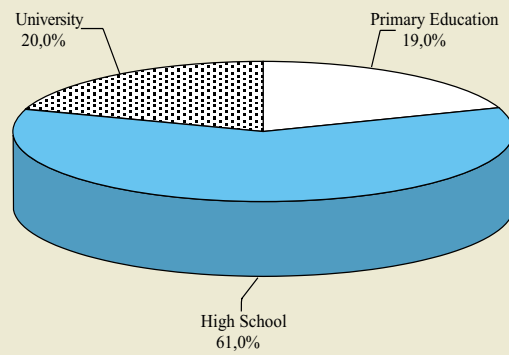
Source: DANE, ENH, September 2000.

**FIGURE 24**  
**UNEMPLOYMENT RATES ACCORDING TO INCOME DECILES SEVEN METROPOLITAN AREAS**  
 (PERCENTAGE)



Note: decile 1 poorest, decile 10 wealthiest.  
 Source: DANE, ENH.

**FIGURE 25**  
**DISTRIBUTION OF UNEMPLOYED PEOPLE ACCORDING TO EDUCATION LEVEL IN YEAR 2000**  
 (PERCENTAGE)



Source: DANE, ENH.

Notwithstanding the fact that unemployment increased for all family members, it is worth pointing out that sons/daughters and spouses increased their participation therein, which could be due to their intention to counterbalance unemployment of the household head (Table 10).

Another feature of unemployment is the trend to increase the time an individual is in search for a job. As it may be seen in Table 11, in 2000 nearly 66,0% of unemployed people had spent 24 weeks or more in search for employment, while the corresponding percentage for the period 1990-1995 was nearly 43,0%. A longer unemployment period is an additional problem, to the extent that it tends to depreciate the human capital, thus leading to a greater structural unemployment.

Lastly, Barranquilla, Bucaramanga. and Pasto during 2000 showed in average, unemployment rates below the seven metropolitan areas, while Manizales, Cali, Medellín and Bogotá continued to show unemployment rates higher than 20,0%. (Table 12).

As a conclusion, the reactivation has not been dynamic enough to absorb the growing labor force. The economic recovery initiated in 2000 has barely been sufficient to hold back the unemployment growth rate.

It is evident that one of the requirements to reduce unemployment to its historic level is to consolidate economic growth through the reestablishment of macroeconomic equilibrium. It may also seem that under the current circumstances, the institutions and practices present in the labor market are aggravating the condition of informal employment and reducing the stimulus for contracting of formal employment. The introduction of amendments in this area shall be essential so that in the coming years a reduction of the unemployment rate can be attained.

**TABLE 9**  
UNEMPLOYMENT RATE ACCORDING TO EDUCATIONAL LEVEL SEVEN METROPOLITAN AREAS  
(PERCENTAGE)

Educational Level	1992	1996	1998	2000
Primary	9,5	10,1	14,3	16,6
High School	13,4	13,5	18,8	23,7
University -Incomplete	11,0	12,3	16,5	22,1
University	4,6	5,4	9,0	13,2

Source: DANE, ENH.

**TABLE 10**  
UNEMPLOYMENT RATE ACCORDING TO HOUSEHOLD POSITION SEVEN METROPOLITAN AREAS  
(PERCENTAGE)

Household position	1992	1996	1998	2000
Head	4,0	5,4	7,7	10,5
Spouse	13,8	12,0	16,9	22,6
Single Son/daughter	20,1	19,9	27,6	34,1
Married Son/daughter	17,0	19,6	20,5	26,0

Source: DANE, ENH.

**TABLE 11**  
TIME SPENT IN SEARCH FOR EMPLOYMENT 1/  
(PERCENTAGE)

	1990/1995	1996/1998	1999	2000
Up to 4 weeks	29,8	22,7	15,5	12,9
Between 5 and 8 weeks	11,9	11,4	9,5	8,0
Between 9 and 24 weeks	15,6	16,5	16,4	13,4
More than 24 weeks	42,5	45,7	58,6	65,7

1/ As percentage of total unemployment.  
Source: DANE.



**TABLE 12**  
**UNEMPLOYMENT RATE BY CITIES**  
(PERCENTAGE)

Períod		Bogotá D. C.	Barranquilla	Cali	Medellín	Bucaramanga	Manizales	Pasto	Total seven áreas
<b>1998</b>	Mar.	12,7	13,0	17,9	16,3	14,5	14,5	14,5	14,4
	Jun.	14,8	13,0	19,7	16,7	15,9	16,6	17,0	15,9
	Sep.	13,3	11,6	20,6	15,8	14,0	17,4	16,6	15,0
	Dec.	15,3	10,4	19,6	15,8	15,0	16,5	16,1	15,6
<b>1999</b>	Mar.	18,0	16,7	21,2	23,1	19,6	21,1	18,6	19,5
	Jun.	19,1	16,3	21,5	21,7	21,1	21,3	19,2	19,9
	Sep.	19,3	16,5	21,9	22,4	18,7	20,8	21,0	20,1
	Dec.	16,9	14,3	20,5	20,1	17,4	21,1	18,4	18,0
<b>2000</b>	Mar.	19,6	18,7	21,6	22,2	19,8	20,6	16,9	20,3
	Jun.	20,7	18,0	21,3	20,8	19,0	22,1	18,5	20,4
	Sep.	20,3	20,2	21,4	21,0	17,9	22,4	21,3	20,5
	Dec. (p)	20,3	15,2	21,0	20,0	16,8	21,1	21,3	19,7
<b>Average 2000</b>		20,2	18,0	21,3	21,0	18,4	21,5	19,5	20,2

(p) Provisional.

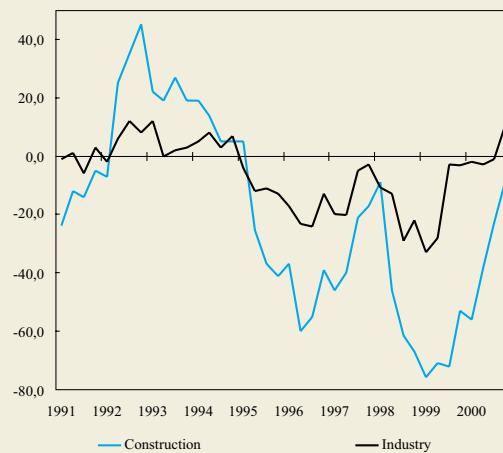
Source: DANE, ENH.

## CREATION AND SUPPRESSION OF EMPLOYMENT

The Entrepreneurial Opinion Survey by Fedesarrollo, comprises a qualitative question that allows to partially compensate the insufficiency of official numbers relating to creation and suppression of waged employment. The survey inquires from each "firm" (medium or large size enterprise) regarding if after discounting the seasonal fluctuations, the number of people employed has increased, decreased, or remained the same as compared to the previous quarter. Even though the number of new or suppressed employment in a given sector cannot be calculated based upon this information, it is useful to know the percentage of firms pertaining to the sector that have created or suppressed employment. Following is the calculation of the difference between the percentage of firms that showed personnel increases with respect to the previous quarter and those who did not. This difference is interpreted as the net proportion of the firms that are generating employment, or the proportion of firms which are suppressing it, if the foregoing difference results negative.

The following figure shows the mentioned percentages for the industry as whole and for the construction sector. In both sectors the proportion of firms creating employment ceased to drop during the second semester 1999. In the industrial sector the percentage of firms generating employment was greater than the percentage firms which suppressed employment in December 2000.

**CREATION AND SUPPRESSION OF EMPLOYMENT:  
INDUSTRY AND CONSTRUCTION**



Source: Fedesarrollo.

## SURVIVAL STRATEGIES OF THE UNEMPLOYED

The strategy of taking refuge in the informal sector of the economy has been used by the members of household affected by unemployment. The informality rate of the household heads increased from 52,6% in 1994 to 59,4% in 2000, spouses from 56,0% to 63,0% single sons/daughters from 45,7% to 54,1% and married sons/daughters from 47,1% to 57,6% (Table1). Thus, many household heads who lost their jobs turned to informal activities when not finding opportunities in the formal sector. The same occurred for youngsters who dropped out from school and for women who abandoned household jobs.

An analysis of the composition of informal groups by income shows that the poorest groups of the population have had to take refuge in the informal sector to overcome current unemployment. (Table2). In June 2000, 93,5% of the occupied population of decile 1 worked in the informal sector of the economy, while in 1994 this percentage was 70,2%. This means that more poor people have taken refuge in the informal sector since they cannot "afford" to be unemployed.

When the household head losses his job, the housewives and the youngsters go out into the labor market to try to get a job to compensate the drop of income. This has two effects: firstly, an increase in the labor supply further enlarging the unemployment rate and, secondly, the youngsters become school dropouts.

Between 1991 and 1997, the school urban attendance rate of youngsters between 12 and 25 years old showed a continuous growth from 41,1% to 47,2%, and in parallel, the global participation rate of that group decreased from 44,5% to 41,0%. As from 1997 this trend was reversed: the school attendance rate decreased to reach 44,4% and the global participation rate increased to reach 44,1% in 1999 (DNP and Misión Social, 2000).

**TABLE 1**  
**EVOLUTION OF INFORMAL EMPLOYMENT**  
**SEVEN METROPOLITAN AREAS 1/**  
(JUNE, 1984- JUNE 2000)

	1984	1986	1988	1992	1994	1996	1998	2000
Household Head	51,5	52,2	54,2	51,6	52,6	54,1	55,5	59,4
Spouse	58,0	57,8	60,1	56,7	56,0	54,0	57,0	63,0
Single son/daughter	49,6	51,1	51,7	51,7	45,7	45,0	48,0	54,1
Married son/daughter	46,6	50,9	50,7	47,1	47,1	52,2	52,8	57,6
Other relatives	52,6	52,4	55,3	51,5	53,4	50,7	59,5	64,6
Non relatives	90,1	86,4	86,4	86,4	82,6	80,6	82,5	87,5

Note: Expanded data with population projections, estimates based upon results of the census in 1993.  
1/ Bogotá D.C., Barranquilla, Cali, Medellín, Bucaramanga, Manizales and Pasto.  
Source: DNP Calculations based on ENH and DANE.

**TABLE 2**  
**EVOLUTION OF INFORMAL EMPLOYMENT BY DECILES**  
**SEVEN METROPOLITAN AREAS 1/**  
(JUNE, 1984- JUNE 2000)

	1984	1986	1988	1992	1994	1996	1998	2000
<b>Decil 1</b>	79,4	83,3	78,7	78,9	70,2	77,4	86,8	93,5
<b>Decil 2</b>	66,3	63,6	67,5	64,6	62,8	64,4	72,6	79,6
<b>Decil 3</b>	59,6	59,6	63,0	61,6	58,6	61,1	69,7	73,3
<b>Decil 4</b>	60,0	58,1	59,4	58,9	56,0	55,4	63,4	69,0
<b>Decil 5</b>	55,8	56,6	56,4	54,2	54,6	54,2	60,9	65,9
<b>Decil 6</b>	53,5	52,3	55,4	54,6	53,7	55,0	55,1	58,8
<b>Decil 7</b>	52,1	52,0	55,1	49,7	48,4	51,1	50,6	54,3
<b>Decil 8</b>	46,4	50,6	51,1	47,5	49,5	47,8	51,1	47,8
<b>Decil 9</b>	46,4	48,0	48,1	43,5	46,5	45,4	40,9	47,1
<b>Decil 10</b>	45,8	45,7	46,7	43,2	44,0	39,1	35,1	41,1

Note: Expanded data with population projections, estimates based upon results of the census in 1993.

1/ Bogotá D.C., Barranquilla, Cali, Medellín, Bucaramanga, Manizales and Pasto.

Source: DNP Calculations based on ENH and DANE.

Pursuant to a recent study carried out by the Mision Social of the DNP<sup>1</sup>, a survival strategy of the poorest households has consisted in forming "extended homes", namely, homes with two or more families. In fact, for the quintile 1 of income, the percentage of extended homes changed from 31,4% in 1998 to 36,9%; for the quintile 2 this proportion changed from 37,5% to 39,5% while the quintile 5 remained in 29%.

Additionally to recur to the mentioned strategies, some homes have found sources of income different than labor revenues of the household head. This has allowed them partially, to absorb the effects of unemployment.

From 311.627 homes in the seven larger metropolitan areas whose household head was unemployed in June 2000, pursuant to the National Household Survey (DANE), 255.614 homes (82,0%), reported some source of income. From these, lacking a labor income by the head, 158.480 reported that at least one of the members worked and thus they had an average income of \$533.181. The second source of income, as per its frequency, were aids: 26,0% of the household reported income for this concept, for an average amount of 101.643 monthly (Table 3).

The results of the social survey by Fedesarrollo in the four largest cities (April 2000) show that unemployment has concentrated without proportions among the most unprotected individuals. As an example, while only 10,0% of those who lost their jobs had savings, 25,0% of those who continued working had money saved.

**TABLE 3**  
**EVOLUTION OF INFORMAL EMPLOYMENT BY DECILES**  
**SEVEN METROPOLITAN AREAS 1/**  
(JUNE, 1984- JUNE 2000)

	<b>Homes</b>		<b>Average Income</b>
	<b>Number</b>	<b>Percentage</b>	
Labor	158.480	62,0	533.181
Other	167.254	65,4	517.549
Rent	42.598	16,7	369.378
Ret. Pension	31.055	12,1	1.408.351
Aids	66.459	26,0	101.643
Interest	5.632	2,2	167.309
Other	17.131	6,7	347.038

Source: Calculations by Fedesarrollo based on ENH from DANE.

Additionally, pursuant to that survey, 26% of the homes affected by unemployment sold assets; on the contrary, only 7% of the unaffected homes did the same. These results suggest that selling assets has been massively common by household affected by unemployment. The type of assets varies accordingly with the socioeconomic level of the families; the poorest have sold home appliances and the richest real estate.

Lastly, the homes affected by unemployment are more inclined to report a drop of consumption than those unaffected by this phenomenon: pursuant to the survey the difference reaches 18 percentage points.

<sup>1</sup> Misión Social (1999). "Social risks and opportunities of Colombian families. Bases for analysis", mimeo.

### III

## MACROECONOMIC POLICY

As it was mentioned in the previous chapter, the macroeconomic policy developed during 2000 met its two main objectives: economic recovery and inflation reduction. Monetary policy contributed to recuperate economic growth by facilitating the interest rate reduction and thus increasing private consumption and investment. On its own, the exchange market has shown a tendency towards devaluation, which has given rise to a very competitive foreign exchange rate, without compromising the inflation target nor exerting upward pressure on interest rate during 2000. There has been advances related to the correction of fiscal deficit, which has led to increasing confidence by both international and national investors in Colombian economy. The coherence of these policies, which will be the following topic of discussion, has constituted the grounds for recovery based upon macroeconomic stability.

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#### A. MONETARY POLICY

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##### 1. Main Guidelines of Monetary Policy

Pursuant to the national Constitution and the Law, the main long term objective of the monetary policy in Colombia is to maintain the purchasing power of money, in coordination with a general macroeconomic policy which aims at attaining both product and employment growth. To meet this purpose, as from 1991, the Board of Directors of the Banco de la República has established decreasing annual targets for the inflation rate. Decisions regarding monetary policy have been

taken with the purpose of guaranteeing compliance with said targets and of attaining the rates of economic growth contained within the respective macroeconomic programs.

In this context, the current challenge of the monetary policy has been to continue with a gradual reduction in inflation, in an atmosphere of economic growth and recovery of the financial system. To that end, the monetary policy has facilitated the reduction in interest rates, through the promotion of easy liquidity conditions within the financial markets, without compromising the inflation targets.

By meeting inflation targets in the last years it has been possible to increase the credibility of the monetary policy. This fact is currently reflected by inflation of expectations that move around the proposed target. On these grounds, the Board of Directors of the Banco de la República has adopted a new monetary strategy which combines elements of an inflation targeting scheme and flexible reference values for the monetary aggregates. This strategy establishes that the monetary policy decision shall be made based upon 1) inflation target; 2) an evaluation of the general economic conditions; of the tendencies and perspectives for inflation and of the unemployment trends, and 3) a follow-up of the behavior of the monetary aggregates, so that they are consistent with the inflation target<sup>14</sup>.

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<sup>14</sup> A detailed description of the new monetary strategy can be found in the Revista del Banco de la República (*Magazine of the Banco de la República*) (2000), Vol. 73, No. 876, October.

With the purpose of guiding inflation expectations, and taking into account the existence of what lags from the effects of monetary policy, the new strategy adopts multi-annual inflation targets. For 2001 and 2002 the Board and the Government ratified the targets of 8% and 6% respectively. As an integral part of this strategy, the Board of Directors shall continue to carry out, on a monthly basis, a detailed assessment, based upon an inflation report developed by the technical team of the Bank, examining the inflationary pressures and perspectives. That report will continue being continuously published on a quarterly basis, so that the markets get to know the perception of the board relating to the probability of meeting the inflation target and for their assessment of the coherence of the political decisions along with the technical analysis.

The new strategy includes the announcement of a path for the evolution of the monetary base -reference line- , which is constructed in a coherent manner along with the inflation target and the growth projection for the real GDP. The foregoing responds to the fact thought that the monetary base is the aggregate upon which a greater degree of control may exist and- as stated on different technical papers- once the changes in the velocity of circulation are accounted for, its relationship with the inflation rate is stable in the medium and long terms.

As in the recent past, the monetary base reference line concept does not imply a commitment by the Board of Directors of the Banco de la República to mechanically correct any deviation of the base in the short term with respect to its reference value. When a significant variation occurs from the reference values for a period of several weeks, the Board shall modify its posture relating to the monetary policy or it shall publicly explain why it does not do so. The latter may happen when the indicators and forecast of inflation and other economic variables show a strong evidence of compliance of the inflation target, or when changes occur in velocity of the monetary aggregates or in the money demand.

To adopt the decisions relevant to the monetary posture, the Board has taken into account the behavior of the mobile average of order 20 and 45 of the monetary base vis a vis the reference line. Technical studies showed that these mobile averages present a relatively close relationship with the price level and they filter the temporary monetary excess or lack with a high probability, as the simultaneously point out permanent monetary shocks.

## **2. Monetary Market Intervention**

The open market transactions OMA analysis and the monetary aggregates throughout 2000 results highly illustrative upon the manner in which exogenous phenomena, such as the change of century, the application and extension of the tax on financial transactions and the segmentation of the financial system, affected the behavior of monetary variables. This analysis also helps to understand both the difficulties of the monetary management, as well as the political decisions taken throughout the year, leading to the adoption of the new monetary strategy described above.

As from the beginning of the year the Board of Directors deemed convenient to add flexibility to the supply of liquidity for the financial entities, to avoid undesirable pressure upon interest rates. Several reasons justified this view. First, the expectations generated by the change of century had unusually increased the demand for bank reserves and for cash. Second, the tax upon financial transactions, applicable both to withdrawals as well as to transfers among accounts, generated an important increase in demand for money. Third, the problem relating to public banking and the heterogeneous set of financial entities caused a fractioning of the interbank market, requiring simultaneous operations of contraction and expansion to attract the funds relating to excess of liquidity of some entities and provide liquidity to those who lacked funds.

To facilitate liquidity supply and to avoid excessive volatility of the interbank interest rate, it was decided

to maintain the expansion REPOs at one and 14 days, while re-establishing the contraction OMA auctions with a sole term of 14 days<sup>15</sup>, despite the fact that the monetary program pointed out net contraction requirements during the first 10 months. At the same time, and in order to simplify the expansion and contraction operations, the seven day REPO auctions were suppressed and the final TES purchase was temporarily suspended. Initially the Board established a maximum closing rate for the contraction auctions of 10,0%, two percent points lower than the minimum expansion rate. On the other hand the contraction window interest rate (6,0%) maintained the same level as in December 1999, and the minimum closing rate for expansion auctions as well as the window rate maintained levels of 12,0% and 18,0% respectively.

During 2000 the Board of Directors decided to reduce the dispersion of the intervention band, to promote a greater stability of the interbank rate and attain a more direct relationship between the monetary policy and the intervention interest rates. Hence, on one part, it increased the contraction window from 6,0% to 8,5% and the maximum rate of the contraction auction for 14 days from 10,0% to 11,0% and, on the other, it reduced the expansion window rate from 18,0% to 16,0%. The minimum rate for expansion auction was kept at 12,0%, which is the basic rate at which the financial system obtains liquidity. With the foregoing, the dispersion between the maximum expansion rate and the minimum expansion rate was reduced from 12 to 7,5 percent points. It is a purpose of the Board of Directors to continue reducing the span of the intervention band, in such a way that the monetary policy continues to be consistent with a low volatility in the interest rate, allowing the monetary aggregates be determined by the liquidity necessities of the market. It is a scheme which is compatible with that of the inflation target, which acknowledges the instability of the money demand.

<sup>15</sup> Which existed for terms of one day only and had been suspended as from August 5, 1999.

The measures for an adequate supply of liquidity were reinforced at the beginning of March, with the transitory purchase of the Fogafín-Public Bank securities for an amount of \$499 billion pesos pursuant to the program defined among Banco de la República and Fogafín<sup>16</sup>. In such a manner, the process of dismantling of the operations of the Banco Central Hipotecario (BCH) was facilitated without affecting those who had deposited their savings in said entity. With the purchase of these securities the transitory liquidity supply to the public banks was partially substituted by a more permanent source of liquidity, thus reducing the pressure upon the interbank market.

The simultaneous contraction and expansion auctions system operated efficiently and the interbank rate fluctuated around 9,6% very close to the maximum contraction auction limit (10,0%) (Figure 26).

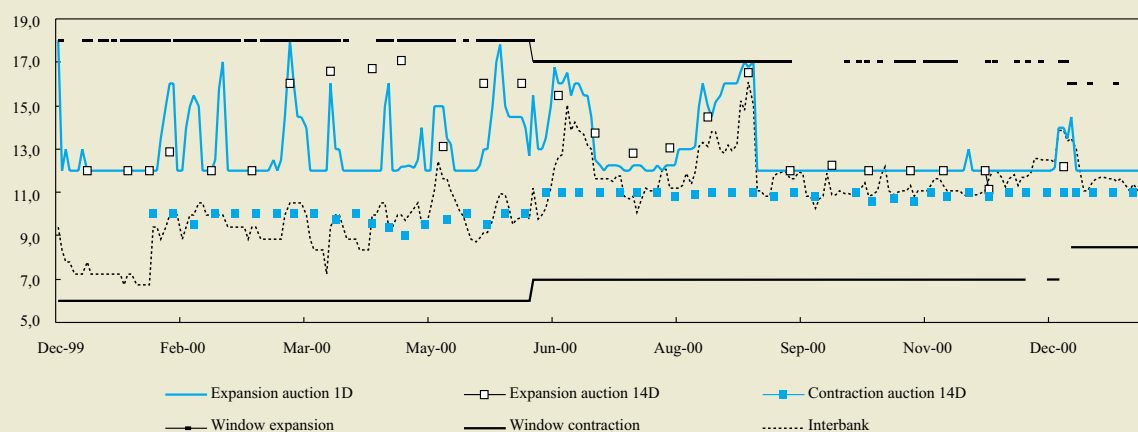
Up to the end of May, the average demand for cash exceeded the corresponding tacit demand within the indicative corridor in approximately 350 billion (Table 13). The opinion of the Board of Directors was that an event of such nature did not have inflationary consequences, since it reflected a permanent reduction of the velocity of money circulation.

In the beginning of July, both the interbank rate and the liquidity demand through the expansion window started to show significant growth vis a vis the average during the first semester (Figures 26 and 27). The average interbank rate of the period July-August was 12,5%, 2,9 percent points above of that present

<sup>16</sup> Some doubts existed within the Congress with regards to the legality of the re-purchasing operation of securities to the BCH carried by the Banco de la República. Last February 1, 2001, the Attorney General of the Nation issued its opinion in favor of the Banco de la República. The Attorney General points out that Law 31, 1992, (C.P.Art 371) "vested the Board of Directors of the Banco de la República for issuing the regulations to establish the size of the monetary base and to establish the conditions to expand and contract the monetary supply, namely, it was granted the capacities to regulate the monetary, foreign exchange and credit policies". Similarly, it stated that the law was clear to grant full powers to the Board of Directors, without limitation for managing currency, except that of maintaining its purchasing power.



**FIGURE 26**  
**CLOSING RATES FOR INTERVENTION AUCTIONS AND WINDOW TRANSACTIONS**  
 (PERCENTAGE)



Source: Banco de la República.

**TABLE 13**  
**MONTHLY AVERAGE OF THE MONETARY BASE INDICATIVE CORRIDOR AND ITS COMPONENTS - 2000**  
 (BILLION PESOS)

Month	Monetary Base				Cash				Reserve			
	Corridor mid point	Observed	Monthly difference	Average aggregate difference	Corridor mid point	Observed	Monthly difference	Average aggregate difference	Corridor mid point	Observed	Monthly difference	Average aggregate difference
Jan.	7.584	7.893	309	309	4.831	5.083	252	252	2.753	2.810	58	58
Feb.	7.439	7.677	238	274	4.559	4.871	312	282	2.881	2.806	(75)	(9)
Mar.	7.432	7.556	124	224	4.555	4.890	335	300	2.877	2.666	(211)	(76)
Apr.	7.640	7.809	169	210	4.532	4.966	434	333	3.109	2.843	(265)	(123)
May.	7.530	7.856	326	233	4.664	5.080	416	350	2.866	2.776	(90)	(117)
Jun.	7.708	8.149	442	268	4.895	5.335	440	365	2.813	2.814	2	(97)
Jul.	7.784	8.396	612	317	4.989	5.518	529	388	2.795	2.878	83	(71)
Aug.	7.778	8.274	497	340	4.876	5.503	627	418	2.902	2.771	(130)	(79)
Sep.	7.756	8.243	487	356	4.800	5.476	675	447	2.956	2.767	(189)	(91)
Oct.	7.739	8.471	732	393	4.753	5.582	829	485	2.986	2.889	(97)	(91)
Nov.	7.998	8.548	549	408	4.885	5.762	877	521	3.113	2.786	(328)	(113)
Dec.	9.331	10.030	699	432	6.096	6.862	766	541	3.235	3.168	(67)	(109)
Average	7.810	8.242	432		4.870	5.411	541		2.940	2.831	(109)	

Source: Banco de la República.

the first semester, and 1,5 percent points above the maximum contraction auction rate (11,0%). This situation generated a broad technical discussion inside the Board of Directors regarding the convenience or the inconvenience of the fact that the monetary policy would validate said increase. It was concluded that the component associated to the change in demand of cash and a fraction of the component of the reserve resulting from the change in the structure of the liabilities subject to float reserve deposits (PSE).

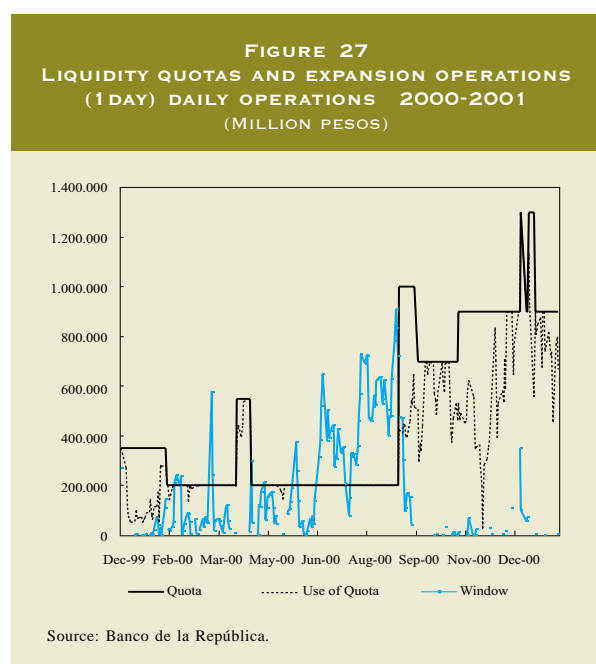
The increase in the demand of monetary base compatible with the inflation target was estimated of the order of \$430 billion, nearly 6,0% with respect to the center of the corridor estimated in the beginning of 2000. From this amount, \$297 billion corresponded to the effect caused by financial transactions upon the demand of cash and \$133 billion to the effect of the re-composition of PSE and the differential of the float deposits.

With this evidence, the Board of Directors reformulated the rule to provide liquidity, adopting a reference line which was 6,1% greater than the center point of the indicative corridor present at the beginning of the year. This measure was translated into an increase of the REPO quotas for one day from \$200 billion to \$1.000 billion (Figure 27). As it may be

seen in Figure 26, this decision allowed the return of the interbank rate to levels of 11,0%. The pressure of resources through window disappeared in practical terms, and the liquidity market returned to normality as from that moment.

On these grounds, towards mid October, the Board of Directors determined that for the remaining period of the year 2000, the monetary base reference line would be slightly over 7,0% at the center of the monetary corridor for the monetary base, as defined at the end of 1999, which included a technical overflow reserve deposit of \$70 billion. Subsequently, the quotas for auctions involving expansion and contraction transactions continued to be adjusted pursuant to the new monetary program and to the needs of liquidity within the economic circumstances present at the year ending period.

Table 14 shows the average monthly balances of the window contraction transactions and 14-day auctions. The behavior of liability transactions,



**TABLE 14**  
**CONTRACTION OMA BY TYPE OF PLACEMENT**  
**MONTHLY AVERAGE BALANCE ON DAILY BALANCES**  
**(BILLION PESOS)**

Date	Total	Window	14 Day Auction
<b>2000</b> Jan.	616	616	0
Feb.	1.119	307	812
Mar.	983	236	747
Apr.	1.020	295	725
May.	907	220	686
Jun.	600	184	415
Jul.	630	131	499
Aug.	756	119	637
Sep.	777	119	658
Oct.	882	192	689
Nov.	871	171	700
Dec.	528	95	433
Average 2000	807	224	584
<b>2001</b> Jan.	94	73	21

Source: Banco de la República, based on the information of the Monetary and Reserves Division.

analyzed together along with the active transactions, sets forth the phenomenon of interbank market fractioning. As a matter of fact, while the liquidity demand increased, exercising a momentary rising pressure upon the interbank rate, some financial entities used their quotas and even the contraction window to deposit their liquidity surplus. This behavior allows an understanding the enormous challenges that the monetary authority has faced to make decisions in an extremely complex financial market undergoing a clearance process.

With regards to other monetary transactions, on October 13, 2000 the Board of Directors decided that the interest rate applicable to liquidity supports should be equivalent to the expansion window rate plus one per cent. This replaced the previous system which was referred to the DTF (Fixed Term Deposit Rate) + 5,0%. The rediscount cost for the loans endorsed by mortgage portfolio remained at the level of the Real Value Unit (UVR) plus 8,5%. On the other hand, as from the second half of November, a limit for the financial intermediaries to access REPO transactions and /or liquidity support transactions was established, for an amount equivalent to 15,0% of their deposits. When said limit is exceeded, the entity shall use exclusively the transitory liquidity supports, with prior authorization by the Banco de la República. These measures are intended to promote a better functioning of the interbank market and enable the interest rate structures of the Issuer respond in the most adequate manner to the liquidity demand of such market.

### 3. Monetary Aggregates

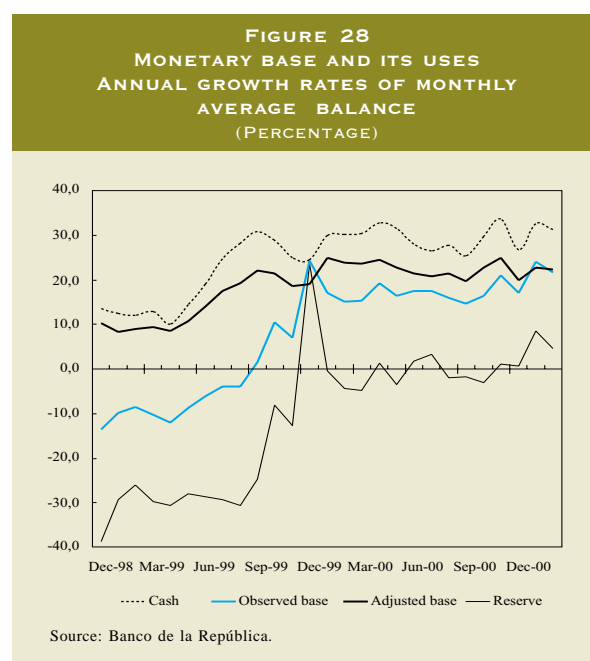
The objective of the monetary policy allowing an adequate liquidity supply to the economy and the decisions with regards to quotas and intervention rates were reflected through the behavior of the monetary aggregates, described as follows.

#### a. Monetary Base

During the first two months of 2000 the financial system normalized its demand for reserves, which had increased by the closing of 1999, due to the

expectations regarding the change of century. As a consequence, the average annual growth rate of the monetary base decreased significantly during this period, and stabilized around 15,0% in the following months, and evolved accordingly with the dynamics of cash and of the components of the PSE. Cash maintained annual growth rates above 30,0% during part of the first semester, to then decelerate and fluctuate around 25,0% during the second semester of 2000. On its part, the growth of the reserve demand fluctuated around 0,0% pursuant to the evolution of PSE and to changes in its composition. (Figure 28).

Figure 28 shows the growth rate of the average balance of the adjusted base in which the demand for reserves for the whole period is calculated using the structure for float reserves existing by the end of 2000. Thus, disturbances of the base are avoided, which may be motivated by changes in the policies for float reserves. As it may be seen during 2000 the annual growth rate of the adjusted base was persistently above the observed base, 5,4 percent points in average. This reflects the fact that the current level of float reserves is below the structure of float reserves applied throughout 1999. In fact, during December 1999 the average float reserves



dropped transitorily and the reference period for complying with the requirement of two to three week reserves was extended. Subsequently, by the end of 2000 the float reserve over the REPO was suppressed which had been placed by the General Treasury of the Nation to the financial system.

Table 15 presents the monthly and total annual supply of the monetary base by its main sources in 2000, classified as transitory and permanent. Throughout the year the monetary based increased \$971 billion and that its main expansion sources had a permanent origin, such as the purchase of foreign currency (\$675 billion), the transfer of profits to the government (\$516 billion) and the definitive purchase of securities issued by Fogafin (\$477 billion). On its part, the REPO transactions

with the financial system caused a transitory net contraction of \$155 billion.

By the end of January 2001, the annual growth rate of the monetary base average balance recorded 24,1%, 6,9 percent points above the growth present during the month of December. This is explained by the acceleration of the reserve and cash growth rates that changed from growing 0,7% and 26,7% in December to 8,6% and 32,6% in January respectively (Figure 28).

### b Money Supply M1

The M1 annual growth rate during 2000 changed from 12,5% in December 1999 to 27,3% in January 2000 and continued to grow persistently up to 40,8% in November to finally end the year with 32,0%.

TABLE 15  
MONETARY BASE SOURCES 2000 (PR)  
(BILLION PESOS)

	Transitory	Permanent							Total Sources	
	Net REPOS 1/	Treasury 2/	4 Month REPOS	Fogafin Securities 3/	TES 4/	Liquid Quota 5/	Foreign Currency 6/	Profit Transfer		Other 7/
Jan.	(2.064)	174			(34)	(206)			33	(2.096)
Feb.	186	(12)			(46)	(204)	23		42	(11)
Mar.	(697)	(613)	(300)	499	(54)	(2)	145	516	6	(500)
Apr.	81	518	(300)		(100)	76			29	304
May.	571	(179)			(134)	93			97	448
Jun.	520	2			(100)	20			42	485
Jul.	(15)	(89)			(61)	(77)	33		100	(109)
Aug.	(182)	(9)			(55)	(68)			15	(299)
Sep.	(323)	51			111	7	38		29	(88)
Oct.	153	(386)			60	(5)	221		(19)	24
Nov.	13	496		(52)	212	(7)	215		49	927
Dec.	1.601	(37)			294	(9)			37	1.886
Total	(155)	(84)	(600)	447	93	(383)	675	516	462	971

(pr) Preliminary Data

1/ Repurchase agreements between Banco de la República and the financial system

2/ Movement of availabilities of the General Treasury of the Nation in the Banco de la República

3/ Final purchase of securities issued by Fogafin

4/ Final purchase of TES B in the secondary market

5/ Utilization of liquidity quotas by Banco de la República

6/ Sale and purchase of foreign currency in the exchange market by Banco de la República

7/ Mainly includes net expansion transactions of the Income Statement of Banco de la República for \$77 billion, dollars purchase to multilateral entities for \$200 billion and the real investment of BR

Source: Banco de la República.

Accounting for M1 components, this significant increase was explained mainly by the strong annual growth of the current accounts, which changed from 3,9% in December 1999 to 36,5% in December 2000, with a maximum rate in November of 47,1% (Figure 29). The foregoing shows the impact of the tax on financial transactions between accounts of a single account holder on the demand of current accounts. This reaction transformed the structure of the demand of liquid financial assets, attenuating the multiplier process of the financial system, as it will be discussed later on.

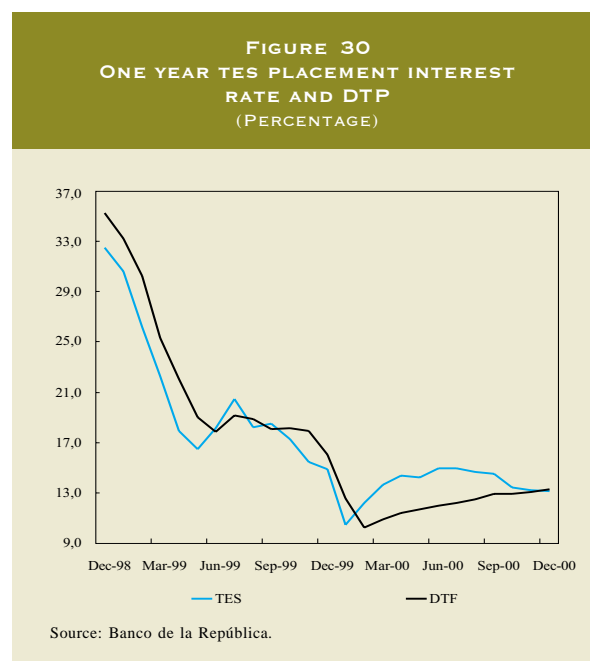
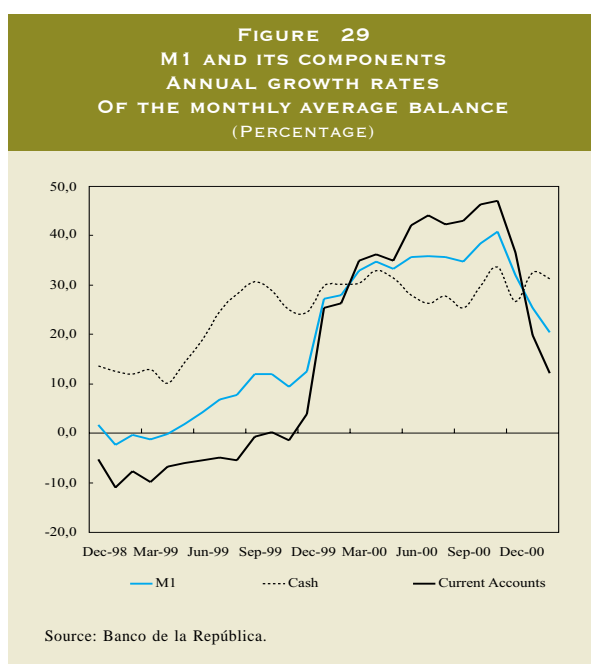
The suppression of the tax on financial transactions between accounts approved within the amendment to the tax law of December 2000 has started to change the growth trend of current accounts. In February it reached 20,4%, less than the 32% recorded in December 2000. However, as it has been discussed, the decrease in the growth rate of M1 has been attenuated by a greater growth of cash.

### c. Extended Monetary Aggregate (M3)<sup>17</sup>

The average annual growth rate for M3 showed a decreasing tendency up to May 2000 when it reached a minimum of 2,1%. Since then its growth rate fluctuated around 3,0% annually and closed at 3,0%

in December. The low growth rate of M3 responds partially to a reduction of its demand, both for the effect left behind by the 4,3% drop in economic activity in 1999, as well as the reduction in interest rate for this aggregate - measured by the DTF- vis a vis the interest rates of the substitute financial assets, and of the public debt securities (TES) and the external assets.

As it may be seen in Figure 30, the TES interest rates were higher than the DTF throughout 2000. These rates have different terms and thus, are not comparable in a direct manner, since the DTF is referred to a period of three months and the TES for annual period deposits. Notwithstanding the foregoing, a greater TES rate along with risk conditions generated a substantial change in the structure of the financial portfolio toward public debt securities. As a consequence, accounting both profitability and security, the financial system deemed that it was more attractive to maintain TES in the assets of its balance sheet instead of providing new credits to the private sector. As a matter of fact, as it may be seen in



<sup>17</sup> As from the fourth quarter, the financial system bonds are included within the group of liabilities subject to float reserve deposits (PSE), consequently, the aggregate that had been denominated as M3 plus bonds in former reports, is called M3 from this report onward.

Table 16, the total credit balance of the financial system decreased 8,5% in 2000, while the TES balance in hands of the financial sector increased 135,9% (Table 17). The foregoing reflects a change in the financial system portfolio structure, where the public debt securities changed from representing 13,0% in 1998 to 24,0% in 2000, while the loan portfolio decreased from 73,0% to 60,0% during the same period. (Figure 31),

Similarly, the private sector also deemed it was more profitable to keep public securities in its portfolio more than having PSE in the financial system (Table 17). Additionally, according to balance of payments

estimates, the balance of the loan portfolio abroad of the non financial private sector increased nearly US\$ 1 billion in 2000, namely more than \$2 thousand billion were not registered as internal portfolio, reinforcing the holding up of the M3 aggregate.

The behavior of M3 presents several variations of its components. The unusual expansion of the current account demands occurred along with a growth in the demand for savings accounts, whose yield decreased both because of the drop in the DTF as well as for the 2 x 100 tax applied to transfers between accounts. Since the float reserve on current accounts is greater than for the saving

**TABLE 16**  
**TOTAL CREDIT AND FINANCIAL PORTFOLIO**  
(BILLION PESOS)

	Balance Dec. 301 de 2000	Annual Variation	
		Absolute	Percentage
<b>I. Total Credit</b>	46.071	(4.306)	(8,5)
1. Commercial banks	23.013	933	4,2
2. Mortgage banks	16.217	(5.003)	(23,6)
3. Financial entities	5.438	(83)	(1,5)
4. Financial Leasing Companies	1.403	(153)	(9,9)
<b>II. Total Financial Portfolio</b>	90.953	9.996	12,3
A. Financial Sector	62.302	1.446	2,4
1. Extended Means of Payment M3 <sup>1/</sup>	61.762	1.614	2,7
Means of Payment M1	16.769	3.912	30,4
Quasimoney	39.486	(1.530)	(3,7)
Other liabilities subject to float reserve deposit	3.275	9	0,3
Bonds	2.232	(777)	(25,8)
2. Banker's acceptances in circulation	55	(9)	(14,7)
3. Assessable electrical sector securities	55	(334)	(86,0)
4. FEN savings securities	430	175	68,5
5. Other financial assets	1	0	0,0
B. Public Sector <sup>2/</sup>	28.651	8.550	42,5
1. TES	19.457	2.720	16,2
2. TES B denominated in M/E	1.913	350	22,4
3. TES B UVR	5.401	3.601	200,0
4. TES Law 546, 1999	1.879	1.879	---

<sup>1/</sup> As from November 24, 2000 the financial system bonds were included among the group of liabilities subject to float reserve deposits. Thus, the aggregate that had been called M3+ Bonds, was thereafter called M3. For such reason the structure of this table was changed.

<sup>2/</sup> Valued at market prices

Source: Banco de la República.

TABLE 17  
BALANCE OF TES BY HOLDER 1/  
(BILLION PESOS)

	Balances as of December			Growth Rate	
	1998	1999	2000	1999	2000
<b>Total</b>	13.856	20.100	28.651	45,1	42,5
Non financial private sector	2.331	3.931	8.891	68,6	126,2
Financial sector	1.150	2.169	5.115	88,5	135,9
Public sector	9.933	12.327	12.530	24,1	1,6
Banco de la República	441	1.674	2.114	279,6	26,3

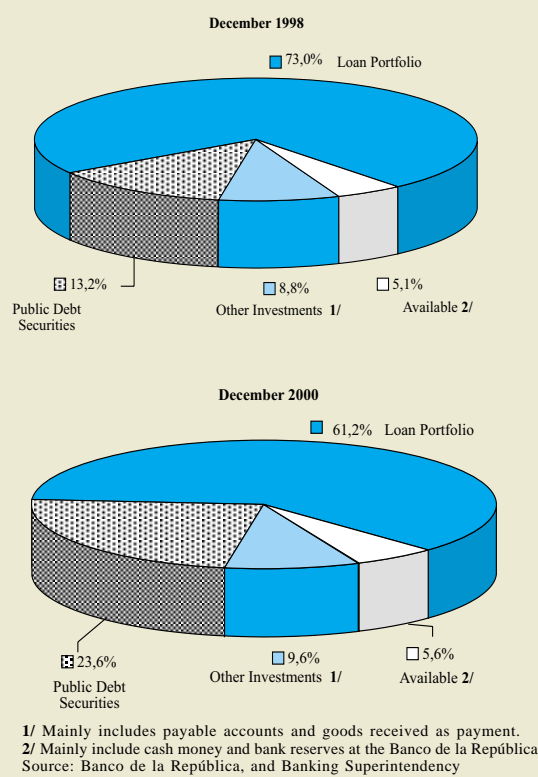
1/ Values at market prices

Source: Banco de la República , Depósito Central de Valores (DCV) and SGEE.

accounts, the greater demand of deposits in current accounts contributed to decrease the amplified multiplier, and thus accentuated the holding of the M3 aggregate.

From a different perspective, the low growth of the M3 aggregate during 2000 was partially determined by the difficulties faced by the financial intermediaries to channel credit into the economy, having the perception of a high credit risk, the weakness of equity of some financial intermediaries and the loss of value of security interest. The phenomenon of the rupture of the credit channel was widely discussed in the Reports to Congress of July 1999 and March 2000. Both then as now the diagnostic relating to such behavior continues to be valid which states that such behavior does not respond to monetary restrictions. The broad supply of liquidity and the interbank interest rate stability during 2000 prove so. What is new in the current situation is the fact that, as it is examined in the section relating to the financial system, the factors which are not part of the monetary policy and that have hindered the desirable functioning of the credit channel are starting to yield. As explained therein, during 2000 the loan portfolio quality and financial system solvency indicators improved significantly. The foregoing, along with the economic recovery has started to remove the obstacles to channel credit into the economy, and begins to show a rebound of

FIGURE 31  
FINANCIAL SYSTEM PORTFOLIO STRUCTURE



ordinary and consumption credit (See Figure 46). Consolidation of this healthy trend requires the restructuring of the financial sector and specially the deepening of the fiscal adjustment to be continued. It is clear that as the government



reduces its internal financing needs, by means of a deficit reduction and obtaining an adequate external financing, the acquisition of public debt securities, which currently absorbs an important portion of the financial sector and of the private sector portfolios, will no longer be an attractive and accessible option, due to the reduction of its profitability and of the amounts issued. This will stimulate a greater channeling of the financial resources toward credit, as well as a greater demand of the PSE by the public, which constitute the source of resources that generate credit.

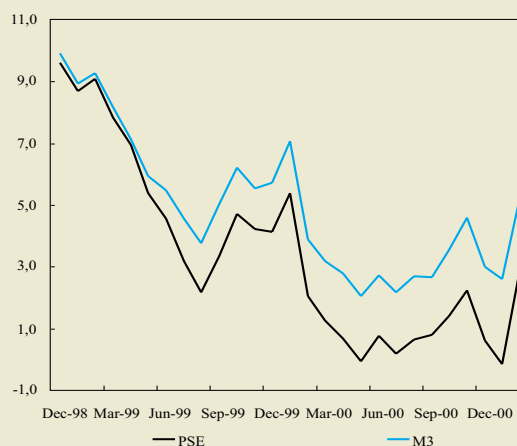
In synthesis, the slow growth of the aggregate M3 has responded to a set of factors, some of which are starting to be solved, such as the resistance to channel credit into the economy by the financial intermediaries, and the re-composition of the PSE toward current accounts. Other, instead, continue to be stressed, such as the increase in the demand of cash induced by a greater tax upon financial transactions.

Under these circumstances, it is expected the correction of the M3 tendencies to take some time. The most recent numbers, however, start to suggest a change of tendency. As of 23 of February the M3 balance was \$62.262 billion with an annual growth of 7,1% as compared to 2,7% present at the end of 2000. Similarly, the annual growth of the average balance in February (5,3%) is higher than in December (3,0%) (Figure 32). This increase responds to a greater growth of the PSE, which changed from 0,6% in December to 2,9% in February. The ascending tendency is explained mainly through the positive growth rates for the CDT (5,1%) annually and the savings accounts (0,4%) which had recorded a significant contraction during 2000 (Figure 33).

#### d. Monetary Multiplier

As from March 2000 the monetary base multiplier started to show a descending tendency with regards to M3, as a result of the increase of the cash and bank reserve coefficients (Figure 34). The preference of cash as compared to TES by the public raised the

**FIGURE 32**  
**M3 AND LIABILITIES SUBJECT TO FLOAT RESERVE DEPOSIT (PSE) ANNUAL GROWTH RATE OF THE MONTHLY AVERAGE BALANCE (PERCENTAGE)**



Source: Banco de la República.

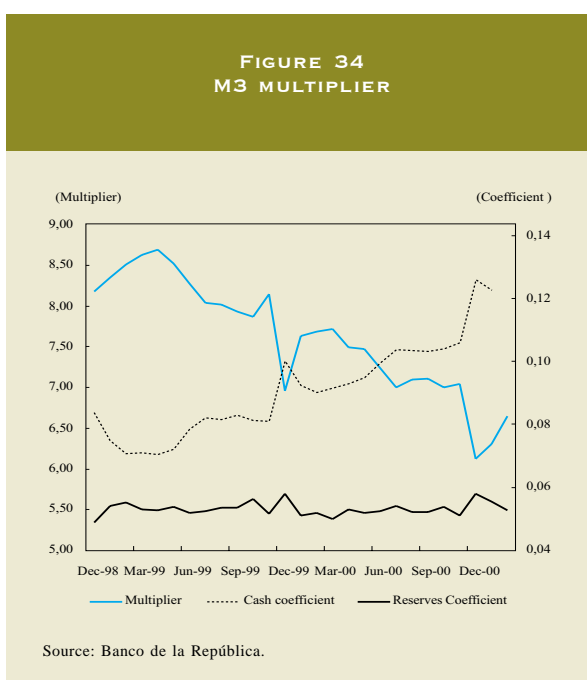
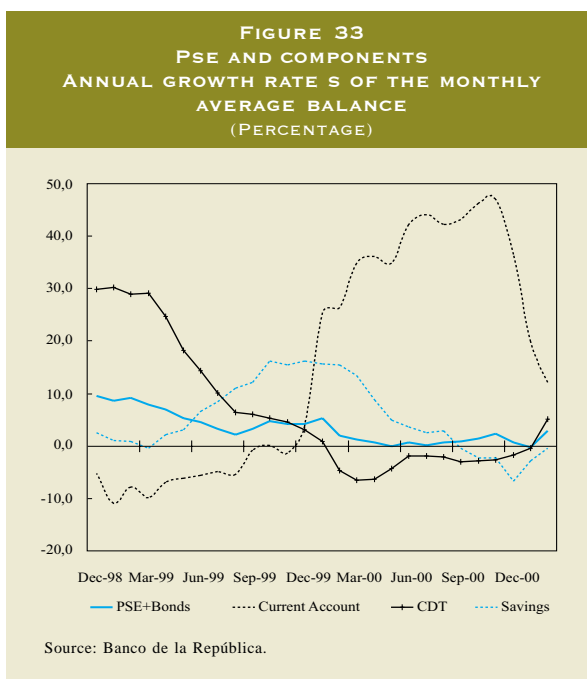
cash coefficient from 0,100 in December 1999 to 0,126 in the same month of 2000. The reserve coefficient that had descended in March to 0,050 started to raise slowly until reaching 0,058 by the end of the year, a level similar to the one it had shown in December 1999. This continuous ascending trend is explained, mainly by the change in structure of the PSE of the savings account toward current accounts and for the tendency of maintaining a greater surplus of reserves by the financial intermediaries.

Between December 2000 and February 2001, the average monetary multiplier of M3 recovered from 6,121 to 6,652. This behavior responds to the lesser effective and reserve coefficients, which changed from 0,126 and 0,058 to 0,115 and 0,053 respectively.

#### 4. Interest Rates and Intermediation Spreads

Based on information provided by the Banking Superintendency, the nominal interest rates for lending and fund raising showed their lowest level in the nineties decade in February 2000, reaching 10,2% and 23,6% respectively. Subsequently, they presented a rising tendency until reaching





13,3% and 29,4% respectively, in December 2000. The real interest rates showed a similar behavior. However, due to the effect caused by the reduction of the inflation rate as from April 2000, their growth trend has been stressed more than for nominal interest rates. Thus the real fund raising rate descended to a level of 1,2% in February 2000 and by the end of the year it reached 4,2%, still the lowest level for the month

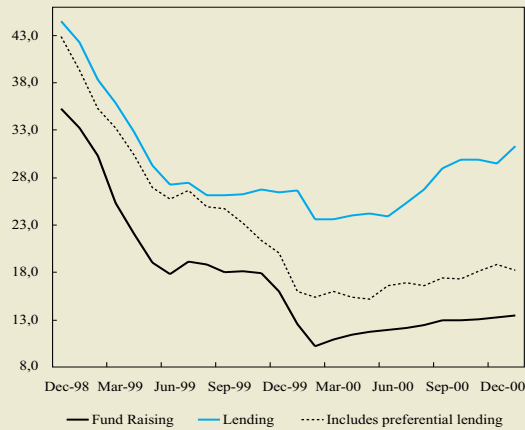
of December since 1994, when the interest rate had fallen dramatically due to the massive inflow of capitals. On its part, the real lending rate fell to 12,6% in March and by the end of 2000 it reached 19,0% (Figures 35 and 36).

The information supplied by the Banking Superintendency has to be examined in detail in order to understand the meaning of the lending interest rate and the reasons that explain its recent tendency to rise. The Banking Superintendency calculates the lending rate based on a weekly report provided by the financial system which relates the effective interest rate and the amount of credit disbursements for different lending terms. The type of credit included in the report are: consumption, ordinary, treasury and preferential or corporate. However, for the calculation of the lending rate, the banking Superintendency excludes most of the credits that are granted at lower rates, which correspond to preferential and treasury credits as shown in Figure 37. Consequently, their exclusion from the calculation implies a relatively higher lending rate.

By including preferential and treasury credits, an alternative measurement of the lending rate is obtained, which is significantly lower than the one calculated by the Banking Superintendency. As a matter of fact, as it may be seen in Figure 35, the nominal lending rate including the four types of credit was barely over 18,0%, equivalent to a real rate of 9,3% at the end of 2000<sup>18</sup> as compared to a rate of 29,4% (19,0% real) calculated by the Banking Superintendency for the same date. This means that an important segmentation of the interest rates occurs in the credit market, pursuant to the type of risk faced by the intermediary. Thus, the ordinary and consumption credits involve a higher risk premium than those for treasury and preferential.

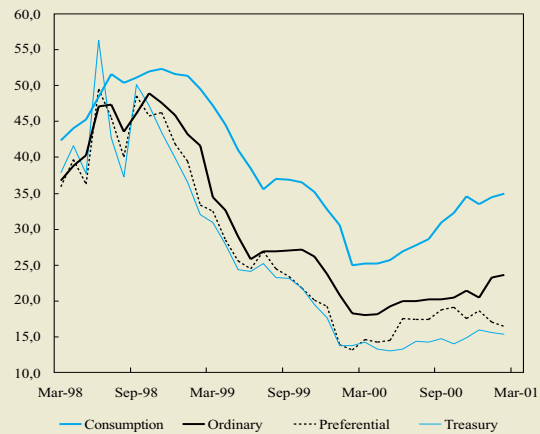
<sup>18</sup> Calculated based on daily information. If in addition, credit cards were included the nominal rate would be 19,8%, equivalent to a real rate of 10,2%.

**FIGURE 35**  
**FUND RAISING AND LENDING NOMINAL**  
**INTEREST RATE**  
 (PERCENTAGE)



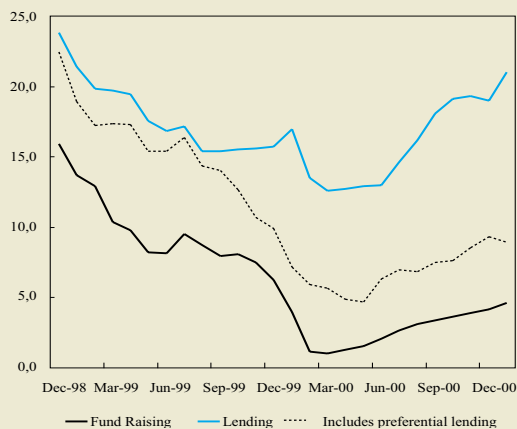
Source: Banco de la República and Banking Superintendency

**FIGURE 37**  
**ACTIVE NOMINAL INTEREST RATES**  
**BY CREDIT TYPE**  
 (PERCENTAGE)



Source: Banco de la República and Banking Superintendency

**FIGURE 36**  
**FUND RAISING AND LENDING REAL**  
**INTEREST RATE**  
 (PERCENTAGE)



Source: Banco de la República and Banking Superintendency

If what is intended is to assess the average cost of credit in the economy, the calculation of the lending rate, including these two types of credit, offers a general measurement.

Another issue that requires examination is the behavior of the intermediation spread. There are two ways of calculating the banking intermediation spread: one ex-ante and another ex-post. When taking the difference between the lending and fund

raising rates calculated by the Banking Superintendency an ex-ante spread is obtained, since it is a spread calculated based on the assumption that all of the credit disbursements of the period will yield productive. However, in practice the intermediaries hold a balance of unproductive portfolio that may lower the financial revenues that had been expected ex-ante. This distortion is corrected by the intermediation spread ex-post, which consists of taking the difference between the average yield rate of the credit loans and the average cost of deposits and payables<sup>19</sup>. The ex-post spread is effectively obtained by the financial intermediary for its credit activity. In this sense, it offers a better measurement of the true intermediation spread than the ex-ante spread, since the latter does not account for the quality of assets and it involves a credit risk premium, for which it tends to be greater than the ex-post spread.

<sup>19</sup> The average yield rate of the credit loans is calculated as the ratio between the financial revenues in the last 12 months due to interests and credit portfolio discounts (including monetary correction) and the balance of the gross credit portfolio. The average cost of deposits and payables is calculated as the ratio between financial disbursements paid during the last 12 months for deposits and payables (including monetary correction) and the balance of the current account deposits, simple deposits, CDT, CDAT, savings deposits and saving certificates.

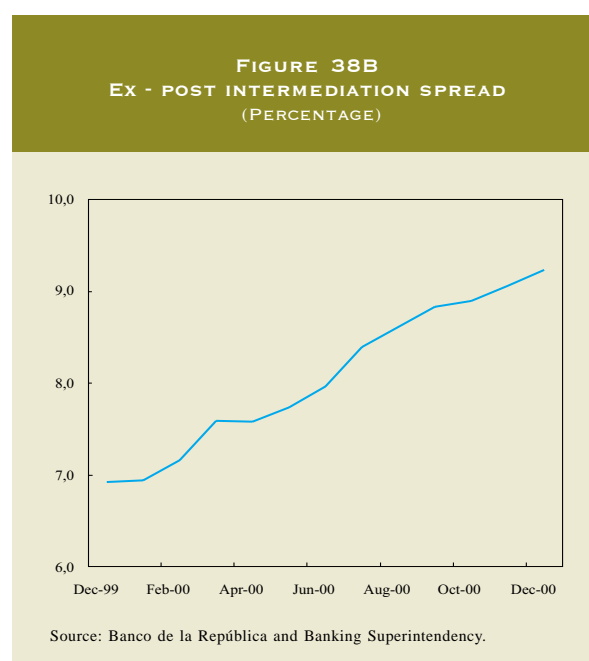
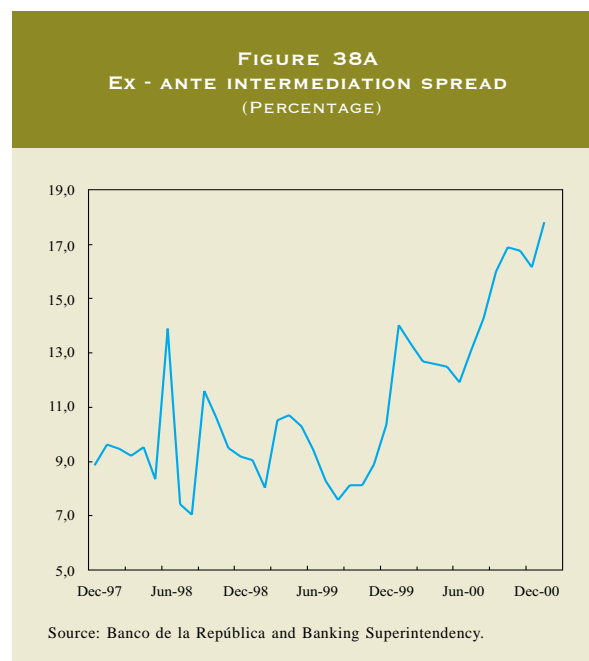
The ex-ante spread showed an important increase in 2000 changing from 10,4% at the end of 1999 to 16,2% at the end of 2000 (Figure 38A). A stressed rebound can be seen as from June 2000, which reflects a progressive change of the composition of total credit towards ordinary and consumption credit, over which the intermediary perceives greater risk than the preferential or treasury credits. In contrast, the ex-post intermediation spread showed a much more moderate tendency changing from 7,0% in December 1999 to 9,1% in December 2000, and different than the ex-ante spread, its level kept very stable as from the middle of the year. (Figure 38B).

### 5. Liquidity Provision for the Year End

In order to meet the permanent liquidity needs present at the end of year 2000, since the first week of September the Board of Directors reestablished the definitive TES purchases up to \$1.300 billion and suppressed the float reserve deposit requirement upon the REPO transactions with the General Treasury of the Nation, with a monetary expansion effect of \$50 billion. For definitive TES purchases the Banco de la República introduced a novel mechanism for futures purchases (\$400 billion) which occurred along with the traditional spot purchases in auction (\$900 billion).

The introduction of the TES futures purchases intend to offer the economic agents a greater degree of certainty with regards to the available liquidity at the year ending period, aiming at facilitating interest rates stability. Additionally, this contributes to the development of the by-products market, thus motivating the other agents through the generation of reference market rates.

The foregoing transactions are supplemented by already existing transitory mechanisms to provide liquidity. In this respect, auctions pursuant to the monetary program based on the reference line were scheduled, which allowed a year closing with a relative calm interbank market.



### 6. Reference Line for 2001

On December 3, 2000 the Board of Directors approved a reference line for the 2001 monetary base, coherent with the inflation target, with the projection of economic growth and the foreseen velocity of circulation. At the time of its design the modifications that the Tax Law Amendment would introduce upon the financial transactions tax were unknown, with regards to its rate and regulations therefor.

The grounds for the construction of the reference line was the assumption that the cash in hands of the public and the monetary aggregate M3 would show during 2000 an average growth similar to the nominal GDP, and that its average circulation velocities would be the same as in 2000. Additionally, it was assumed that the monetary base and the cash that remained for the rest of 2000 would follow a path similar to the reference line set forth on October<sup>20</sup>. In this way, the annual average growth of cash tacit in the reference line for 2001 is 13,0% and 7,2% for the year end. The annual cash average growth rates for each of the four quarters of 2001 were 17,1%, 14,0%, 11,2% and 10% respectively.

With regards to M3, it was assumed it would end 2000 with an annual growth rate of 4,3% recording an average annual growth rate of 3,3%. Thus the average annual growth rate of M3 would be 13,2% in 2001, and by the year end it would grow 19,2%. Its average growth rates in each quarter follow an increasing scale of 7,0%, 11,8%, 15,6% and 18,2% respectively, thus reflecting the recovery expected for the aggregate behavior.

The path for the PSE was deducted based on the weekly cash and M3 behavior<sup>21</sup>. The path for the monetary based was calculated based on this result. For the calculation it was assumed that the PSE composition would follow the pattern observed during 2000. By applying the float reserve deposit coefficients required for each PSE, an estimate of the demand of the banking reserve was obtained. The estimated cash for the corresponding week were added to the calculations of required reserve, thus resulting the estimate for the monetary base reference line.

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<sup>20</sup> As a consequence of the suppression of the float reserve on REPO transactions performed by credit establishments with the National Directorate of Treasury, the reference values for the monetary base as of December 2000 were adjusted.

<sup>21</sup> The liabilities subject to float reserve deposits (PSE) are defined as the sum of current account deposits, the quasi-money, the trust deposits of commercial banks and sight deposits.

The average growth rate and end of the reference line of the monetary base for 2001, based on what was approved in November, is 13,0% and 11,4% respectively. The quarterly path for its annual growth throughout 2001 was established in 16,9%, 12,8%, 11,9% and 10,9% respectively. This path reflects a gradual reduction of the growth rate, starting from an average growth during the first semester of 2001 being very close to that of the fourth semester of 2000.

With the evidence available as of March 2001, it is known that some of the assumptions upon which the reference line was designed for the current year are being validated. Without a doubt, the changes in the tax on financial transactions, due to its increase of 3 x 1000 and eliminating the tax on transactions between accounts of the same agent, has repercussions on the demands of deposits and cash. In fact, up to date during 2001, the cash demand has been greater than the demand implied in the reference line and the PSE structure is being modified in favor of the savings accounts, which has affected the behavior of the monetary base demand as compared to what had been foreseen. For this reason, after analyzing the facts, the Board of Directors has disclosed, on a monthly basis, the reasons for which the deviations of the base observed with respect to the projections do not compromise the achievement of the inflation target. As it was established in the in the monetary strategy, the Board shall make the corrections that are deemed convenient to the reference line, in order to assure an acceptable operation of the market and to avoid pressures upon the interest rates, which shall be reported in the Report to Congress of the month of July.

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## B. FINANCIAL SITUATION

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The main indicators of the Colombian financial system during 2000 reveal a clear improvement of the sector, up to the point that some of them, such as the

solvency ratio, reached the level that had been observed before the crisis. Other indicators such as profitability and percentage of unproductive assets, evidence that the tendency towards deterioration that had been observed up to the end of 1999 was interrupted.

## 1. Financial System Indicators

### a. Restoration of the Financial System

#### Solvency

Solvency indicators of the financial system, as a whole, improved significantly during year 2000. Before the crisis, the *solvency* ratio<sup>22</sup> for the system was 13,2%; in the deepest of the crisis it dropped to 10,6%, and by the end of 2000 it recovered to reach 13,8% (Figures 39A and 39B). As shown in part (2) of this section, the improvement in the soundness of the system, measured by this indicator, is due greatly to efforts to clear the balances sheets of both, public banks and private financial system. Both the banking sector as well as the institutions specialized in mortgage credit reached solvency levels similar or greater to those they had during the financial system boom in the nineties. To this respect, it can be stated that during 2000 one of the necessary conditions to overcome the financial crisis was satisfied.

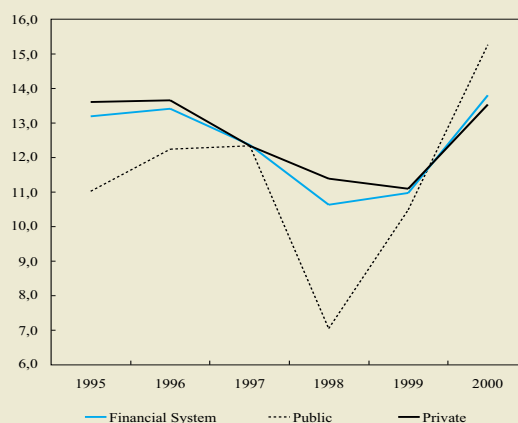
### b. Losses Reduction and Asset Quality

#### Improvement

After two consecutive years of deterioration of the financial system profitability indicators, the tendency was changed in 2000. Despite the fact that the profitability indicators are still negative, for the system as a whole an improvement was made with respect to 1999 (Figure 40A). The recovery of the return on assets of the institutions specialized in mortgage portfolio, stands out, which ceased to be negative reaching 0,2% (Figure 40B). This is an important progress which may contribute to increase the generation of credits for housing during the oncoming years.

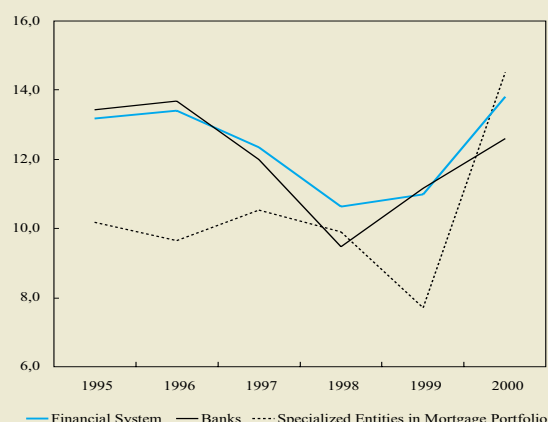
<sup>22</sup> The solvency ratio equals Technical Equity as a share of risk-weighted assets.

FIGURE 39A  
SOLVENCY RATIO 1995-2000  
(PERCENTAGE)



Source: Banco de la República and Banking Superintendency.

FIGURE 39B  
SOLVENCY RATIO 1995-2000  
(PERCENTAGE)

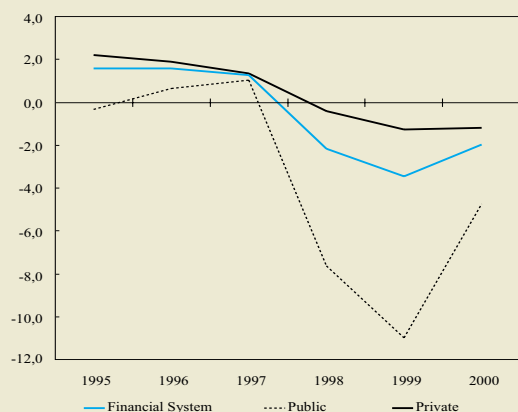


Source: Banco de la República and Banking Superintendency.

Similarly, the performance of the public financial sector improved significantly, since its profitability indicator increased from -11,0% to -4,8% between the end of 1999 and 2000, which suggests a positive forecast for the capitalization policies for the public banks. (Figure 40A).

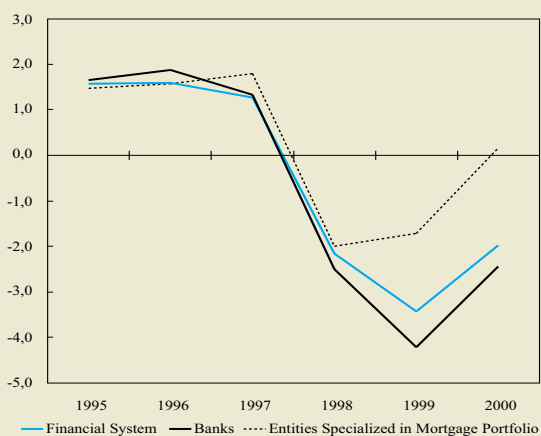
The financial system as a whole keeps reporting losses for the fiscal year 2000, because of two basic

**FIGURE 40A**  
**RETURN ON ASSETS 1995-2000**  
 (PERCENTAGE)



Source: Banco de la República and Banking Superintendency

**FIGURE 40B**  
**RETURN ON ASSETS 1995-2000**  
 (PERCENTAGE)



Source: Banco de la República and Banking Superintendency

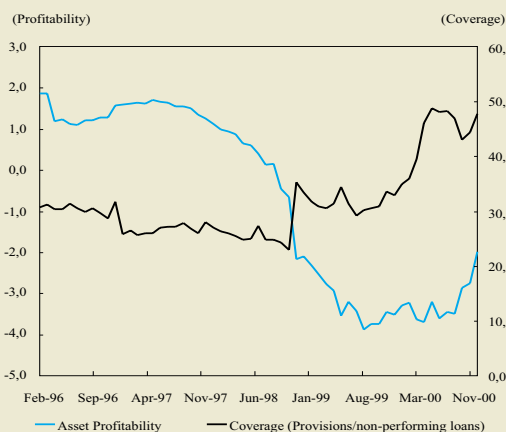
reasons. First, the clearance operations carried out by the entities by withdrawing impaired assets from their balance sheets cause some losses. Second, the Banking Superintendency increased provision requirements for loan portfolio protection; these requirements are more demanding due to the lower coverage levels observed before the crisis developed. (Figure 41). The clearing of the balances and its greater coverage shall

contribute, to the fact that in the future, the financial entities will start to report profits and to improve their soundness indicators.

The assets quality indicators also improved. The percentage of impaired assets for the financial system dropped from 6,5% of the total assets in December 1999 to 4,2% in the same month of 2000, mainly as a result of the clearance operations of the balance sheets carried out throughout the year.

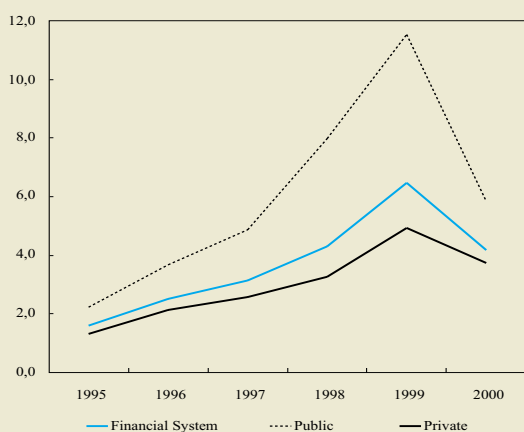
Analyzing this indicator in light of the main intermediaries of the system (Figures 42A and 42B), we can observe that during 2000 the banks made an important improvement since they decreased their percentage of impaired assets to a level lower than they had in 1995. On its part, the entities specialized in mortgage portfolio also showed an improvement in the ratio impaired assets/total assets, but its level continues to be high. On the other hand, the most important improvement of the decrease of impaired assets percentage is shown by the public financial sector, that through the wind up of the BCH and the transfer of impaired assets to a Fogafin affiliate, Central de Inversiones S.A (CISA), it was able to reduce its impaired assets in nearly 50%.

**FIGURE 41**  
**PROFITABILITY AND COVERAGE OF THE FINANCIAL SYSTEM 1996-2000**  
 (PERCENTAGE)



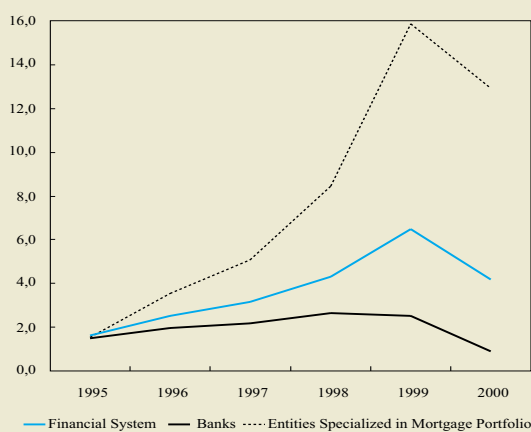
Source: Banco de la República and Banking Superintendency

**FIGURE 42A**  
IMPAIRED ASSETS PERCENTAGE  
1995-2000  
(PERCENTAGE)



Source: Banco de la República and Banking Superintendency.

**FIGURE 42B**  
IMPAIRED ASSETS PERCENTAGE  
1995-2000  
(PERCENTAGE)



Source: Banco de la República and Banking Superintendency.

The asset clearance process previously described allowed an improvement of the indicator of *loans quality*. For the whole financial system, the ratio of *non-performing loans / total loans* was 6,9% at the end of 1995, it reached its highest level in 1999, 13,4% and dropped to 10,7% at the end of 2000 (Figures 43A and 43B).

In the banks case, the *loans quality* is even higher than in 1995. The institutions specialized in mortgage

portfolio show a slight improvement in its *loans quality* indicator.

### c. Credit Behavior

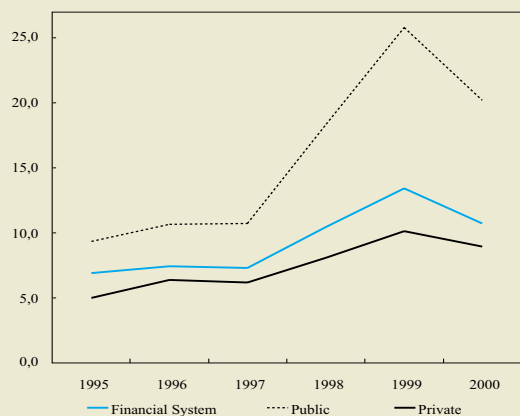
The numbers concerning the evolution of the financial system loans shall be carefully analyzed, because in the current economic circumstances, while carrying out assets clearance and debtors relief, a decrease in the stock of loans does not necessarily implies a reduction in the supply of new credits within the economy.

During 2000, the stock of gross loans for the financial system decreased at an annual rate of nearly 8,0%. The public financial sector showed the greatest drop in its stock of loans, 31,2%, due mainly to the clearance operations of non-performing loans carried out throughout the year. As it may be seen in Figure 44A, for the public financial sector, both the stock of mortgage loans and the stock of non-mortgage loans showed similar drops in their annual growth rates. On its part, the private financial sector portfolio, which represents 90,0% of the total financial sector stock of loans, showed a different behavior, depending on the type of institutions. The non-mortgage private institutions showed a growth in their stock of loans of about 3,0% during 2000, which to some extent was compensated by a reduction in the stock of loans of private mortgage entities, mainly due to the relief to debtors that had been authorized by the "1999 law on housing". Consequently, total private financial sector stock of loans showed a drop of nearly 2,0%, more moderate than that observed during 1999 (Figure 44B).

The decrease of the stock of loans is not caused of loans contraction. This can be seen in two ways. First, taking into account the transactions related to withdrawal of *impaired assets* from the balance sheets and debt relief as of December 2000, a 3,1% increase of the *adjusted stock of loans in local currency without adjustments* (Table 18). This is a phenomenon present since the end of 1999 when the clearance process of balance sheets started as

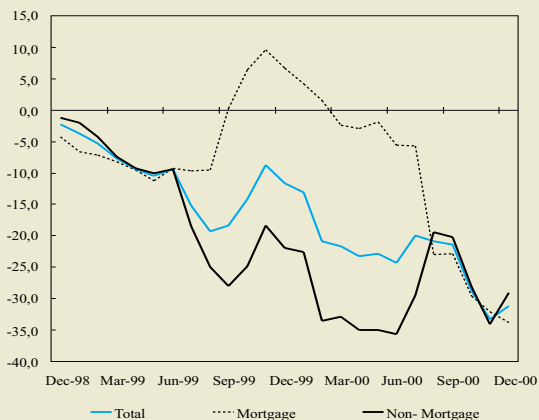


**FIGURE 43A**  
**FINANCIAL SYSTEM LOANS QUALITY**  
 (NON-PERFORMING LOANS / TOTAL LOANS)



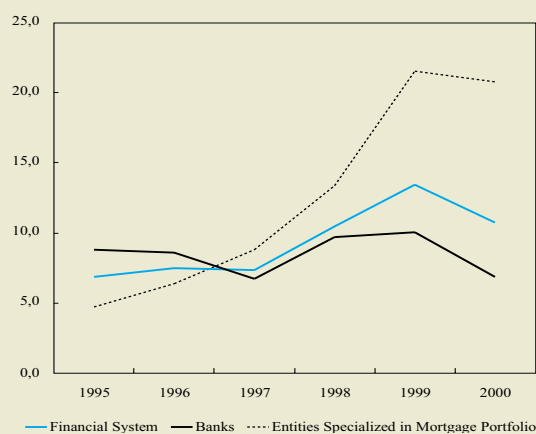
Source: Banco de la República and Banking Superintendency.

**FIGURE 44A**  
**GROWTH OF THE GROSS STOCK OF LOANS OF THE**  
**FINANCIAL PUBLIC SECTOR**  
 (PERCENTAGE)



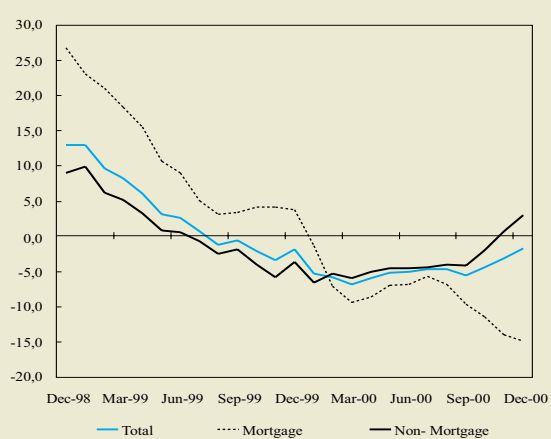
Source: Banco de la República and Banking Superintendency.

**FIGURE 43B**  
**FINANCIAL SYSTEM LOANS QUALITY**  
 (NON-PERFORMING LOANS / TOTAL LOANS)



Source: Banco de la República and Banking Superintendency.

**FIGURE 44B**  
**GROWTH OF THE GROSS STOCK OF LOANS OF THE**  
**FINANCIAL PRIVATE SECTOR**  
 (PERCENTAGE)



Source: Banco de la República and Banking Superintendency.

part of the financial restructuring; as a result the growth rates of the observed *stock of loans* have moved further away from the adjusted stock of loans (Figure 45). Second, the credit disbursements in 2000 were higher than those in 1999 in 3,0% annually (Table 19), which is one of the factors that contributed for the reactivation of the demand of goods and services during 2000. Additionally, the composition by type of credit was also modified.

Between June 1999 and June 2000 the financial intermediaries showed a clear inclination to grant more credit, of the *preferential or corporate* type, namely, the credit granted to the best clients, while the *consumption* credit and *ordinary* credit were stalled (Figure 46B).

However, during the second semester of 2000 such trend was reversed. Both ordinary credit and

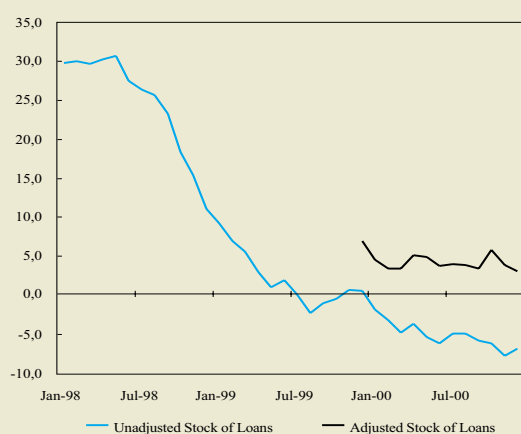


TABLE 18  
FINANCIAL SYSTEM ADJUSTED STOCK OF LOANS IN LOCAL CURRENCY

	Stocks as of December (billion of Colombian pesos)			Percentage variations	
	1998	1999	2000	1999	2000
<b>A. Stock of Gross Loans</b>	46.735	47.231	44.027	1,1	(6,8)
<b>B. Portfolio withdrawn from balance sheets</b>	4.169	7.232	10.266	73,4	42,0
Real assets received as payment	1.624	2.161	2.171	33,1	0,5
"Punishments" on Stock of Loans	1.369	2.840	4.520	107,4	59,2
Stock of Loans in Management	930	1.271	2.566	36,7	101,8
Stock of loans of foreclosed entities (Caja Agraria)	-	710	710	-	-
Securitized loans and stock of loans sales	247	250	299	1,4	19,6
<b>C. TES Law 546 (Government bonds for reduction of mortgage portfolio)</b>	-	-	1.879	-	-
<b>D. Adjusted Stock of Gross Loans (A)+(B)+(C)</b>	53.681	54.463	56.172	1,5	3,1

Source: Banco de la República, SGEE.

FIGURE 45  
ADJUSTED STOCK OF LOANS IN LOCAL CURRENCY - ANNUAL VARIATIONS (PERCENTAGE)



Source Banking Superintendency and: Banco de la República

consumption credit showed reactivation, with an annual growth rate of 10,6% and 15,1% respectively (Table 19), while the *preferential credit* disbursements had increasingly negative monthly variations (Fig-

res 46A and 46B), accumulating a drop during the year of \$788 billion (11,7%). In addition of revealing a recovery in the confidence level of the financial intermediaries to channel credit into the economy, reactivation of *consumption* and ordinary *credit* type are essential to sustain increased household consumption and private investment, two of the main growth engines during 2000.

## 2. Results of the Banking Recapitalization Process

During 2000 new capitalizations of the financial system were made, for an amount of \$3.365 billion of Colombian pesos from which \$2.146 billion were made with FOGAFIN resources and \$1.219 billion with resources from the shareholders of private financial institutions. From the capitalizations carried out by FOGAFIN during 2000, \$2.082 billion correspond to public banks (Table 20) and \$64 billion to the private financial sector (Table 21). The amount of capitalizations carried out by FOGAFIN as from

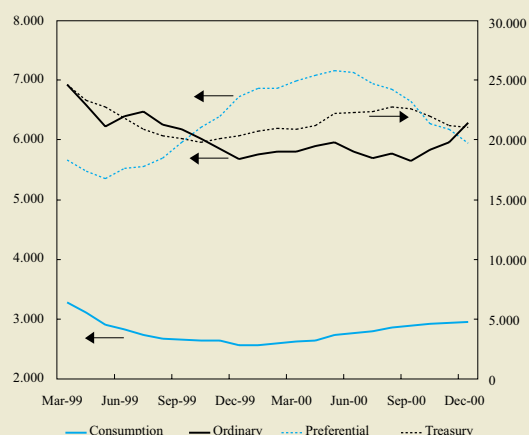
**TABLE 19**  
**CREDIT DISBURSEMENTS, BY TYPE 1/**  
**TOTAL FINANCIAL SYSTEM**  
 (BILLION OF COLOMBIAN PESOS)

	1999	2000	Percentage variation
Consumption	2.566,3	2.953,2	15,1
Ordinary	5.683,8	6.283,8	10,6
Preferential	6.728,3	5.940,3	(11,7)
Treasury	20.333,5	21.311,1	4,8
Mortgage	333,2	242,2	(27,3)
<b>Total</b>	<b>35.645,1</b>	<b>36.730,5</b>	<b>3,0</b>

1/ Ordinary is credit to enterprises, preferential to best clients, treasury is a type of preferential credit but of very short term.

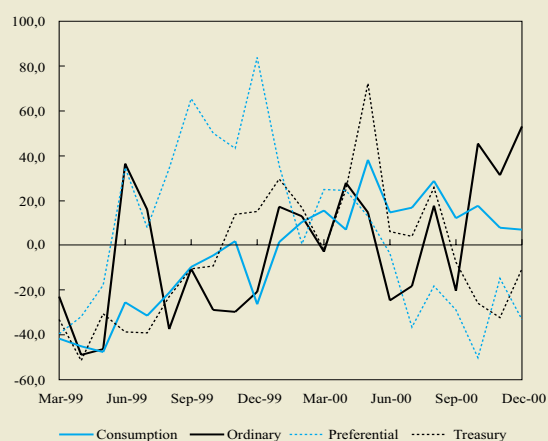
Source Banking Superintendency, Instituto Colombiano de Ahorro y Vivienda (ICAV) and Banco de la República, SGEE

**FIGURE 46B**  
**DISBURSEMENTS BY TYPE OF CREDIT**  
**TOTAL FINANCIAL SYSTEM**  
 (12 - MONTH ACCUMULATED, BILLION OF COLOMBIAN PESOS)



Source: Banking Superintendency and Banco de la República

**FIGURE 46A**  
**DISBURSEMENTS BY TYPE OF CREDIT**  
**TOTAL FINANCIAL SYSTEM**  
 (PERCENTAGE VARIATION COMPARED TO THE SAME MONTH OF THE PREVIOUS YEAR)



Source: Banking Superintendency and Banco de la República.

the last quarter of 1998 when the emergency was declared sums up to \$6.085 billion.

With regards to the public banking, capitalizations were carried out with Fogafin bonds for a value of \$1.941 billion pesos (Table 20), whose terms start to be due on 2002 for approximately \$350 billion and thereafter, a similar amount every two years. Capitalizations in cash were carried out only for the

dismantling of the BCH. Additionally, the Investments Central (Central de Inversiones) of the BCH (CISA) was converted into an affiliate of FOGAFIN which, as from September 2000 performs the functions of management of the non-performing assets of the public banking. To achieve this, a capitalization of CISA was required for an amount of \$521 billion, in order to make possible the purchase of impaired assets from institutions like BCH for \$1.282 billion and Bancafé for \$941 billion. Finally with the capitalizations to the public banks carried out by FOGAFIN and the sale of non-performing assets to CISA up to December 2000, a great percentage of capitalizations of the initially expected capitalizations required to regain levels of solvency of the public banks was completed.

Within the private financial system, most of the capitalizations carried out during 2000 for \$1.219 billion were performed with resources owned by the institutions, from which 46,7% corresponds to the Banco Ganadero and 28,1% to Bancolombia. FOGAFIN carried out capitalizations only for \$64 billion (Table 21). Additionally, in October 2000, FOGAFIN provided liquidity to some intermediaries through the repurchase of securities for \$86 billion.

**TABLE 20**  
**PUBLIC BANKING CAPITALIZATION WITH FOGAFIN RESOURCES**  
 (BILLION OF COLOMBIAN PESOS)

	1998	1999			2000			Capitalization	
		Total	Bonds	Cash	Total	Bonds	Cash	Total	Estimated total 1/
Banco Agrario	0	150	150	0	0	0	150	150	
Banco del Estado	0	1.240	823	417	0	0	1.240	1.290	
Bancafé	0	600	600	0	270	270	870	1.530	
IFI	0	100	100	0	300	300	400	n.d.	
Granahorrar	247	82	22	60	250	250	579	600	
FES	0	45	0	45	0	0	45	90	
BCH	0	550	550	0	742	600	1.292	1.590	
CISA	0	0	0	0	521	521	521	n.d.	
<b>Total</b>	<b>247</b>	<b>2.768</b>	<b>2.245</b>	<b>522</b>	<b>2.082</b>	<b>1.941</b>	<b>5.097</b>	<b>5.250</b>	

n.d. Not available

1/ Calculations by Fogafin in May 2000.

Source: Fogafin.

**TABLE 21**  
**CAPITALIZATION OF THE PRIVATE FINANCIAL SYSTEM**  
 (BILLION OF COLOMBIAN PESOS)

	With own resources Fogafin				With own resources 2000
	1999	2000		Total	
	Capitalization	Securities Repurchase	Capitalization Fogafin		
Banco Unión	27	0	6	27	0
Banco Superior	52	56	11	108	0
Banco Colpatría	212	0	42	212	0
Coltefinanciera	28	0	5	28	0
Interbanco	42	0	10	42	0
Multifinanciera	3	0	1	3	0
Banco de Crédito	57	2	11	59	0
Cofinorte	20	0	0	20	7
Megabanco	478	0	0	478	0
Credinver	0	2	0	2	0
Confinanciera	0	3	0	3	0
Bancolombia	0	0	0	0	343
Leasing Colombia	0	0	0	0	8
Banco de Bogotá	0	0	0	0	30
Banco de Occidente	0	0	0	0	40
Corp. Fciera. Colombiana	0	0	0	0	88
Banco AV Villas	0	0	0	0	35
Leasing Bogotá	0	0	0	0	4
Banco Popular	0	0	0	0	5
Banco Interbanco	0	0	0	0	18
BBV Banco Ganadero	0	0	0	0	570
Corfigan	0	0	0	0	30
Leasing Sudameris	0	0	0	0	2
Banco Sudameris	0	0	0	0	13
Lloyds TSB Bank	0	0	0	0	25
Cía. Fto. Giros y Divisas	0	0	0	0	2
<b>Total</b>	<b>920</b>	<b>64</b>	<b>86</b>	<b>984</b>	<b>1.219</b>

Source: Fogafin and Banking Superintendency.

### 3. Progress in the Restructuring of the Entrepreneurial Debt

Through Letter No. 039 of 1999 the Banking Superintendency created a transitory regime, during which exceptional measures would apply for the restructuring of the entrepreneurial debt<sup>23</sup>. The general balance for the first year is quite positive in terms of negotiations, which began, and agreements reached among creditors and company owners in the country.

As of the end of 2000, a total of 295 enterprises utilized the debt restructuring plan. These enterprises generate nearly 34.409 jobs, their assets amount \$4.271 billion and their liabilities \$2.955 billion. (Table 22). The sectors that benefited the

most from the entrepreneurial debt restructuring agreements were in their order, the textile, industrial, mining, construction, health and trade, whose participation in the amount of restructured liabilities adds up to nearly 84,8%. Regarding the size of the enterprises undergoing a debt restructuring process 56,0% of them corresponds to small medium size enterprises and 35,0% to large enterprises (Figure 47). The number of enterprises that stayed within the Law of Economic Intervention is within what had been foreseen, since the initial estimate was between 250 and 300 enterprises for the first year.

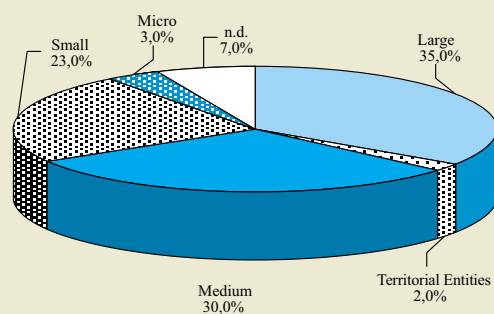
<sup>23</sup> It was decided that the financial entities would remit the delinquent interests; that grace periods could be established for interest payment (up to a year) and for capital repayment (up to three years).

TABLE 22  
ENTERPRISES WHICH ADOPTED THE RESTRUCTURING  
OF ENTREPRENEURIAL DEBT IN 2000 - LAW 550/99

Sector	Number of		Assets (billion of Colombian pesos)	Liabilities (billion of Colombian pesos)	% Participation in restructured Liabilities
	Enterprises	Employment			
Textile	18	13.250	1.737,4	1.094,5	37,0
Industrial	47	4.832	504,8	383,3	13,0
Mining	8	2.797	614,1	351,7	11,9
Construction	37	1.046	364,9	274,3	9,3
Health	18	3.653	297,7	230,2	7,8
Trade	60	2.456	177,4	172,7	5,8
Servicies	28	1.299	86,6	77,9	2,6
Food	5	768	60,5	62,8	2,1
Other	8	32	65,2	61,3	2,1
Metal-mechanic	9	993	83,3	59,7	2,0
Agriculture & livestock	20	695	79,2	40,5	1,4
Telecommunications	8	325	40,4	37,5	1,3
Clothing Manufacture	5	552	28,7	24,6	0,8
Lodging	4	142	25,7	24,1	0,8
Metallurgical	3	225	38,8	19,8	0,7
Transportation	5	358	23,5	11,9	0,4
Editorial	4	367	17,4	11,5	0,4
Pharmaceutical	5	277	12,8	8,7	0,3
Footwear	2	190	9,8	6,4	0,2
Education	1	152	3,0	1,3	0,0
<b>Total</b>	<b>295</b>	<b>34.409</b>	<b>4.271,1</b>	<b>2.954,6</b>	<b>100,0</b>

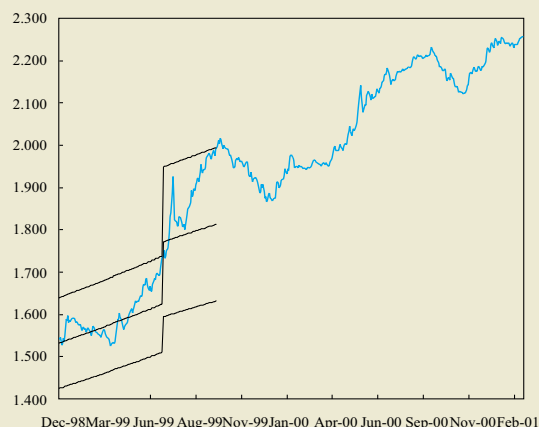
Source: Superintendency of Corporations.

**FIGURE 47**  
CORPORATIONS UNDER AGREEMENT BY RANGE



Source: Superintendency of Corporations

**FIGURE 48**  
EVOLUTION OF THE MARKET REPRESENTATIVE EXCHANGE RATE  
DECEMBER 31, 1999 - FEBRUARY 28, 2001  
(PESOS PER DOLLAR)



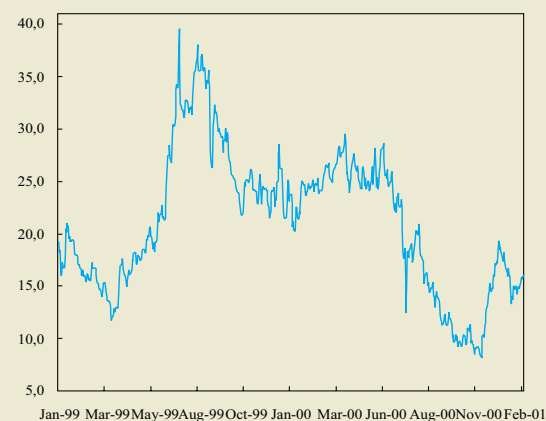
Source: Banco de la República and Banking Superintendency

### C. FOREIGN EXCHANGE MARKET AND FOREIGN CURRENCY EXCHANGE POLICY

The Market Representative Exchange Rate (TRM) closed, in December 29 at \$2.229,2, which meant an annual devaluation of 19,3%. The behavior of its monthly average level as from early 2000 and up until September was characterized by a tendency towards devaluation. During this period its level raised permanently from a monthly average of \$1.888,5 in December 1999 to \$2.213,8 in September. This represented a yearly devaluation of 17,2%. Between October and November the tendency was reversed until it reached \$2.136,6 and a yearly devaluation of 13,1%. By the year end, the average TRM closed at \$2.186,2 (15,8%) with a rising tendency (Figures 48, 49, 50).

The evolution of the TRM throughout 2000 was affected by the expectations of the agents regarding different announcements about external public financing, privatizations, prices of export goods and political atmosphere.

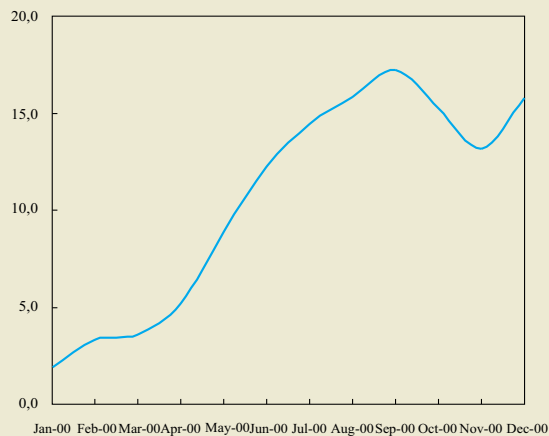
**FIGURE 49**  
EVOLUTION OF THE MARKET REPRESENTATIVE EXCHANGE RATE  
NOMINAL ANNUAL DEVALUATION 1999-2001  
(PERCENTAGE)



Source: Banco de la República.

The Board of Directors has continued to call auctions of rights of sale of foreign currency to the Banco de la República at the TRM, in order to accumulate international reserves, pursuant to the macroeconomical program that had foreseen an accumulation of international reserves throughout 2000. These transactions do not seek to maintain a particular level of the exchange rate, but to attain two goals clearly defined: the accumulation of

**FIGURE 50**  
**EVOLUTION OF THE MARKET REPRESENTATIVE**  
**EXCHANGE RATE**  
**NOMINAL AVERAGE DEVALUATION -2000**  
**(PERCENTAGE)**



Source: Banco de la República.

international reserves and to control volatility excess in the exchange rate<sup>24</sup>.

Table 23 shows how the quota of these auctions was extended during 2000 from US\$80 million per month in force up to February, to US\$100 million per month from March to December. As from January 2001 and in light of the perspective of a lower accumulation of reserves, the quota for the auction of rights of sale was reduced to US\$75 million. The whole quotas were approved during all of the months of 2000, except in April, when only US\$55 million were approved. From the purchase options offered in the auctions, the following have been exercised: US\$12 million in January, US\$74 million in March, US\$15,5 million in June, US\$17,1 million in August, US\$100,0 in September and October, and US\$80 million in December, 2000. In January 2001 US\$69,3 million of the purchase options were exercised. On the other hand the Banco de la República has not been forced to carry out rights of purchase auctions or sale of foreign currency to avoid excessive volatility in the exchange rate.

<sup>24</sup> Volatility makes reference to the variance in the exchange rate.

Undoubtedly, the consolidation of external financing during the second semester helped to the decrease of the growth rate of the TRM up to September, and it contributed to the expectations regarding revaluation in October and November. This circumstance was reflected in an increase of the closing premiums of the options for purchase auctions of foreign currency by the Banco de la República (Table 23). It can be observed that in the auctions of September 29, applicable for October and 31 of October applicable to November, the highest premiums of the year were present: \$4.510 and \$ 6.350 for every US\$1000. Furthermore, these were the only two months of the year in which the agents exercised all of the assigned quotas, thus confirming the existence of string revaluation expectations.

With regards to regulation, during the first semester of 2000 the Board of Directors of the Banco de la República adopted measures towards providing more flexibility and development to foreign exchange market, through allowing the participation of a larger number of agents, both national and foreign, and expand the use of coverage operations. The first measure was adopted through a majority decision on April 28, 2000 through External Resolution 6, which reduced the deposit related to external indebtedness to 0%.

Similarly, External Resolution 8 of May 5, 2000, introduced modifications to the international exchange regime, which regulates the development of the coverage market, and authorizes stock exchange broker entities to act as foreign exchange market intermediaries.

The existing regulations were modified to stimulate the coverage market. In this manner the Colombian residents were authorized to perform financial peso-dollar derivative operations, not only with the market financial intermediaries but also with foreign entities participating in a professional way in the international by products markets. Similarly, the Colombian residents were authorized to perform peso-other

**TABLE 23**  
**PUT OPTIONS AUCTION FOR ACCUMULATING INTERNATIONAL RESERVES**

Auction date	Amount		Quota	Premium			Exercised Amount (Million Dollars)
	Presented	Approved		Minimum	Maximum	Closing	
	(Million Dollars)			(\$ / US\$1,000)			
27-Jan-00	204.00	80.00	80.00	10.00	3,020.00	210.00	12.00
28-Feb-00	368.00	80.00	80.00	130.00	4,100.00	1,600.00	0.00
28-Mar-00	607.50	100.00	100.00	101.00	4,800.00	3,000.00	74.00
28-Apr-00	394.00	55.00	100.00	230.00	5,000.00	600.00	0.00
29-May-00	493.00	100.00	100.00	50.00	4,500.00	2,250.00	0.00
28-Jun-00	474.00	100.00	100.00	50.00	5,100.00	3,000.00	15.50
28-Jul-00	368.00	100.00	100.00	200.00	6,100.00	3,650.00	0.00
31-Aug-00	522.00	99.90	100.00	220.00	6,957.00	3,500.00	17.10
29-Sep-00	434.50	100.00	100.00	220.00	7,000.00	4,510.00	100.00
31-Oct-00	511.00	100.00	100.00	5.00	7,535.00	6,350.00	100.00
30-Nov-00	442.80	100.00	100.00	210.00	5,160.00	3,560.00	0.00
28-Dec-00	287.00	100.00	100.00	320.00	4,110.00	1,860.00	80.00
31-Jan-01	405.70	75.00	75.00	212.00	7,100.00	5,560.00	69.30

Note: The amount approved for the auction dated April 28 changed from US\$100 million to US\$55 million due to non compliance in payment of the premium by an entity.

Source: Banco de la República.

currencies financial by products operations and on prices of basic goods even with no underlying risk existing. Additionally, in the case of by-products of basic products, these operations were authorized with new agents. These measures were supplemented allowing the market intermediaries to acquire debts in dollars and utilize these resources in the local market to cover their future purchase positions, without demanding the deposit of external indebtedness.

The authorization to stock exchange broker entities to act as foreign exchange market intermediaries as from July 2000, has allowed them to perform exchange operations such as money transfers and foreign currency negotiations related with foreign trade exchange, foreign investment and Colombian investment abroad, as well as money transfers and

foreign currency negotiations in the free market. The conditions present so that stock exchange broker entities could act as exchange market intermediaries were regulated: own a net worth of \$3.500 million accredit before the Superintendency of Securities fulfillment of their technical and operating capacity. The main objective of this measure is to provide greater competition within the exchange market and facilitate small and medium size industry operations.

Finally, External Resolution 8 modified the exchange regime in order to adapt it to the new customs regulations and facilitate some exchange operations. In this sense, foreign exchange money transfers between main offices and branches of operations corresponding to foreign trade reimbursable transactions were authorized and the

residents of the country were authorized to purchase and sell foreign currency in a professional manner without the authorization by the Banking Superintendency.

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#### D. BALANCE OF PAYMENTS

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##### 1. Balance of Payments preliminary situation: end of 2000

Pursuant to estimates by Banco de la República, by the end of 2000 the balance of payments recorded a current account surplus of US\$ 158 million (0,19% of the GDP), and equilibrium in the financial and capital account, US\$-73 million (-0,09% of the GDP) (Table 24).

The behavior of the current account is explained mainly by the surplus in the goods balance of US\$2,568 million, as a result of a greater growth of exports over imports. Particularly, goods exports increased 13,2% reaching US\$13,619 million, and imports grew 7,8% reaching US\$11,051 million. On its part, the non factor services<sup>25</sup> account showed a deficit of US\$1,205 million and the account of revenues from factors was negative in US\$2,084 million, as a result from greater interest payments, dividends and profit remittance payments related with income.

Exports growth is due to greater income from oil exports and to the recovery of non-traditional exports, namely industrial exports. As it may be seen in Table 25, with numbers as of December 2000, hydrocarbon exports added up to US\$4,569 million, which meant an annual variation of 21,6%. The foregoing is explained by a significant increase in the international oil price, which changed from an average of US\$17,8 per barrel during the period between January-December 1999 to US\$28,8 per

barrel during the same period in 2000. As a contrast, the external revenues from coffee decreased US\$255 million, dropping from US\$1,324 million to US\$1,069 million in the same time span. This behavior is explained by fewer exports of coffee, which were reduced from 10.010 thousand 60kg sacks in 1999 to 9.247 thousand 60kg sacks in 2000. Additionally, the international price of the grain dropped from US\$1.19 ex-dock price per pound in 1999 to US\$1.02 in 2000.

With regards to non-traditional exports, they showed an important recovery growing 17,1%. Industrial exports showed the greater dynamism increasing 21,7% representing 36,2% of total exports and nearly 74,8% of non-traditional exports. On the contrary, the agriculture and live stock exports fell 2,5%, mainly as consequence of the banana sales drop. (-15,0%).

Relating to geographical destination, total exports towards the United States and Venezuela are highlighted, which grew nearly 15,0% and 40,0% respectively, as compared to 1999. During 2000, as a proportion of the total exports they have represented 51,0% to the United States and 10,0% to Venezuela, with which the United States continues to consolidate as the main destination of Colombian exports.

It is important to point out that as a consequence of the aggregate demand recovery, imports showed an increase of 7,9%. The greater growth of imports originated in an increase of purchases of intermediate goods and of raw materials, whose amount in dollars grew 18,9% as a result of an increase in imports directed to industry (20,9%). On its part, the consumption goods imports increased 8,4%, being concentrated in durable goods (28,6%). Finally, the amount of imports of capital goods fell 6,6% despite the growth of import volumes (19,3%). The reduction of imports of goods destined to agriculture, transportation and industrial equipment is highlighted, as a consequence of low prices (Table 26).

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<sup>25</sup> Includes transportation, travel and other services different than revenues from factors.



**TABLE 24**  
**COLOMBIA'S BALANCE OF PAYMENTS - SUMMARY**

	Million Dollars			As % of GDP		
	1999 (pr)	2000 (pr)	2001 (proj.)	1999 (pr)	2000 (pr)	2001 (proj.)
<b>I. CURRENT ACCOUNT</b>	(61)	158	(1,411)	(0.07)	0.19	(1.61)
Income	15,764	17,624	17,937	18.22	21.36	20.51
Outlays	15,825	17,466	19,348	18.30	21.16	22.13
<b>A. Nonfactor goods and services</b>	514	1,363	510	0.59	1.65	0.58
Income	13,866	15,605	15,638	16.03	18.91	17.88
Outlays	13,352	14,243	15,128	15.44	17.26	17.30
1. Goods	1,775	2,568	1,691	2.05	3.11	1.93
Income	12,030	13,619	13,596	13.91	16.50	15.55
Outlays	10,255	11,051	11,904	11.86	13.39	13.61
2. Nonfactor Services	(1,261)	(1,205)	(1,181)	(1.46)	(1.46)	(1.35)
Income	1,836	1,987	2,042	2.12	2.41	2.34
Outlays	3,097	3,192	3,223	3.58	3.87	3.69
<b>B. Factor Income</b>	(1,422)	(2,084)	(2,823)	(1.64)	(2.53)	(3.23)
Income	795	886	1,129	0.92	1.07	1.29
Outlays	2,217	2,970	3,952	2.56	3.60	4.52
<b>C. Transfers</b>	846	880	901	0.98	1.07	1.03
Income	1,102	1,133	1,170	1.27	1.37	1.34
Outlays	256	253	269	0.30	0.31	0.31
<b>II. Capital and Financial Account</b>	(94)	(73)	1,737	(0.11)	(0.09)	1.99
<b>A. Financial Account:</b>	(94)	(73)	1,737	(0.11)	(0.09)	1.99
1. Long-Term Financial Flows	2,132	850	1,059	2.46	1.03	1.21
a. Assets	35	40	150	0.04	0.05	0.17
i. Colombian direct investment abroad	(6)	40	150	(0.01)	0.05	0.17
ii. Loans <sup>1/</sup>	0	0	0	0.00	0.00	0.00
iii. Financial Leasing	6	0	0	0.01	0.00	0.00
iv. Other Assets	35	0	0	0.04	0.00	0.00
b. Liabilities	2,167	890	1,209	2.50	1.08	1.38
i. Direct Foreign Investment in Colombia	1,110	1,500	1,238	1.28	1.82	1.42
ii. Loans <sup>1/</sup>	972	(463)	25	1.12	(0.56)	0.03
iii. Financial Leasing	86	(147)	(54)	0.10	(0.18)	(0.06)
iv. Other liabilities	0	0	0	0.00	0.00	0.00
c. Other long-term financial movements	0	0	0	0.00	0.00	0.00
2. Short-Term financial flows	(2,226)	(924)	678	(2.57)	(1.12)	0.78
a. Assets	1,494	1,183	(336)	1.73	1.43	(0.38)
i. Portfolio Investment	1,420	953	(521)	1.64	1.15	(0.60)
ii. Loans	74	230	185	0.09	0.28	0.21
b. Liabilities	(733)	259	342	(0.85)	0.31	0.39
i. Portfolio investment	(23)	17	150	(0.03)	0.02	0.17
ii. Loans	(710)	242	192	(0.82)	0.29	0.22
<b>B. Special Capital Flows</b>	0	0	0	0.00	0.00	0.00
<b>III. NET ERRORS AND OMISSIONS</b>	(163)	654	0	(0.19)	0.79	0.00
<b>IV. CHANGE IN GROSS INTERNATIONAL RESERVES <sup>2/</sup></b>	(319)	739	326	(0.37)	0.90	0.37
<b>V. BALANCE OF GROSS INTERNATIONAL RESERVES</b>	8,103	9,006	9,332	9.37	10.91	10.67
<b>VI. BALANCE OF NET INTERNATIONAL RESERVES</b>	8,102	9,005	9,331	9.37	10.91	10.67
Months of goods imports	9	10	9			
Months of goods and services imports	6	6	6			
Nominal GDP in millions of Dollars	86,501	82,523	87,440			
<b>VII. CHANGE IN NET INTERNATIONAL RESERVES</b>	(320)	740	326	(0.37)	0.90	0.37

Assumptions. Export prices: coffee US\$1.00 /lb.; Oil US\$25.2/barrel; Growth in goods imports 7,8%. (proj): Projection

<sup>1/</sup> Includes portfolio investment, direct loans and commercial credit.

<sup>2/</sup> According to Balance of Payments methodology.

Source: Banco de la República

**TABLE 25**  
**EXPORTS ACCORDING TO MAIN PRODUCTS AND ECONOMIC SECTORS**  
(MILLION DOLLARS)

	<b>January-December</b>		<b>Variation</b>	
	<b>1999</b>	<b>2000 (pr)</b>	<b>Absolute</b>	<b>%</b>
<b>Total Exports</b>	11,576	13,043	1,467	12.7
<b>A. Traditional Exports</b>	6,192	6,741	549	8.9
Coffee	1,324	1,069	(255)	(19.3)
Coal	848	795	(53)	(6.3)
Ferronickel	154	211	57	37.0
Oil and Byproducts	3,757	4,569	812	21.6
Gold	1	0	(1)	(100.0)
Esmeralds	108	97	(11)	(10.2)
<b>B. Non-Traditional Exports</b>	5,384	6,302	918	17.1
Agricultural Products & Livestock Sector	1,379	1,344	(35)	(2.5)
Industrial Sector	3,875	4,717	842	21.7
Mining Sector	130	241	111	85.4

(pr) Preliminary estimate

Source: National Administrative Department of Statistics (DANE)

**TABLE 26**  
**IMPORTS ACCORDING TO USE OR ECONOMIC DESTINATION**  
(MILLIONS DOLLARS)

	<b>January-December</b>		<b>Variation</b>	
	<b>1999</b>	<b>2000 (pr)</b>	<b>Absolute</b>	<b>%</b>
<b>Total Imports</b>	9,985	10,775	790	7.9
<b>Consumption Goods</b>	1,877	2,034	157	8.4
Durable	1,324	1,323	(1)	(0.1)
Non-durable	553	711	158	28.6
<b>Intermediate Goods and Raw Materials</b>	4,587	5,453	866	18.9
Fuel, lubricants and neighboring products	237	225	(12)	(5.1)
For Agriculture	395	445	50	12.7
For industry	3,955	4,783	828	20.9
<b>Capital Goods</b>	3,521	3,288	(233)	(6.6)
Construction Materials	138	154	16	11.6
For Agriculture	24	22	(2)	(8.3)
For Industry	2,256	2,154	(102)	(4.5)
Transportation equipment	1,103	958	(145)	(13.1)

Source: National Directorate of Customs and Taxes (DIAN).

A greater dynamism of exports as compared with imports is originated in the good behavior in terms of exchange which improved 28,8% as a consequence of the increase recorded in the exports unit values (20,8%) and a decrease in the import unit values of 6,3%. The increase in export prices originated mainly in the growth of international oil prices, and the greater export unit values of industrial products and ferronickel (Table 27).

Regarding the financial and capital account, it recorded net long term revenues for US\$850 million originating in a direct net foreign investment for US\$1,500 million and loans for US\$-463 million. Namely, this revenue inflow was less than in 1999,

as a result of a lesser external net indebtedness, especially by the private sector. On the other hand, the short term financial net outflows reached US\$924 million, mainly as a result of the net payment of credits for a total amount of US\$17 million and a positive portfolio investment of US\$953 of Colombians abroad. In comparison with 1999, a lesser short term outflow of resources is observed, mainly as a result of less outflows of Colombian external public portfolio investment, and lesser credit net payments. As in previous years, the balance of payments external financing mainly comes from long term resources.

As a result of goods, services and capital movements, during 2000 the Banco de la República accumulated international reserves for US\$739 million. With this accumulation, the gross balance of international reserves at the year end reached US\$9,006 million, equivalent to 9,8 months in terms of goods imports and 6,3 months as payment of factor and non-factor goods and services.

## 2. Projections of the Balance of Payments for 2001

Pursuant to the current projection of the balance of payments (Table 24), during 2001 the deficit in current account would reach US\$1,411 million (1,6% of the GDP). Financing of such deficit would be covered by capital revenues expected for US\$1,737 million (2% of the GDP), which may be explained by net long-term capital inflows of US\$1,059 and short term capital inflows for US\$678 million.

Relating to current account estimates, an annual reduction of exports of goods in dollars of 0,2% is expected as a consequence of fewer revenues from oil and ferronickel. The lower price quotation of these goods will lead a drop in exports of 17,0% and 15,0% respectively. The dynamism of industrial exports is expected to remain, which will contribute for the growth of non-traditional exports of 12%,0. On the other hand, the annual growth of imports of goods is estimated in 7,8%.

<b>CUADRO 27</b>			
<b>PRECIOS DE EXPORTACIONES, IMPORTACIONES Y</b>			
<b>TÉRMINOS DE INTERCAMBIO</b>			
<b>(DÓLARES POR KILO O UNIDAD BÁSICA)</b>			
<b>(ENERO-DICIEMBRE)</b>			
	<b>Prices</b>	<b>1/</b>	<b>Var. %</b>
	<b>1999</b>	<b>2000</b>	
<b>A. Exports</b>			20.8
Traditional			34.1
Coffee	1.19	1.02	(14.3)
Oil and			
Byproducts	17.81	28.76	61.5
Coal	27.16	25.67	(5.5)
Ferronickel	1.14	1.75	53.7
Gold	278.98	279.72	0.3
Esmeralds	19.84	11.48	(42.1)
Non-Traditional			5.4
Agricultural &			
Livestock Products	0.64	0.64	(0.8)
Industrial Products	0.78	0.83	6.4
Mining sector	0.19	0.26	39.0
<b>B. Imports</b>			6,3
Fuel	17.40	24.70	42.0
Other products			(7.4)
Agricultural sector	0.20	0.19	(5.0)
Industrial sector	1.36	1.26	(7.2)
Mining sector	0.97	0.74	(23.4)
<b>C. Terms of Exchange (A/B)</b>			28.8

1/ For non-traditional exports and imports different from fuel, reference is made to implied price in the exported or imported value.  
Source: Banco de la República, SGEE, External Sector

For 2001, an inflow of long term resources is expected for US\$1,059 million, coming partially from foreign investment in Colombia of US\$1,238 million in which no revenues from privatizations are expected. With regards to long term external indebtedness the reduction of the net debt of the private sector on US\$1,576 million is expected, amount that will be compensated by the external indebtedness of the public sector (US\$1,547 million). With regards to the short term financial resources a drop of the Colombian investment abroad of US\$521 million is expected.

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## E. FISCAL POLICY

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### 1. Results of 2000

At the end of 2000 the consolidated public sector finances recorded a deficit equivalent to 3,4% of the GDP, which is two points less than the to the value observed for the GDP during 1999. This result fits into the terms of the Agreement with the International Monetary Fund, and reflects the advances in the process of fiscal adjustment carried on by the government and the favorable circumstances presented by the oil activity, due also to the favorable international crude oil prices (Table 28).

With regards to the Central Government Finances, the official numbers account for a deficit of 5,8% of the GDP, which represents a decrease of 1,7% of the GDP referred to the value present during 1999. The good fiscal performance of the government was due by the dynamism of revenues, thanks to the rebound of the economical activity, which allowed covering an increase of payments of effective transactions, which registered an expansion of 13,1% during the year. The most dynamic taxes were the VAT of imports, customs duties and income with growths of 31,0% 27,0% and 22,0% respectively. Less dynamic than the foregoing were the internal VAT, taxes on gasoline and on financial transactions with

growths of 18,0%, 17,8%, and 17,7% in their order. The non-taxes revenues recorded an increase of 34,7% due to the sale of merchandise seized by the National Directorate of Customs and Taxes (DIAN), whose value reached \$100 billion during the year. Regarding the revenues of capital it is necessary to point out the increase of the amount of the financial yields that reached 75,3% due to the resources generated by the funds administered by the National Treasury Directorate (Table 29).

With regards to expenditure, government calculations reveal a growth of 31,9% in interests, 9,2% in operation and 18,8% in investment. The expansion of the debt cost was associated with external interests who recorded a growth of 44,7%, especially because of the increase in the balance of the debt and the financial cost of credits acquired during 1998 and 1999. Included within the operating costs, personal services recorded a growth of 13,9%, general expenditures 6,1% and transfers 8,2%. Part of the increase in the payroll was originated in the decision of the Constitutional Court, which stated that the government had to pay retroactively an increase of 9,2% of the salaries of the officers that earned more than two minimum salaries. The Court decision meant an increase of the budget of nearly \$800 billion, from which almost \$600 billion affected the account of personal services of the government.

The low growth of transfers throughout the year was associated to an optimistic estimate of the initial revenue budget in 1999, and to the legal impossibility to perform during that year the adjustments corresponding to the disbursements of transfers to Departments and Districts (situado fiscal) and participation, after the drop in the collection of taxes had been detected. In order to establish territorial transfers, these adjustments shall have been performed during 2000 through a negative re-appraisal of the revenue budget of the government. Including the resources assigned to the Educational Credit Fund, the growth of transfers to regions barely reached 0,6% in 2000.

**TABLE 28**  
**CONSOLIDATED PUBLIC SECTOR**  
**DEFICIT (-) OR SURPLUS (+)**

Entity/Sector	1999	2000	2001	1999	2000	2001
	(Billion Pesos)			(Percentage of GDP)		
Electricity	(412,0)	237,9	378,0	(0,3)	0,1	0,2
Carbocol (Coal Company)	266,0	179,3	0,0	0,2	0,1	0,0
F.A.E.P. (oil stabilization fund)	533,0	1.622,4	642,0	0,4	0,9	0,3
Ecopetrol	808,0	1.272,2	570,0	0,5	0,7	0,3
Telecom	(70,0)	(41,2)	41,0	(0,0)	(0,0)	0,0
Other Entities	280,0	389,1	616,0	0,2	0,2	0,3
Social Security	1.254,0	808,9	687,0	0,8	0,5	0,4
Regional and Local Entities	(512,0)	(170,7)	344,0	(0,3)	(0,1)	0,2
National Coffee Fund	(43,0)	(274,6)	(205,0)	(0,0)	(0,2)	(0,1)
<b>1. Subtotal Decentralized Sector</b>	2.104,0	4.023,3	3.073,0	1,4	2,3	1,6
<b>2. National Government</b>	(11.450,0)	(10.080,0)	(8.102,0)	(7,5)	(5,8)	(4,1)
<b>A. Total non-financial public sector (SPNF) (1+2)</b>	(9.346,0)	(6.056,7)	(5.029,0)	(6,1)	(3,5)	(2,6)
B. Cash Profits and Losses of the Banco de la República	608,0	877,0	995,0	0,4	0,5	0,5
C. Cash Profits and Losses of Fogafin	828,0	30,0	194,0	0,5	0,0	0,1
D. Financial Sector restructuring cost	(10,0)	(666,0)	(1.672,0)	(0,0)	(0,4)	(0,9)
E. Statistical Adjustments	(351,0)	(45,0)	0,0	(0,2)	(0,0)	0,0
<b>F. Total Consolidated Public Sector (A+B+C+D+E)</b>	(8.271,0)	(5.860,7)	(5.512,0)	(5,4)	(3,4)	(2,8)

(proj) Projections  
Source: Confis.

With regards to the investment payments, the numbers reveal an important recovery associated to the resources assigned for the reconstruction of the Coffee Growing Region (Eje Cafetero) and for the development of the social housing program. As a whole, these two accounts generated disbursements greater than \$600 billion, equivalent to 23,0% of the total capital payments done by the government throughout the year. The net loan reached \$832 billion, from which the credit operations through the Special Account for External Debt and the guaranteed debt transactions for \$281 billion are highlighted.

The financing of the government deficit dropped in connection with the credit resources and the sale

of assets. The external indebtedness reached \$3.675 billion, as the product of disbursements for \$5.731 billion and capital repayments for \$2.056 billion. On its part, the internal credit reached \$6.638 billion that come from disbursements for \$12.006 billion and capital repayments of \$5.368 billion. The privatization of Carbocol achieved during the first days of October generated resources for \$748 billion. The internal debt instruments used by the government were TES securities, Peace and Security bonds and securities of debt reduction, with placements for \$11.380 billion, \$388 billion and \$370 billion respectively.

With regards to the fiscal results of the remaining of the public sector (RSP), the official numbers reveal

**TABLE 29**  
**CENTRAL NATIONAL GOVERNMENT**  
(THOUSAND MILLION - [BILLION]- PESOS)

	1999	2000	2001 (proj.)	Var. %	
				1999/2000	2000/2001
<b>I. Total Revenues (A+B+C+D)</b>	18.927,1	22.679,9	28.443,0	19,8	25,4
A. Tax Revenues	16.067,7	19.637,0	25.530,0	22,2	30,0
Income Tax	6.410,0	7.824,0	8.934,0	22,1	14,2
Internal VAT	4.734,0	5.585,0	6.067,0	18,0	8,6
External VAT	1.935,0	2.535,0	2.895,0	31,0	14,2
Customs	1.373,0	1.744,0	2.034,0	27,0	16,6
Financial Transactions	880,7	1.037,0	1.568,0	17,7	51,2
Gasoline	707,0	833,0	1.044,0	17,8	25,3
Other 1/	28,0	79,0	752,0	182,1	851,9
Tax law Amendment	0,0	0,0	2.236,0	n.a.	n.a.
B. Non-tax revenues	363,0	489,0	135,0	34,7	(72,4)
C. Special Funds	438,9	430,6	589,0	(1,9)	36,8
D. Capital Resources	2.057,5	2.123,3	2.189,0	3,2	3,1
Capital Revenues	477,6	837,3	814,0	75,3	(2,8)
Financial Surpluses	1.419,6	1.191,3	1.253,0	(16,1)	5,2
Other	160,3	94,7	122,0	(40,9)	28,8
<b>II. Total Expenditures (A+B+C+D)</b>	29.117,1	32.940,9	37.743,0	13,1	14,6
A. Interest	5.025,5	6.630,2	7.523,0	31,9	13,5
External	1.559,2	2.256,4	3.241,0	44,7	43,6
Internal	3.467,0	4.373,8	4.282,0	26,2	(2,1)
B. Operating costs	20.875,4	22.799,7	26.236,0	9,2	15,1
Personal Services	4.106,0	4.675,0	5.384,0	13,9	15,2
General Expenditures	1.295,6	1.375,2	1.631,0	6,1	18,6
Transfers	15.473,8	16.749,5	19.221,0	8,2	14,8
Transfers to Departments & Districts (Situado Fiscal)	4.500,0	4.250,0	5.803,0	(5,6)	36,5
Educational Credit Fund	426,0	1.062,0	575,0	149,3	(45,9)
To Municipalities	3.142,0	2.807,0	3.653,0	(10,7)	30,1
Pension Payments	3.036,0	3.720,0	4.496,0	22,5	20,9
Other	4.369,8	4.910,5	4.694,0	12,4	(4,4)
C. Investment	2.254,7	2.679,0	3.232,0	18,8	20,6
Disaster Reconstruction	325,0	467,0	142,0	43,7	(69,6)
Social Interest Housing	0,0	150,0	171,0	n.a.	14,0
Other	1.929,7	2.062,0	2.919,0	6,9	41,6
D. Net Loan	961,5	832,0	752,0	(13,5)	(9,6)
<b>III. Adjustments (B - A)</b>	(1.260,0)	181,0	1.198,0	(114,4)	561,9
A. Budget lag	1.332,0	(144,0)	(1.233,0)	(110,8)	756,3
B. Other	72,0	37,0	(35,0)	(48,6)	(194,6)
<b>IV. Deficit (-) or Surplus (+) (I-II+III)</b>	(11.450,0)	(10.080,0)	(8.102,0)	(12,0)	(19,6)
<b>V. Financing (A+B+C) 2/</b>	11.450,0	10.080,0	8.102,0	(12,0)	(19,6)
A. Net External Credit	3.244,0	3.675,0	4.113,0	13,3	11,9
Disbursements	5.102,0	5.731,0	7.812,0	12,3	36,3
Repayments	1.858,0	2.056,0	3.699,0	10,7	79,9
B. Net Internal Credit	5.713,0	6.638,0	4.474,0	16,2	(32,6)
Disbursements	12.003,0	12.006,0	12.846,0	0,0	7,0
Repayments	6.290,0	5.368,0	8.372,0	(14,7)	56,0
C. Privatizations	87,0	748,0	0,0	759,8	(100,0)
D. Other	2.406,0	(981,0)	(485,0)	(140,8)	(50,6)
<b>VI. Deficit as percentage of the GDP</b>	(7,5)	(5,8)	(4,1)	(22,6)	(29,1)

(proj.) Projection.

n.a.: not applicable

1/ includes greater revenues in 2001 due to improved performance by the DIAN (National Directorate of Taxes and Customs)

2/ Additional to this financing the government absorbs the cost of the financial system restructuring set forth in Table 28.

Source: Higher Council of Fiscal Policy (Confis)

an increase of approximately 1,0% of the GDP in the surplus value, due to a better performance of the finances of entities related to the oil activity, which have received extraordinary revenues because of the good level of crude external prices. Compared to 1999, Ecopetrol recorded an increase in the surplus of 0,2% of the GDP and the Oil Savings and Stabilizing Fund (FAEP) received additional contributions for 0,5% of the GDP. With these new contributions, the balance of saved resources in FAEP reached \$2.509 billion. Different than FAEP and Ecopetrol, Social Security showed deterioration signs expressed through a drop of 0,3 of the GDP in the value of the fiscal surplus of the sector. The major cause for this deterioration was the reduction of contributions for the health and retirement units, especially because of a process of de-affiliations and because of the legal impossibility of enlisting new health affiliates to the Social Security Institute.

Two of the regulations regarding tax issues approved during 2000 were the tax amendment law (Law 633, 2000) and the territorial fiscal clearance law (Law 617, 2000). Both regulations will affect national public sector finances and, regional and local public sectors finances as from 2001. Particularly, the tax amendment law established the tax on financial transactions on a permanent basis, increased the general VAT in one point and introduced adjustments to the tax regulations, in order to reduce smuggling and the evasion levels. Similarly, the law established some incentives to promote technical and scientific development and granted an amnesty for assets in foreign currency abroad that had not been declared.

On its part, the fiscal clearance law established categories for the Departments and Municipalities of the country based on the number of inhabitants and the current income of free destination, which correspond to revenues not linked for specific ends determined by previous regulations. This law also established that the territorial (local) operating costs shall be financed with revenues of free destination

pursuant to the maximum limits therein defined for different categories of Departments and Municipalities. The law also set limits for the operating costs of the governing bodies of political subdivisions such as Departmental Legislatures, Municipal Councils, and other comptroller entities, and defined new conditions for the creation of municipalities. Finally, through this law the granting of guarantees by the Nation in favor of territorial entities was allowed, when the loans obtained with the credit establishments had the purpose of developing programs for fiscal adjustment. The granting of these guarantees is subject to compliance of other requirements, within which the development of the fiscal program and the justification of the fact that the territorial entity does not have enough resources needed to develop said adjustment.

## **2. Fiscal Perspectives for 2001**

For 2001 the Confis projects a consolidated deficit of 2,8% of the GDP, which is less in 0,6% of the GDP referred to the value recorded in 2000. As it may be seen in Table 28, this projection reveals an adjustment of nearly 1,0% of the GDP in the finances of the non-financial public sector (SPNF) and an increase of 0,5% of the GDP in the financial restructuring costs. The reduction of the fiscal deficit of the SPNF shall depend, to a great extent on the success of the amendments adopted during 2000 and of the approval by the Congress of the amendments currently being reviewed and those to be presented by the government throughout the year.

At a sector level, a deficit of 4,1% of the GDP is estimated for the National Central Government and a surplus of 1,6% of the GDP for the RSP. Compared to 2000 these estimates imply a reduction of nearly two GDP points with regards to the size of the government deficit and a drop of 0,7% of the GDP in the RSP surplus. The deterioration of the RSP finances is associated to the reduction in the surplus projected for Ecopetrol and the FAEP, which assume a decrease in the external prices of crude

and of the daily production volumes, because of the production conditions in the Cusiana and Cupiagua fields.

The performance of the National Central Government finances in 2001 will be subject to the success of the tax law amendment approved at the end of the previous year, and of the application of the laws regarding control to the growth of expenditure. Relating to revenues, a growth of 30,0% is projected in tax collection and a drop of 72,4% of non-tax revenues is foreseen. The dynamism of tax revenues is linked to economic recovery and to additional collections derived from the amendment, estimated in 1,2% of the annual GDP. The expenditures will record a growth of 13,5 % in interests, 15,1% in operating, and 20,6% in investment. Regarding operating costs, personal services will grow 15,2%, general expenditures 18,6% and transfers 14,8%. The net loan is projected in \$752 billion from which \$351 billion will be destined for payment of guaranteed purchases of energy to Corelca, and \$420 billion for loans to cover the debt service of Urrá, Emcali, and the enterprise of the Metro of Medellín. (Table 29).

Financing of the deficit of the National Government will lie upon the credit resources. External indebtedness will reach \$4.113 billion, product of disbursements for \$7.812 billion and capital repayments of \$3.699 billion. On its part, the internal indebtedness will reach \$4.474 billion, originating in disbursements for \$12.846 billion and capital repayments for \$8.372 billion. The main instruments for internal debt will be TES with gross placements for \$11.900 billion.

Within the set of measures necessary to stabilize public finances in the medium term, it is worth mentioning the Bill of Law that modifies the territorial transfers system and the amendment to the retirement pensions system and the Departmental and municipal taxes regime. The Bill of Law is currently subject to review by the Congress and

its approval shall be supplemented with an amendment of Law 60, 1993, which is the provision that regulates the territorial and municipal transfers ("Situado Fiscal"). The retirement pensions amendment constitutes the main tool to recover the financial feasibility of the social security system in Colombia, which has shown deterioration signs in the past years, particularly due to the weakening of the National Institute of Social Security (ISS).

Besides the transfer system amendment, the government pretends to promote a bill of law to strengthen the fiscal capacity of the territorial entities. With the approval of this bill, the government wishes to provide a greater degree of taxing autonomy for the departments and municipalities, and at the same time simplify the number of taxes and administrative processes of the territorial tax regime.

### **3. Territorial Finances**

Despite the fact that is not a tradition to include a section on territorial finances on this report, this time it was deemed necessary to describe the more relevant issues of the sub-national finances, which have developed within a fiscal decentralizing process, which has shown some weaknesses, both due to its effects on the national fiscal systems as well as for the problems it has generated on the departmental and municipal finances. This description results particularly timely at the time when the economical amendments are being studied, and which will affect the fiscal performance of the government at every level and when there exist expectations regarding the results of applying the law of territorial fiscal clearance described above.

To start, it is necessary to annotate that the fiscal deficit of the territorial government grew from 0,5% of the GDP in 1990, to 1,3% of the GDP in 1999. As it may be seen in Table 30, the fiscal deterioration in these government levels became explicit as from 1996, especially because the greater revenues from



**TABLE 30**  
**FISCAL SITUATION OF SUB-NATIONAL GOVERNMENTS 1/**  
**SURPLUS OR DEFICIT AS % OF GDP**

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
<b>Total Revenues</b>	7,6	7,8	8,0	8,3	8,7	9,6	10,6	11,6	11,3	12,9
Taxes	2,1	2,1	2,1	2,2	2,3	2,4	2,5	2,6	2,6	2,9
Other	5,5	5,7	5,9	6,1	6,4	7,2	8,1	9,0	8,7	10,0
<b>Total Expenditures</b>	8,1	8,1	8,1	8,8	9,5	9,7	11,8	12,4	12,3	14,2
Interests	0,5	0,6	0,8	0,5	0,6	0,7	0,8	0,8	0,9	0,9
Personal Services	3,3	3,3	3,4	3,4	3,5	3,6	3,9	3,9	4,6	5,1
Transfers	0,5	0,4	0,3	0,4	0,4	0,4	0,5	0,5	0,5	0,5
Capital	2,0	2,0	2,0	2,2	2,6	2,3	3,0	3,5	2,7	3,2
Other	1,8	1,8	1,6	2,3	2,5	2,7	3,6	3,6	3,5	4,5
<b>Deficit(-) or Surplus (+) 2/</b>	(0,5)	(0,3)	(0,1)	(0,5)	(0,8)	(0,1)	(1,2)	(0,8)	(1,0)	(1,3)

1/ Includes central governments and decentralized entities

2/ This calculation does not include territorial enterprises and is based on budget execution. Does not coincide with the corresponding deficit presented in Table 28 which includes enterprises and it is calculated based on net financing.

Source: Banco de la República.

national transfers, the oil royalties and the own revenues are not enough to compensate the expenditure expansion generated by the development of regulations on fiscal decentralization. While regional and local revenues changed from representing 9,6% of the GDP in 1995 to 12,9% in 1999, the effective operating expenditure during the same period changed from 9,7% of the GDP, to 14,2% of the GDP.

The fiscal deterioration observed during the second half of the nineties decade was expressed in the levels of indebtedness of several departments and municipalities of the country. Tables 31 and 32 show the balances of the internal debt for the central governments of departments and municipalities of capital cities during the period 1990-1999. A generalized increase of the levels of departmental indebtedness was observed during this period, especially in the cases of Valle, Antioquia, Cundinamarca and Santander. Similarly, an important expansion of the balance of the internal debt of cities such as Cali, Bogotá, Medellín, Barranquilla, Cartagena, Ibagué and Manizales may be observed.

The excessive indebtedness has led several territorial governments to a fiscal and financial crisis and to the need of adopting severe adjustment programs, several of which have been developed with financial aid from the National Government through what is known as territorial performance plans. Regarding to legislation, several important measures have been adopted to control the growth of the debt, to stop the growth of expenditure and create the necessary savings to finance the retirement pension liabilities of territorial entities.

Law 358, of 1997 established indebtedness limits in an attempt to ensure that contracting new debt would not exceed the payment capacity of each territorial entity. Pursuant to the Law such payment capacity should be measured as the ratio between the debt interests and the operating savings, which corresponds to the difference between current revenues and operating expenditures and transfers. The precise definition of this type of revenues, of the debt interests and of those situations in which the territorial entities require authorization for contracting new debt was set forth in the Regulatory Decree 696 of 1998.

**TABLE 31**  
**INTERNAL PUBLIC DEBT BALANCES OF DEPARTMENTS**  
(MILLION PESOS)

Departament	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Valle del Cauca	20.644	30.924	40.133	67.767	89.075	133.117	280.358	365.520	442.106	562.468
Antioquia	26.752	46.830	40.398	44.268	56.896	88.466	167.206	309.058	358.604	338.197
Cundinamarca	4.822	8.673	11.153	27.805	43.491	45.780	54.383	93.108	105.237	197.012
Santander	4.918	5.668	6.626	9.951	33.229	43.023	100.305	108.632	107.613	189.128
Atlántico	3.771	3.591	2.670	10.511	28.479	33.025	53.499	74.183	95.590	96.408
Casanare	0	0	0	3.676	924	7.023	12.223	91.950	93.178	95.622
Tolima	254	555	897	9.275	8.812	17.289	25.334	45.922	44.661	69.182
Bolívar	1.915	3.300	8.755	16.849	23.647	44.942	38.860	43.119	46.838	66.463
Huila	5.051	5.317	5.099	7.254	22.417	24.122	29.695	39.866	40.304	58.510
Córdoba	0	1.828	2.240	2.948	8.284	11.701	9.401	22.798	34.081	49.189
Risaralda	3.769	4.836	4.624	5.865	14.068	16.986	20.517	41.964	49.034	46.157
Meta	2.421	2.576	4.350	9.313	24.376	21.790	21.135	35.442	34.931	45.076
Cauca	3.037	2.943	3.890	4.738	5.681	9.129	17.581	22.815	44.509	45.021
Magdalena	0	0	5.109	6.550	8.400	8.517	16.833	22.607	33.277	44.442
La Guajira	2.094	2.209	3.520	17.532	23.795	22.590	26.354	30.902	34.594	44.212
Norte de Santander	1.604	1.748	1.778	5.001	10.468	16.291	23.708	32.079	34.672	39.034
Nariño	708	1.057	1.378	3.029	7.720	10.736	14.292	27.544	28.671	33.981
San Andrés y Providencia	0	1.100	1.724	1.576	4.955	2.616	9.620	14.475	23.551	25.693
Caldas	2.108	1.666	2.592	5.192	11.497	15.839	18.847	22.167	22.879	23.099
Cesar	633	655	1.563	4.574	8.561	12.757	19.880	22.240	22.062	22.114
Boyacá	2.013	1.823	3.163	6.728	8.546	11.157	9.681	23.260	21.658	20.859
Arauca	0	3.591	0	34.523	35.500	33.833	31.717	35.312	27.644	19.795
Putumayo	0	0	1.385	2.318	2.990	5.924	9.427	11.583	15.910	16.392
Chocó	815	792	0	0	5.011	8.424	9.757	10.542	10.445	15.113
Caquetá	24	477	265	250	1.438	2.325	3.727	6.662	10.478	11.271
Quindío	1.144	960	710	2.720	4.948	6.027	5.369	5.809	8.705	8.495
Sucre	988	1.087	2.500	4.051	4.702	6.217	5.935	5.727	6.012	5.652
Amazonas	0	0	0	0	14	153	83	2.172	3.313	2.888
Guaviare	167	92	84	488	307	560	263	295	2.432	1.979
Guainía	0	0	0	0	0	300	0	300	760	760
Vaupés	0	0	0	78	64	38	20	20	275	275
Vichada	0	0	0	0	0	0	0	0	300	225
<b>Total</b>	<b>89.651</b>	<b>134.298</b>	<b>156.607</b>	<b>314.829</b>	<b>498.293</b>	<b>660.695</b>	<b>1.036.009</b>	<b>1.568.073</b>	<b>1.804.321</b>	<b>2.194.713</b>

Source: Office of the Comptroller General of the Republic.

The territorial fiscal clearance law established categories for the territorial entities based on the criteria of population and current revenues of free destination. Likewise, the law established limits to the operating expenditures of Departments, Municipalities, territorial bodies such as councils, comptrollers, representatives, and defined the conditions for the creation of new Municipalities and

allowed the concession of guarantees by the Nation for those credits contracted by the territorial entities, aimed at developing fiscal adjustment programs.

Law 549 of 1999 created the National Fund for Territorial Pensions ("Fondo Nacional de Pensiones Territoriales" - Fonpet), which constitutes the long term savings mechanism to attend retirement pension

**TABLE 32**  
**INTERNAL PUBLIC DEBT BALANCES OF THE CAPITAL MUNICIPALITIES**  
(MILLION PESOS)

Capital City	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Santiago de Cali	11.519	26.019	38.778	60.504	112.817	166.827	264.305	320.976	352.395	417.647
Bogotá, D.C.	45.095	68.226	78.612	129.510	207.130	257.864	321.919	381.353	367.228	410.640
Medellín	15.209	17.198	29.021	54.597	88.080	111.971	153.854	162.914	183.084	243.664
Barranquilla	2.299	5.660	20.396	30.644	53.734	56.620	64.700	103.642	163.280	166.143
Cartagena	2.272	1.562	8.311	32.711	44.662	53.637	52.381	71.998	64.367	67.179
Ibagué	0	855	2.175	2.381	5.804	9.014	18.271	33.406	39.154	62.849
Manizales	1.395	1.577	2.280	6.754	12.817	35.313	25.179	35.403	42.362	62.544
Bucaramanga	1.793	1.718	1.919	4.567	20.529	45.649	46.238	50.903	47.486	26.244
Pereira	1.412	3.398	5.075	8.257	13.087	15.469	21.654	25.185	25.651	22.750
Valledupar	1.155	1.666	2.036	3.994	6.048	5.424	6.678	6.162	13.277	20.945
Neiva	0	0	2.040	3.487	3.387	4.485	8.648	16.943	17.875	19.402
Montería	454	501	677	2.726	5.165	5.142	11.300	11.385	15.197	17.663
Santa Marta	892	1.190	2.849	8.213	15.292	8.517	16.833	11.776	13.704	15.064
Villavicencio	610	715	868	743	3.061	8.185	7.380	19.760	14.420	14.839
Pasto	1.072	1.339	1.293	2.529	2.362	2.507	7.754	10.312	12.410	14.090
Arauca	5.424	6.726	7.222	4.967	3.691	6.653	9.577	13.520	12.539	12.293
Popayán	1.640	1.874	1.565	1.810	3.776	3.362	4.953	10.444	12.912	11.359
Tunja	847	1.048	1.800	2.287	5.166	9.026	7.911	11.130	11.124	11.109
Armenia	870	1.126	732	1.555	1.503	1.730	5.829	8.457	8.680	10.687
Sincelejo	304	351	776	1.702	4.627	4.623	5.564	4.391	9.565	9.427
Cúcuta	2.792	2.761	2.107	3.916	4.827	5.142	3.555	6.460	7.993	9.156
Florencia	103	345	1.548	2.070	2.143	2.749	3.465	4.311	6.453	7.439
Quibdó	0	0	0	0	1.902	1.643	2.264	4.264	4.163	4.217
Yopal	0	0	0	945	1.503	3.549	4.332	4.501	4.431	3.560
San José del Guaviare	0	0	0	0	627	847	1.922	3.006	3.160	2.991
Riohacha	335	410	871	2.518	2.985	3.140	5.379	5.083	4.352	2.934
Mocoa	25	25	125	195	399	423	400	1.291	1.022	1.109
Leticia	0	77	65	128	224	470	634	686	644	561
Mitú	0	0	0	0	51	185	204	204	465	449
Puerto Inírida	0	0	0	0	0	0	200	200	163	163
Puerto Carreño	0	0	0	50	50	41	34	34	34	34
<b>Total</b>	<b>97.517</b>	<b>146.364</b>	<b>213.141</b>	<b>373.761</b>	<b>627.448</b>	<b>830.209</b>	<b>1.083.318</b>	<b>1.340.100</b>	<b>1.459.592</b>	<b>1.669.149</b>

Source: Office of the Comptroller General of the Republic.

liabilities of the territorial entities. This fund is maintained receiving resources from the Nation, the Departments, the municipalities and other types of income defined specifically within the law. The resources provided by the nation originate from 70,0% of the stamp tax collection, 10,0% of the amounts due to privatizations and capitalizations and 20,0% of the amounts of goods that have been liable of ownership extinguishment in favor of the Nation.

Although these measures are directed towards clearing the finances of the sub-national governments, there is an additional effort to be made in order to overcome many limitations of the current applicable law, which affects the behavior of revenues, expenditure and territorial indebtedness. An effort towards this direction acquires relevance, when acknowledging that to some extent, the current fiscal lack of order can be associated to the Political

Constitution of 1991, and to the previous and subsequent legal framework, which has promoted an inconsistent management yet aiming at attaining fiscal stability.

In order to attempt understanding some of these limitations, it is necessary to recall that the Political Constitution of 1991 strengthened the fiscal decentralization process, which had started during the mid eighties with the assignment of a percentage of the annual value added tax revenues. Articles 365 and 357 of the New Constitution established the legal framework for assigning functions among different government levels as well as the distribution of the transfers from the national to the regional level -("Situado Fiscal") and municipal participation -. The precise regulations as how to calculate, distribute and spend these transfers was set forth in Law 60, 1993.

Pursuant to the Constitution and the law, while the regional Transfers to Departments and Municipalities should cover exclusively the accounts of education and health expenditures, the municipal participation shall provide financing for different types of activities such as of education and health, recreation and sports, culture and entertainment, among others. The distribution of the regional transfers is done taking into account a territorial criterion, the current and potential demand of health and educational services and fiscal and administrative efficiency criteria. The share of territorial distribution, takes into account the number of inhabitants with unsatisfied basic needs, the relative degree of poverty of Municipalities, and a series of additional criteria such as population, fiscal and administrative efficiency and basic unsatisfied needs.

In general terms, the amendments regarding fiscal decentralization had as basic objectives attaining decentralization of national expenditure and the enhancement of coverage and efficiency for the supply of goods and public services. As it has been stated, these amendments gave way to a transfer of functions from the central government

to the departments and municipalities and to an important modification of the national transfer system, not only by the increase in the volume of resources conveyed but also for the introduction of new criteria for their territorial distribution and utilization.

From a different point of view, the amendments carried out during the nineties did not grant a greater degree of regional autonomy because the necessary conditions for generating new revenues were not established and the subnational governments were not free to manage the transferred resources at their own discretion. With these amendments the subnational governments should have assumed new functions and responsibilities regarding expenditure without counting on an adequate tax scheme that may have allowed them to improve significantly their tax collection. In this sense, it is necessary to point out that the development of the decentralizing project did not give way to a deep review of the territorial tax legislation, which essentially remains with the basic scheme established within Law 14 of 1983. This scheme is characterized by the existence of a great number of taxes with low collection potential and by the existence of revenues which are partially linked to financing of expenditure activities which had been previously defined in the regulations.

The specific destination of various taxes has limited the possibilities of improving collection, because any effort done in order to increase its level is not reflected simultaneously in the amount of free utilization resources of the territorial governments. With the current applicable law the subnational government entities may modify some taxes within the ranges legally defined. However this does not ensure that the increase of collection levels due to technical inconveniences originating in the generalized increase of the taxation rates and to the pressure exercised by interested parties which hinder the adoption of this type of policies.

The limitations that the scheme imposes upon generating new revenues, along with the existence

of revenues and their corresponding transfers, have led the subnational government entities into a race of indebtedness, which has been favored by the design of aid or financial rescue plans by the National Government. In a context in which the National Government frequently attends to the financial rescue of entities in crisis, the development of a generalized indebtedness becomes highly probable, which would not be a consequence of a responsible fiscal management by the local and regional authorities.

From the national finance point of view, the deepening of the decentralization process meant a loss of control over the Central Government revenues, since the Constitution and the law linked the amount of the territorial transfers to the current revenues of the Nation. In this type of scheme any effort regarding tax issues necessarily generates new expenditure, and thus the fiscal adjustment policies based on increasing revenues result ineffective in practice in order to stabilize finances.

With regards to the distribution of responsibilities and capacities related to expenditure, the decentralizing amendments did not lead to free the National Government of regional expenditure commitments different than the regional transfers. Both the operating and investment budgets continued to include disbursements to attend regional expenditure. A recent paper by the Banco de la República<sup>26</sup>, showed how during the nineties the government investment budget experimented an atomization process which reflects the duplicity of expenditure functions among the Central government and the regional entities. In order to attain an idea of the dimensions of this process, it is worth pointing out that during 1998 the 82,0% of the projects included in the investment budget were expenditure accounts destined for financing regional expenditure.

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<sup>26</sup> Iregui A.M. Ramos, J.E. Saavedra L.A. (2001). "Analysis of Fiscal Decentralizing in Colombia", working paper, Banco de la República, SGEE.

Finally, it is necessary to highlight the recent efforts regarding legislative matters that have been made in order to adapt the regulations, which affect public finances to the challenges, imposed by the fiscal decentralizing process. However, it is necessary to recognize the fact that there is still a lot to achieve, especially with regards to the territorial taxation regime, which shall be amended taking into account limitations of the applicable law, and the necessity of adapting the regulations to a decentralized fiscal system. Relating to expenditure, the amendment of Law 60 of 1993 shall conduct to a careful review of the criteria used as the basis for territorial distribution and for the utilization of national transfers. Similarly, the review of this lay shall conduct to define in a precise manner, each of the capacities of each government level to avoid the problems associated with functions duplicity which were observed throughout the past decade.

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#### F. PROGRESS IN THE ADJUSTMENT PROGRAM

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As it has been mentioned in prior reports, within the strategy for adjustment and economic recovery, the government agreed to develop a macroeconomic plan with the International Monetary Fund, based on maintaining a monetary discipline, a financial restructuring, a reduction of the fiscal deficit and a policy of external indebtedness compatible with the macroeconomic adjustment. To fulfill these objectives and to guarantee compliance with the plan, quarterly performance criteria were designed upon i) net international reserves (RIN); ii) net domestic assets (ADN) of Banco de la República; iii) global public sector consolidated balance, and iv) net short, medium and long term external debt disbursements for the public sector.

As it may be seen in Table 33, the macroeconomic policy previously described has allowed compliance of the performance criteria so far in the development

of the plan. We highlight the fact that the program includes certain flexibility upon the limits of the variables mentioned, through adjustments that may be applicable under special circumstances. Particularly Table 33 presents the quarterly performance criteria originally defined within the macroeconomic program and the observed results with numbers available as of December 2000.

During 2000 all the goals relating to the macroeconomic agreement were met. The minimum limit for the net international reserves (RIN) before adjustments, was overcome during all of the quarters except for the month of June, when the level of reserves surpassed the minimum limit after adjustments. With regards to the net domestic assets (ADN) performance criterion, which establishes a maximum limit for the same, this was complied with for the

months of March, September and December before adjustments. During June, the amount of ADN was below the corresponding limit after applying adjustments.

Relating to the performance criterion of the public sector consolidated deficit, which establishes a maximum limit for the accumulated deficit in each quarter, it may be observed that the amount of such deficit in all quarters was less than the maximum limit established in the agreement.

Lastly, the net short, medium and long term external debt disbursements, accumulated since January 1st , 1999, have been lower in all quarters with respect to the limits established in the program, even without including any of the adjustments that would apply, given the delay of the privatizations program.

**TABLE 33**  
**PERFORMANCE CRITERIA OF THE PROGRAM WITH THE INTERNATIONAL MONETARY FUND**

	December 31, 1999			March 31, 2000		
	Planned IMF (a)	Observed (b)	Difference (b) - (a)	Planned IMF (a)	Observed (b)	Difference (b) - (a)
<b>Minimum Level</b>						
Net International Reserves (RIN) (Million Dollars)	7.850	8.116	266	8.150	8.254	104
<b>Adjusted Minimum Level</b>						
Net International Reserves (RIN) (Million Dollars) 1/	7.850	8.116	266	7.551	8.254	703
<b>Maximum Level</b>						
Net Domestic Assets (ADN) (Million Dollars)	(7.650)	(6.898)	752	(8.950)	(9.789)	(839)
<b>Adjusted Maximum Level</b>						
Net Domestic Assets (ADN) (Million Dollars)	(7.650)	(6.898)	752	(7.722)	(9.789)	(2.067)
<b>Minimum Level</b>						
Overall Balance of the Combined Public Sector From January 1st, 1999 (Million Dollars)	(9.150)	(8.271)	879	(11.550)	(7.366)	4.657
<b>Maximum Level</b>						
Net Aggregate Disbursements Short Term Public Sector External Debt From January 1st, 1999 (Million Dollars)	382	368	(14)	70	56	(382)
<b>Maximum Level</b>						
Net Aggregate Disbursements Short Term Public Sector External Debt From January 1st, 1999 (Million Dollars)	2.450	1.766	(684)	2.600	2.355	(309)
<b>Adjusted Maximum Level</b>						
Net Aggregate Disbursements Short Term Public Sector External Debt From January 1st, 1999 (Million Dollars)	2.450	1.766	(684)	2.793	2.355	(438)

1/ Does not include performance adjustment in 1999.

2/ Estimated value, since the information relating to public sector external debt and assets movement abroad is not yet available for closing in June. A missing figure of external public financing is estimated between US\$700 m and US\$ 900 m.

3/ Shows non-compliance of the goal before accounting for technical exemptions. Once these are included all the performance criteria are met.

Source: Banco de la República and Ministry of Finance and Public Credit, Acuerdo Extendido de Colombia con el Fondo Monetario Internacional, 1999.

Junie 30, 2000			September 30, 2000			December 30, 2000		
Planned IMF (a)	Observed (b)	Difference (b) - (a)	Planned IMF (a)	Observed (b)	Difference (b) - (a)	Planned IMF (a)	Observed (b)	Difference (b) - (a)
8.350	8.335	(15)	8.250	8.496	246	8.570	8.822	252
7.450	8.335	885	7.350	8.496	1.146	7.670	8.822	1.152 2/
(9.050)	(8.718)	332 3/	(8.500)	(9.543)	(1.043)	(7.100)	(7.374)	(274)
(7.205)	(8.718)	(1.513)	(6.655)	(9.543)	(2.888)	(5.255)	(7.374)	(2.119)
(13.300)	(8.632)	4.668	(13.700)	(9.073)	4.627	(14.550)	(14.133)	417
70	56	(14)	70	2	(68)	70	0	(70)
2.750	2.247	(503)	3.200	2.587	(613)	3.500	2.958	(542)
3.383	2.247	(1.136)	4.318	2.587	(1.731)	4.893	2.958	(1.934)



## IV

### INFLATION RESULTS AND BASIC TRENDS

#### A. GENERALITIES

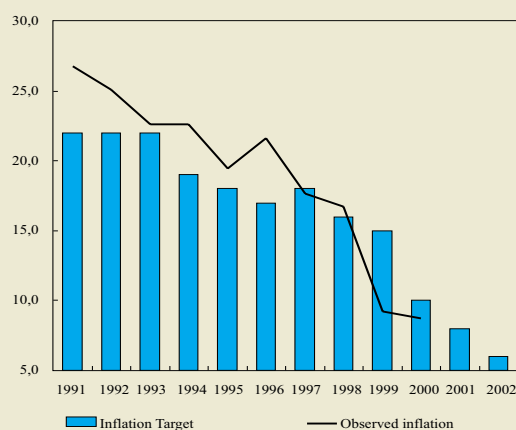
The annual consumer inflation for December 2000 was 8,7%, below the inflation target of 10,0% established by the Banco de la República for that year. With this number during 2000, for four consecutive years the inflation present has been very near or lower than the inflation target defined by the monetary authorities. Similarly, with this number, a decade of practically uninterrupted reduction of inflation is achieved in Colombia, from levels of nearly 30,0% to levels lower than 10,0% (Figure 51). In fact, based on the price performance during the previous year, it may be stated that the country consolidated gains with regards to the

inflation reduction attained during 1999 and it ceased to form part of the list of high inflationary economies.

The consolidation of a one digit inflation during 2000, and its reduction as compared to the level during 1999 (9,2%), are particularly important taking into account that this happened within a context of economic recovery. This was possible due to the definition of a prudent monetary policy whose permanent objective was to attain price stability and to comply with the inflation target, yet permitting an economic recovery. As it was widely mentioned in the chapter regarding macroeconomic policy, the monetary strategy was grounded in maintaining an intervention interest rate compatible with growth, and at the same time accounting for its effect on prices and on the evolution of external conditions. Likewise, the strategy assumed a definition of monetary expansion goals which would account for the effects of the tax on demand of cash and current account transactions. Thus real positive interest market rates could be maintained throughout the year, but that for the case of passive rates these were lower than historic average levels.

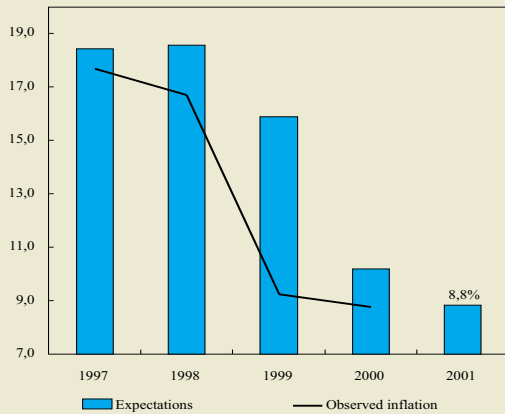
The reduction of inflation expectations was an important factor that facilitated greater price stability in a growth environment. These reduction has occurred slowly and simultaneously with the reduction of inflation as pointed out by the results of the survey of expectations carried out by the Banco de la República on a quarterly basis (Figure 52). The reduction of expectations has not led to a total dismantling of the indexation

**FIGURE 51**  
OBSERVED INFLATION AND INFLATION TARGET  
(PERCENTAGE)



Source: DANE and Banco de la República, SGEE.

**FIGURE 52**  
OBSERVED INFLATION AND INFLATION  
EXPECTATIONS RECORDED DURING THE FIRST  
SEMESTER EACH YEAR  
(PERCENTAGE)



Source: Banco de la República.

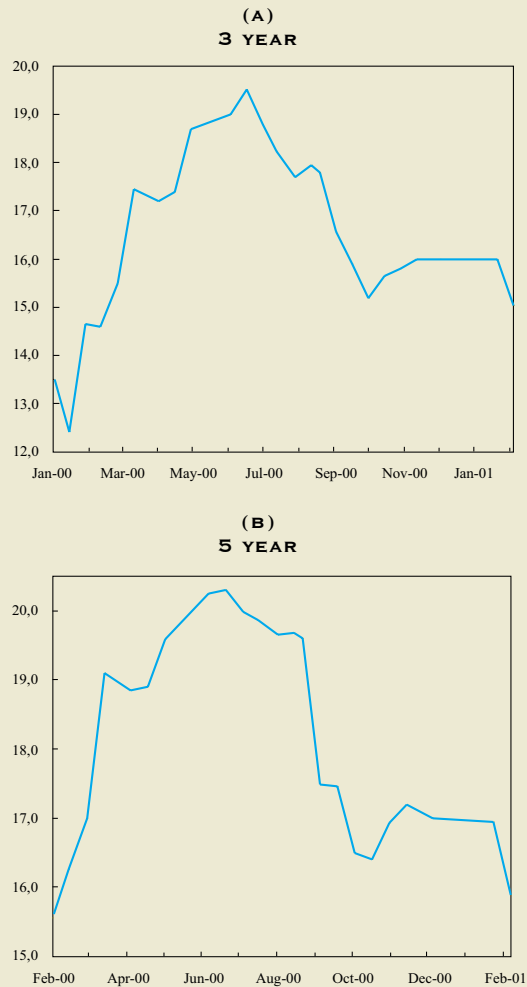
mechanisms, which in some cases have become strengthened by Court decisions such as the adjustment for the public sector salaries, but it has allowed that these mechanisms increasingly account for the inflation target established by the monetary authority.

The reduction of inflationary expectations is allowing the appearance of a virtuous circle among them and the observed inflation which enables goals compliance and increases the credibility of the monetary policy. This virtuous circle allows a reduction of the short term cost regarding growth, cost which eventually is present with the deflation strategies and that arises when these are not anticipated correctly by the markets or when lacking credibility before them and hence not conducting to moderation in price adjustments pursuant to what is intended through monetary policy.

The positive results of the inflation reduction and its expectations have been observed during the last months, as lower indebtedness costs for the public sector. In fact, the greater price stability has promoted the decrease of the interest rate of the TES securities at different terms as from the middle of last year, which, if it remains, it will produce an

important relief in the expenditure of the Central Government due to a lower debt service (Figures 53A and B). Preliminary calculations indicate that for the current debt balance in TES (nearly \$30.000 billion), a reduction of one percent point in the TES rate at different terms frees resources of about \$300 billion of the National Government budget. Along with the foregoing result, it is worth highlighting the favorable investment atmosphere generated by the expectations of a lower inflation, since they allow reduction of uncertainty levels and information problems associated with the process of price fixing.

**FIGURE 53**  
TES CLOSING RATE  
(PERCENTAGE)



Source: Banco de la República.

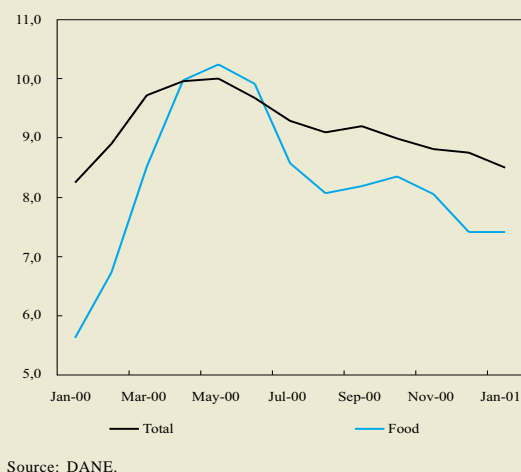
## B. CONSUMER PRICE INDEX (IPC) AND BASIC INFLATION

In general terms, the behavior of inflation during 2000 was within the forecasts by the Banco de la República. As it was anticipated in the Report to Congress dated July 2000, the cyclic behavior of foodstuff supply showed an ascending trend of consumer inflation during the first semester of the year, trend that was reversed during the second semester.

The rebound of prices at the beginning of the year responded to a supply shock originating in a transitory reduction in the production of primary food products that should be reversed towards the year end. With the agricultural supply recovery as from May, the food prices returned to their normal levels thus contributing to the deceleration of inflation in the second semester. By the year end, the annual food price variation was 7,4%, lower than the one observed during May (10,2%). If meals consumed outside homes are excluded, whose prices depend more on demand than on supply, the reduction in the food price variation among the first and second semesters is much higher, changing from 12,2% in May to 8,1% in December 2000. (Figure 54).

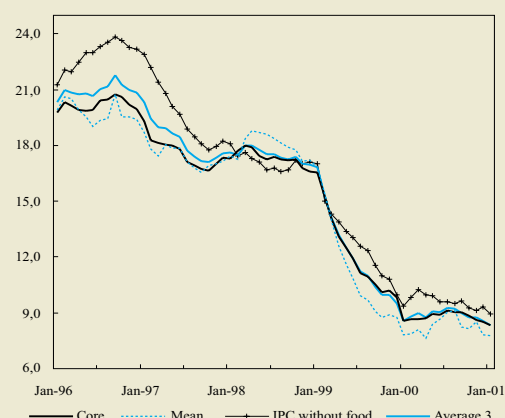
With food price normalization inflation continued with the decreasing trend it has exhibited as from several years ago and which has been closely linked to the monetary policy strategy. Basic inflation, measured by the component of the price variation, which is attributable to monetary policy, maintained the practically uninterrupted descending trend, as judged by the evolution of the indicators utilized by the Bank. The basic inflation, measured as the average of the three most reliable indicators was 8,6% in December 2000, lower than the one recorded in December 1999 (9,5%) and than in June 2000 (9,0%) (Figure 55).

**FIGURE 54**  
IPC ANNUAL VARIATION & IPC FOR FOOD  
(PERCENTAGE)



Source: DANE.

**FIGURE 55**  
BASIC INFLATION  
(ANNUAL VARIATION %)



Source: Banco de la República - SGEE.

Additional to the good behavior of food prices, the inflation deceleration during the second semester continued to be feasible due to the good performance of prices, basically determined by demand conditions with major participation in the Consumer Price Index (IPC) basket, such as rent, clothing and health professional services, among others. The case of rents is significant, since it is the

second consecutive year when adjustments have been lower than inflation and have maintained a decreasingly uninterrupted tendency. Particularly, in December the annual rent price variation increased 2,6%, the least recorded in two decades. For clothing, up to December the annual price variation also continued to be very low, as it has occurred during the past years, even though it showed an increasing trend as of June. Lastly, the professional health services showed price adjustments of nearly 7,0% in December, not very different than those observed throughout the year (Figure 56).

Other groups of products of the family consumption basket whose prices are also closely related to the evolution of demand and income, slightly reduced their inflationary impact during the second semester, even though in December they still showed annual price variations higher than consumer inflation. Such is the case of education costs, which exhibited an annual price variation of 9,4% in December, lower to the variation observed in June (9,7%) and in December 1999 (12,4%). Within the group of education, the reduction in price variation of the item education and teaching (enrollment fee and monthly fees) was even higher,

reaching 8,7% in December 2000 as compared to 13,3% a year earlier. During 2000 this item recorded for the first time in the past 10 years, price variations lower than IPC inflation, and even more important, variations lower than the inflation of the previous year. (Figure 56).

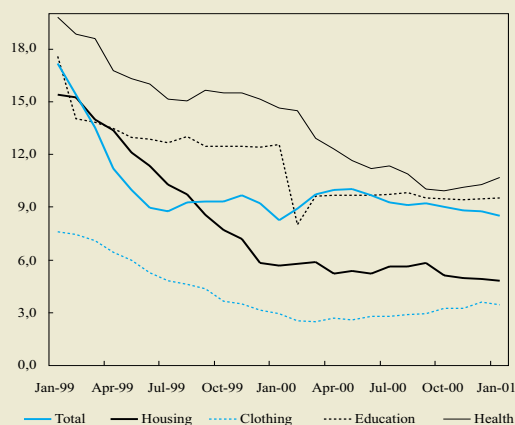
During the second semester 2000, three factors exercised a rising pressure on consumer inflation. The first two - the rise in fuel price and the dismantling of the subsidies to utilities- were also present during the first semester of the year and correspond to supply shocks which escape from the influence of the monetary policy in the short term. The third factor refers to devaluation.

The rise in fuel price as a consequence of the rebound of international oil price during the first half of the year continued throughout the year, despite the fact that the international crude price did not record important gains during the second half of the year. This was due to the fact that the formula used to calculate the domestic price of gasoline is tied to the international price with an ample lag. This circumstance, joined to prices adjustments in urban transportation explains the annual variation of 16,2% of the prices in the transportation group up to December, which is however, lower than that recorded in June 2000 (18,4%) and in December 1999 (18,7%) (Figure 57).

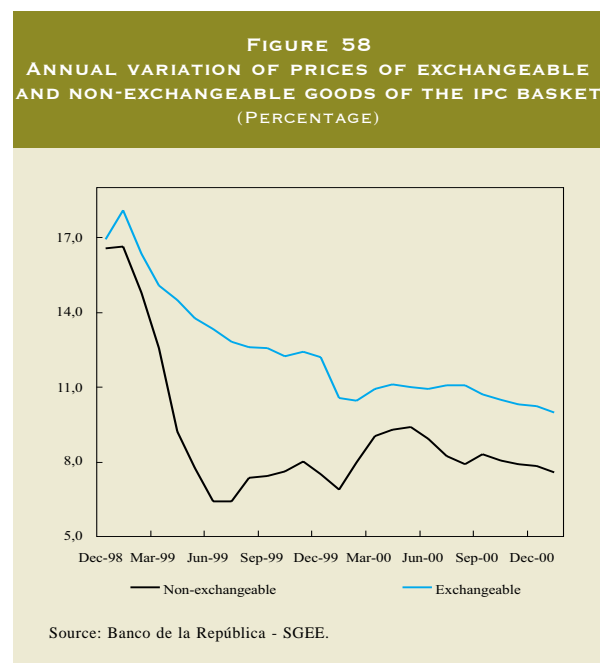
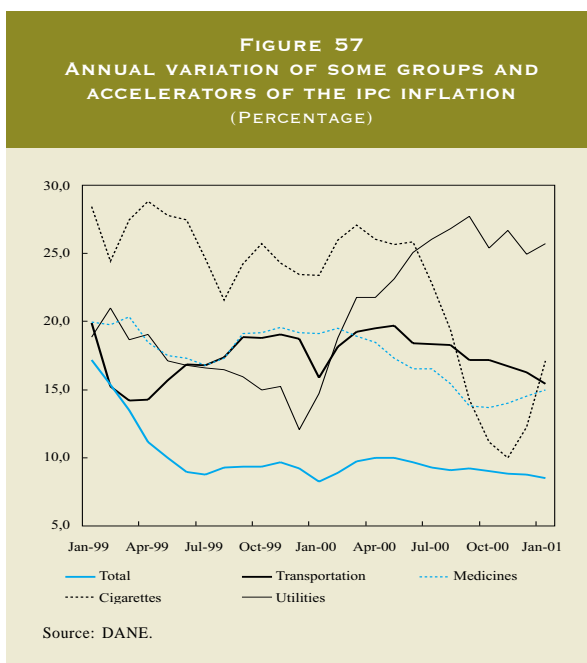
With regards to utilities, the dismantling of subsidies induced an annual price variation significantly greater than the consumer inflation throughout all of 2000, including the second semester. As of December, it had reached 25,0%, higher than that observed in December 1999. Readjustments were important for all utilities, even though the international price increase of fuels had a greater incidence for the case of gas than the effect of dismantling subsidies.

With respect to devaluation, its effect has been evident on the consumer prices along the year, in a moderate fashion. During the second semester

**FIGURE 56**  
ANNUAL VARIATION OF DECELERATING IPC  
INFLATION GROUPS  
(PERCENTAGE)



Source: DANE.



evaluation was lower than in the first, but it continued to affect the consumer prices, especially through its impact on exchangeable goods. Additionally, during the past two years devaluation has accumulated significantly, and this fact, along with the demand recovery, produce entrepreneurs to develop an inclination towards rising prices to compensate greater costs of imported goods and hence improve their profit spreads. This phenomenon partially explains the fact that the annual exchangeables price variation was maintained above the total inflation throughout the year reaching 10,2% in December (Figure 58). Particularly, the devaluation during 2000 may be explaining to a great extent the adjustments, over inflation, in prices of goods such as medicines, personal hygiene products, cigarettes and others.

Finally, it is worth pointing out that the price of financial services, which has strongly pulled the IPC as from the end of 1999 and the beginning of 2000, did not experience any additional upturns during the second semester. Yet the annual variation in December was significant, (22,2%), due to the high readjustments during the first quarter. Partially, due to these prices and partially due to a regular performance of items such as

cigarettes and personal hygiene products, the group of other expenses presented an important annual variation in December (15,2%), and not very different than what had been observed during 1999, but yet showing a descending trend.

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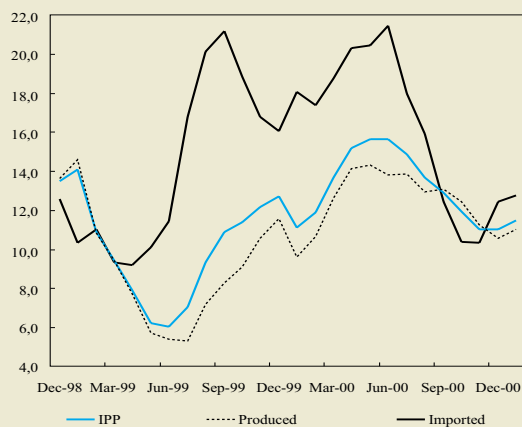
### C. PRODUCER PRICE INDEX (IPP)

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Two phases may be identified within the evolution of inflation measured as the Producer Price Index (IPP) during 2000 (Figure 59). Between January and June the producer inflation maintained a growing trend that had begun during mid-year 1999. During the first half of 2000, the increase was five percent points, and similar to the consumer inflation during this period, it was associated to agricultural supply shocks and to the upturn of the international fuel prices. Similarly, the devaluation effect was also important during this period, especially upon imported goods. To this respect, it is convenient to point out that due to its nature, the IPP is usually more sensitive to devaluation than the IPC.

For the second semester the inflationary pressure originating in food prices, fuel, and devaluation

**FIGURE 59**  
**PRODUCER PRICE INDEX BY ECONOMIC DESTINATION**  
 (ANNUAL VARIATION %)



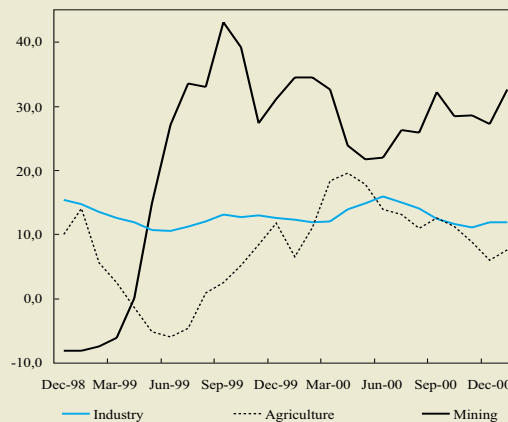
Source: Banco de la República.

became significantly moderate allowing the producer inflation to recover the path lost during the first semester. In December the annual producer inflation reached 11,0%, lower than the one present in June 2000 (15,6%) and that of December 1999 (12,7%).

The effect of the devaluation upon the IPP during 2000 can be seen clearly, analyzing the behavior of prices of imported goods with the prices of the produced and consumed goods. (Figure 59). During the first half of the year, the prices of imported goods showed variations much higher than the producer inflation and in accordance with the annual devaluation. As from July, with the reduction in the devaluation rate and the drop of international prices of imported goods, the inflation for this group decelerates and only with the rebound of the dollar price at the year end symptoms of acceleration have become present, which have persisted at the beginning of 2001.

With regards to the incidence of fuel prices and agricultural prices upon the producer inflation, it can be analyzed through the evolution of different IPP components by economic destination (Figure 60). The mining IPP, which to a great extent

**FIGURE 60**  
**PRODUCER PRICE INDEX BY ORIGIN**  
 (ANNUAL VARIATION %)



Source: Banco de la República.

reflects the behavior of fuels price, was readjusted to annual rates over 20,0% throughout 2000, and ended the year with an annual variation of 27,3%. The fluctuations shown by this subindex throughout the year respond to variations in the oil price as well as the devaluation behavior. With regards to the annual agriculture IPP variation, it reached a maximum of 19,6% in April , and therefrom it was reduced to reach 6,0% in December.

Lastly, the incidence of the demand factors upon producer prices can be determined through the evolution of the industry IPP, which showed a decreasing trend as from June 2000 and in December it reached 11,9%. In general terms, this type of goods have recorded a greater stability than those from an agricultural and mining origin, which explains why do demand factors are more relevant in their determination than supply factors. In this sense, it is worth to highlight that the lowest inflation levels for industrial goods, specially during the second half of the year, also suggest that the demand factors showed a small incidence on the producer inflation as compared to other groups. (Figure 60).

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#### D. PERSPECTIVES FOR 2001

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The Inflation Report of December 2000 by Banco de la República includes the inflation projections for the present and next year. In accordance with these projections, there is a high probability of reaching an inflation target of 8% in 2001, being also feasible to attain an inflation target of 6% for 2002. Similarly, it is expected that the basic inflation maintains its decreasing trend and that for the year end it reaches a level lower than the inflation target of 8%.

The behavior of consumer inflation during the first month of the year ratifies the forecasts performed by the Bank. As a matter of fact, in January the annual inflation was reduced once more and reached 8,5%. During this month the prices of items such as rent, clothing and health services among others continued being adjusted at very low rates, which facilitated the reduction of inflation. Similarly, the prices of financial services showed adjustments of levels much less than those observed during the same period on the previous year. These facts point out that the current demand is being comfortably attended by the suppliers within the different markets and that no bottlenecks in production are foreseen yet, which may trigger important price rises.

In fact, except for a few sectors that attend external demand, no significant inflationary pressures are expected during this year. In accordance with the indicators of utilization of installed industrial capacity, currently most productive areas of this sector counts with sufficient non-utilized installed capacity that should allow them to attend the expansion of demand during 2001 without major inconveniences. This is also suggested by the fact that the production in most productive sectors was still less than the one reached during several years of the nineties decade.

Despite the foregoing, it is possible to identify circumstances present at the beginning of the year, which could generate rising pressures upon prices. The first is related to the effects that could be produced by a devaluation greater than that foreseen. Compliance with inflation target of 8% for this year and 6% for next year assume a relative foreign exchange stability during 2001, which would allow to maintain the current real exchange level. However, an additional real devaluation motivated upon external circumstances or by internal security problems could be transferred to prices in a faster and complete manner than what has been observed in past years, if it occurs during the moment of greater dynamism of demand.

Another factor that could restrain the drop of inflation, is related to the behavior of agriculture supply. The excellent performance of prices of this sector during the second semester of the previous year along with climate factors may combine to affect the food supply and produce a rising pressure on prices during the oncoming months. Some indications of this were present in January, showing significant increases in primary consumption goods prices, important within the consumers basket such as potato, milk and bread.

Thirdly, during 2001 the pressure on consumer inflation will persist, originated in the dismantling of subsidies for utilities. Since the order of magnitude of the dismantling of subsidies for this year is similar to that present the previous year, the prices of these items shall undergo adjustments much higher than the inflation target.

Lastly, the price of fuels will keep being readjusted at rates over the 8% target during a good portion of the year, even in the expectations of lower international oil prices are confirmed for 2001. The foregoing as a result of the fact that the increase in the international price and devaluation during last year have not yet been fully translated to the domestic price, given the lag with which the latter is fixed with respect to external prices.

## INFLATION AND ECONOMIC GROWTH

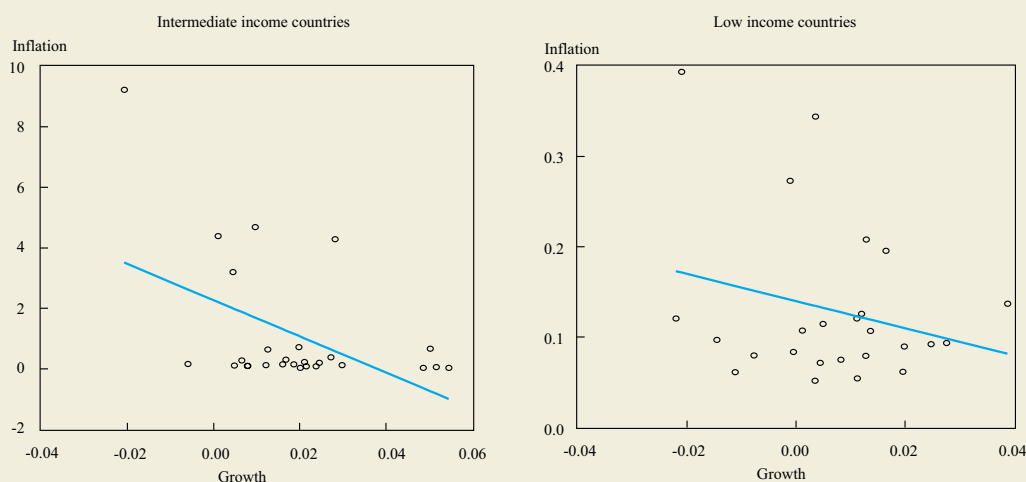
Between 1973 and 1998 Colombia maintained moderate inflation levels (between 16,0% and 33,0%), which caused having been called the "country with moderate inflation by excellence" 1.

The foregoing would not have only been a world record for Colombia, except for the fact, empirically evidenced in several papers (Uribe 1994 2 , Partow 1994 3 , Ma 1998)4, that having maintained such inflation levels, despite their stability, affected negatively the economic growth of the country during such period.

To illustrate in a simple manner the relationship existing inflation and economic growth, Figure 1 shows the average growth rate (horizontal axis) and average inflation (vertical axis) as well as the regression line that best fits the relationship between those two variables, for each of the countries which constitute the two groups present: one of intermediate income (in its majority Latin American countries) and the other of low income (in its majority African and South East Asian countries). As it may be seen, the regression line indicates a clear negative correlation between these two variables. A similar relationship is obtained for Colombia during the period 1954 - 1999 (Figure 2).

The empirical evidence suggests that economies show a better economic performance, in terms of growth 5 employment and standard of living, in low inflation environments than those where inflation rates are high and persistent. This literature have identified several channels for explaining the manner through which inflation affects economic growth. Some of these are summarized below.

**FIGURE 1**  
**RELATIONSHIP BETWEEN GROWTH AND INFLATION**  
**BY GROUPS OF COUNTRIES, 1960-1995**





**FIGURE 2**  
**RELATIONSHIP BETWEEN GROWTH AND INFLATION IN**  
**COLOMBIA, 1954-1999**



The first channel is distortion of the information contained in the relative price system. This channel is based on empirical observation where a higher inflation level goes along with a greater variability in relative prices<sup>6</sup>. This means that not all the prices of the products comprising the IPC basket vary in the same proportion. Thus, for example, if the December 2000 inflation was 8,75 it does not necessarily imply that all the products in the IPC basket increased in the proportion. In fact, if the latter were true, inflation would cause no problems through this channel. However, as frequently occurs in situations of high inflation, if agents do not perceive changes in relative prices accurately (namely if they do not perceive to what extent did the price of a good change with respect to another in the reference basket), the decisions made regarding resources allocation shall not be optimal, hence, the economic performance will not be the best attainable.

In a second channel, to higher inflation, greater uncertainty on the future level of this variable. Since agents make decisions permanently on consumption and investment based on real expected profitability, the uncertainty existing in inflationary environments concerning profitability or concerning real payments, discourages investment destined for productive purposes while promoting speculative activities.

A third channel that combines elements of the two aforementioned, is that of financial instability. To the extent that banks and investors make decisions based on projections of prices of assets (housing, goods of capital, etc.) which involve excessive uncertainty, the consequent allocation of financial assets will not be adequate, and it is highly probable that problems (unbalances) arise within the financial market. Additionally, to the extent that the existing uncertainty on future inflation is greater the agents (investors) shall demand an additional risk premium over the interest rate, in order to cover them from the risk of obtaining real yields (exports) less than those expected at the moment of signing the contract.

In summary, the economies with high inflation levels are characterized by higher uncertainty levels on the future evolution of profitability, salaries and real payments, and therefore, there exists a higher probability of errors by the agents when deciding where productive resources should be allocated.

Since inflation is a long term monetary phenomenon and that high persistent levels of such variable affect economic growth, the greatest contribution by central bank toward long term economic growth is by keeping inflation rate at low and stable levels.

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<sup>1</sup> Dornbusch R. Fisher, S. (1992). "Inflación Moderada", *Ensayos sobre política económica*, No. 21 Banco de la República, Junio.

<sup>2</sup> Uribe, José D. (1994). "Inflación y Crecimiento Económico en Colombia : 1951-1992", Borradores Semanales de Economía, *Banco de la República*.

<sup>3</sup> Partow Z. (1994). "Investigación empírica sobre el impacto de la inflación en el crecimiento económico colombiano", *Ensayos sobre política económica*, No. 26, Banco de la República, Diciembre.

<sup>4</sup> Ma, H. (1998). "Inflation Uncertainty, and Growth in Colombia", *IMF*, Working Paper No. 161, Noviembre.

<sup>5</sup> See Barro, R. (1997). *Determinants of Economic Growth: A Cross-Country Empirical Study* MIT Press.

<sup>6</sup> The price of a well defined good in terms of the price of another good or the price of the basket of goods.

## INTERNATIONAL RESERVES AND FINANCIAL SITUATION OF THE BANCO DE LA REPÚBLICA

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### A. INTERNATIONAL RESERVES

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#### 1. Balance of International Reserves

By the end of 2000, the net international reserves<sup>27</sup> reached US\$9,004.1 million, with an increase of US\$903.0 million respect to the balance of the previous year. The net international reserves are composed mainly by financial investments, US\$8,083.2 million, which correspond to foreign deposits and securities held abroad. The remaining balance is distributed as reserve position at the International Monetary Fund and at the Latin American Reserves Fund, US\$ 638.2 million; Special Drawing Rights ("Derechos Especiales de Giro" - DEG), US\$135.7 million and gold, cash availabilities, andean pesos and positive balances from international agreements US\$149.1 million. On the other hand, the short term external liabilities reached US\$2.0 million. (Table 34).

#### 2. Management Criteria for International Reserves

The Banco de la República defines three major criteria for the management of international reserves: safety, liquidity and profitability. Responding to these criteria and in order to ensure that the external obligations of the country are met, the reserves are invested in financial assets having a broad secondary market, and part of them is kept as working capital, guaranteeing their immediate

availability. During 2000 Bank maintained the scheme of having the first level international financial institutions manage part of the investment portfolio of the international reserves.

From the total financial investments (including working capital), the Banco de la República managed directly a portfolio of US\$5,173.0 million (64,0% of the total) and the specialized firms Barclays Global Investors, Morgan Investment Management and Goldman Sachs Asset Management managed the remaining 36%, US\$2,910.2 million.

In order to guarantee that the portfolio matches the external operations of the country, its currency distributions by the end of 2000 was as follows: U.S. Dollars 80,4%; Euros, 15,3%; Japanese Yens, 4,2% and other currencies 0,1%<sup>28</sup>. Despite the fact that this investment policy sometimes brings as a consequence extraordinary revenues or disbursements, which are product of the variations occurred in the exchange rates of different currencies vis a vis the dollar, it allows the existence of equilibrium among the international reserves and the composition of external payments.

#### 3. Safety, Liquidity and Portfolio Yields

The investment portfolio, including that under direct management and that managed by others, is placed on sovereign governments securities, 72,0 % and in banking institutions and corporations 28,0%. The credit risk of investments is distributed, in accordance with the ratings of specialized agencies, as follows:

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<sup>27</sup> Equal to the total of international reserve or gross reserves minus short-term liabilities of Banco de la República. The latter are constituted by sight liabilities in foreign currency.

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<sup>28</sup> Other currencies such as Sterling pounds.

**TABLE 34**  
**INTERNATIONAL RESERVES BY MAIN COMPONENTS 1/**  
(MILLION DOLLARS)

Components	December 1998	Share %	December 1999	Share %	December 2000 (p)	Share %
<b>Cash</b>	80.4	0.9	91.2	1.1	30.0	0.3
Vault Cash	79.9	0.9	90.2	1.1	28.5	0.3
Sight deposits	0.6	0.0	1.0	0.0	1.5	0.0
<b>Investments</b>	7,524.2	86.1	7,122.0	87.9	8,083.2	89.8
Directly managed	5,300.5	60.6	4,395.9	54.3	5,173.0	57.5
Delegated management	2,223.7	25.4	2,726.1	33.7	2,910.2	32.3
<b>Gold</b>	103.1	1.2	95.4	1.2	89.4	1.0
In vault	1.0	0.0	0.0	0.0	0.0	0.0
Custody	102.2	1.2	95.4	1.2	89.4	1.0
<b>International Monetary Fund</b>	771.3	8.8	523.0	6.5	508.1	5.6
Special drawing rights	196.4	2.2	131.2	1.6	135.7	1.5
Reserve position	574.9	6.6	391.8	4.8	372.4	4.1
<b>Latin American Reserve Fund</b>	255.0	2.9	270.0	3.3	285.8	3.2
Contributions	235.0	2.7	250.0	3.1	265.8	3.0
Andean Pesos	20.0	0.2	20.0	0.2	20.0	0.2
<b>International Agreements</b>	6.5	0.1	1.8	0.0	9.7	0.1
<b>Total Gross reserves</b>	8,740.5	100.0	8,103.4	100.0	9,006.1	100.0
<b>Short term liabilities</b>	0.7	0.0	2.3	0.0	2.0	0.0
International agencies	0.0	0.0	0.0	0.0	0.0	0.0
Outstanding balance international agreements	0.0	0.0	0.0	0.0	0.0	0.0
Payable amounts investment purchase	0.0	0.0	0.3	0.0	0.0	0.0
Interests accrued on FMI allocations	0.7	0.0	2.0	0.0	2.0	0.0
<b>Total Net Reserves</b>	8,739.8	100.0	8,101.1	100.0	9,004.1	100.0

(p) Provisional.

1/ Restated figures. As from December 1998, the interest on special drawing rights and the liabilities on management and custody of funds abroad are included as short term liabilities. Hence the balance of NET international reserves (RIN) decreases. With the foregoing, the calculation of RIN adjusts to the IMF's methodological recommendations.

Source: Banco de la República.

77,0% "AAA", 11,0% "AA+", 6,0% "AA", and the remaining 6,0% in "AA-" and "A+".

In order to ensure the immediate foreign currency availability, the Banco de la República maintains a working capital represented by financial assets with immediate liquidity, amount which may fluctuate inside a range between US\$240 million and US\$500 million. In December 30, 2000, such working capital was US\$327.4 million.

During 2000, the Banco de la República obtained profits relating to the yields of the investment portfolio of reserves for US\$504,9 million, of which US\$268 million correspond to effective cash revenues and US\$237 million to the valuation of international reserves valuation at market prices. The valuation revenues are mostly explained by the recovery of the euro with respect to the dollar at the end of the year (investments in euros represented 15,3% of the total portfolio) and to the effects of a greater valuation of long term bonds associated to the decline of the international interest rates. In addition, the average amount of the invested portfolio during 2000 was

<sup>29</sup> Standard & Poors, Moody's and IBCA

larger than in 1999 since the balance of international reserves recorded a growth of US\$903 million during the year.

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## B. FINANCIAL SITUATION OF THE BANCO DE LA REPÚBLICA

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### 1. Results of 2000

The assets of the Banco de la República reached \$29.142,2 billion with an annual growth of \$4.619,7 billion 18,8%, (Table 35). This increase is explained by a:) the variation of the international reserves expressed in Colombian Pesos, \$4.218,8 billion from the effect of accumulation of reserves for US903.0 million and the devaluation of the peso with respect of the dollar; b) the increase in portfolio investment \$853,2 billion by the acquisitions of bonds from Fogafin and the outright purchases of TES to attend the demand of liquidity; c) variation of other assets, \$549,5 million explained by the valuation of the portfolio representative of funds set aside for retirement pensions and of the works of art and culture, and d) valuation of contributions in international organizations, \$209,0 billion which corresponds to the adjustment caused by raise in the type of exchange peso-dollar. These increases were partially compensated by the drop of the REPO and transitory liquidity for \$1.163,4 billion.

The liabilities amounted to a total of \$13.821,5 billion and the net worth balance was \$15.327,7 billion with an annual growth of \$1.051,1 billion and \$3.568,6 billion respectively. The larger level of liabilities is explained, mainly, by : a) increase of the monetary base of \$970,9 billion, 10,0%, and b) an increase in the deposits of the General Treasury of the Nation for \$170,3 billion. The net worth change is explained by the exchange adjustment peso-dollar of the international reserves, \$2.531,5 billion, and higher profits obtained during 2000, as compared to the previous year, \$928,1 billion.

During 2000, the profits of the Banco de la República reached \$1.435,9 billion (Table 36), as a consequence of revenues for \$2.090,8 billion and disbursements for \$654,9 billion. Among the major revenues we have: i) the yield of international reserves for \$1.086,1 billion which is the equivalent in pesos of the yield in dollars US\$504.9 million, ii) valuation of TES due to monetary expansion operations, \$311,0 billion, and iii) the interest received due to the transitory purchase of securities (REPO) and liquidity quotas, \$147,3 billion. On the other hand, the main disbursements were represented by personnel expenditures and the remuneration of float reserve deposits with \$150,6 billion and \$125,5 billion respectively. It should be noted that, the net effect of the transactions between Banco de la República and the financial sector was negative in \$49,6 billion, due to revenues for \$147,3 billion and disbursements for 196,9 billion, corresponding to float reserve deposits remuneration and the cost of reverse REPOS.

### 2. Constitution of Reserves and Distribution of Profits

Pursuant to the By-Laws of the Banco de la República, the Board of Directors determined to distribute resources for \$1.460,6 billion this year. These resources correspond to profits obtained during 2000, \$1.435,9 billion, and part of the accumulated reserves for protection of assets, \$24,7 billion. The distribution will be carried out as follows: a) 7,9 billion for net investment in goods for cultural activity and b) the remaining, \$1.452,8 billion for the National Government (Table37).

With regards to the reserves for monetary and exchange stability which currently show no balance, the Board deemed that it was not necessary to constitute reserve whatsoever, since no losses are foreseen for the oncoming years. On the other hand reserve for floating currencies was maintained in \$103,3 billion. Finally, since there were no losses due to daily purchase and sale of foreign currency during 2000, the Board did not modify the reserve of these operations.

**TABLE 35**  
**GENERAL BALANCE SHEET OF THE BANCO DE LA REPÚBLICA, 1999-2000 RESULTS**  
 (THOUSAND MILLION [BILLION] PESOS)

	December, 1999		December, 2000	
	Balance	Share %	Balance	Share %
<b>Assets</b>	24.529,5	100,0	29.149,2	100,0
Gross International Reserves	15.170,5	61,8	19.389,3	66,5
Contributions to International Agencies	2.059,6	8,4	2.268,6	7,8
Investments	2.395,5	9,8	3.248,7	11,1
Consolidated public sector debt	390,0	1,6	366,4	1,3
Public-sector securities for liquidity regulations	2.005,5	8,2	2.398,0	8,2
Private sector			484,3	1,7
Loan Portfolio	379,8	1,5	323,9	1,1
National Government, Public Sector	4,0	0,0	3,7	0,0
Commercial banks	24,8	0,1	6,0	0,0
Financial corporations	66,0	0,3	154,1	0,5
Savings and loans corporations	284,9	1,2	160,1	0,5
Remaining financial system	0,1	0,0	0,0	(0,0)
Repurchase agreements & access to Discount window	2.892,3	11,8	1.729,0	5,9
Accounts receivable	55,8	0,2	64,3	0,2
Other net assets	1.576,0	6,4	2.125,5	7,3
<b>Liabilities and Net Worth</b>	24.529,5	100,0	29.149,2	100,0
<b>Liabilities</b>	12.770,4	52,1	13.821,5	47,4
Foreign currency liabilities affecting international reserves	4,3	0,0	4,3	0,0
Monetary base	9.739,6	39,7	10.710,4	36,7
Notes in circulation	7.457,6	30,4	8.698,6	29,8
Treasury Coins	319,4	1,3	344,2	1,2
Bank's reserve requirement float deposits	1.648,7	6,7	1.362,8	4,7
Current Account deposits financial sector	313,9	1,3	304,9	1,0
Other deposits	142,7	0,6	77,5	0,3
National Government Treasury	83,4	0,3	253,7	0,9
International agencies liabilities	1.779,9	7,3	1.853,8	6,4
External credit liabilities	218,0	0,9	207,6	0,7
Securities for regulating domestic & foreign exchange liquidity	147,4	0,6	28,7	0,1
Reverse REPOs & Central bank securities	46,1	0,2	20,9	0,1
Certificados de cambio	0,7	0,0	0,8	0,0
Foreign currency funding certificates & Board res. 5/97 Dep.	100,6	0,4	6,9	0,0
Other	0,0	0,0	0,1	0,0
Accounts payable	38,7	0,2	31,4	0,1
Other liabilities	616,4	2,5	654,1	2,2
<b>Total Net Worth</b>	11.759,1	47,9	15.327,7	52,6
Capital	12,7	0,1	12,7	0,0
Reserves	360,1	1,5	345,9	1,2
Capital surplus	10.557,7	43,0	13.094,6	44,9
Liquidation of Special Exchange Account	453,5	1,8	453,5	1,6
Ajuste cambiario 1993 en adelante y superávit	10.088,2	41,1	12.619,7	43,3
Other	16,0	0,1	21,4	0,1
Valuations	320,9	1,3	438,7	1,5
Results	507,8	2,1	1.435,9	4,9
Profit or loss from previous year				
Profit or loss for fiscal year	507,8	2,1	1.435,9	4,9

Source: Banco de la República.

**TABLE 36**  
**INCOME STATEMENT- BANCO DE LA REPÚBLICA, 1999-2001**  
 (BILLION PESOS)

	1999	2000		2001
	Flow	Outlook	Flow	Outlook
<b>I. Total Income</b>	1.219,6	1.521,7	2.090,8	1.631,7
1. Operating income	1.200,8	1.491,6	2.055,8	1.626,9
Interest and yields	878,0	1.247,0	1.733,9	1.437,4
Net international reserves	187,1	670,0	1.086,1	996,7
External credit lines	14,1	25,9	21,7	14,2
Valuation TES "A" & "B" at market prices	166,8	22,2	46,4	42,6
Valuation TES for monetary expansion transactions	189,3	262,4	311,0	279,5
Valuation capitalization bonds public banking		43,0	48,2	23,6
Transitory purchase of securities & access to				
Discount window	201,5	122,5	147,3	35,3
Other	119,2	101,0	73,2	45,5
Commissions	58,3	67,9	77,3	83,7
Banking services	50,2	57,6	65,4	72,0
Foreign currency purchase & sale	7,5	10,3	11,0	11,7
Other	0,5	0,0	0,9	
Exchange differences	164,5	128,6	170,0	62,5
Coin Issuance & precious metals	7,4	1,9	2,8	20,8
Securities redemption in advance	73,2	22,1	22,5	0,0
Other	19,4	24,1	49,3	22,5
2. Non operating income	18,8	30,1	35,0	4,8
<b>II. Total Outlays</b>	711,9	672,0	654,9	646,7
1. Operating outlays	706,8	669,4	642,2	646,1
Interest and yields	243,7	176,9	219,1	137,7
Float deposit accounts	194,9	143,9	125,5	113,1
Transitory securities sale	32,5	18,3	71,4	13,5
External credit lines and exchangeable securities	16,3	14,7	22,2	11,1
Commissions and fees	20,1	21,0	17,8	16,1
Exchange differences	97,3	70,7	77,4	33,0
International agencies	29,7	23,7	27,1	9,9
External lines	45,6	28,0	34,7	14,0
Other	22,0	19,0	15,5	9,1
Cost of issuing bills and coins	28,6	25,9	17,7	115,6
Personnel expenses	142,5	151,0	150,6	164,4
Retirement pensions	56,5	52,5	52,5	66,6
Other	118,1	171,4	107,1	112,7
2. Non operating outlays	5,1	2,5	12,7	0,6
<b>III. Fiscal year's profit or loss including depreciation</b>	507,8	849,7	1.435,9	985,0

Source: Banco de la República.

**TABLE 37**  
**DISTRIBUTED PROFIT - 2000**  
**RESERVES UTILIZATION BY BANCO DE LA REPÚBLICA**  
**(BILLION PESOS)**

<b>I. Resources to be distributed</b>	1,460,6
a. Profits - 2000	1,435,9
b. Reserve reduction for assets protection	24,7
<b>II. Allocation</b>	1,460,6
a. National Government	1,452,8
b. Net investment on goods for cultural activity	7,9

Source: Banco de la República.

### 3. Projection of Revenues and Expenditures for 2001

For the present year revenues of \$1.631,7 billion are estimated as well as disbursements for \$646,7 billion, and profits for \$985,0 billion. Interests and yields

constitute the main source of revenues with \$1.437,4 billion, corresponding to international reserves of \$996,7 billion and TES securities acquired by the Bank in its OMA \$279,5 billion. The estimated revenues for yields of international reserves do not include possible effects due to variation in interest rates and changes of currencies in the portfolio of reserves. Hence, this projection is subject to the uncertainties regarding the behavior of such variables.

In connection with disbursements, projected in \$646,7 billion, the payment of interests for \$137,7 billion stands out, which includes mainly the remuneration of reserves deposits on savings accounts and CDT; personnel expenditures, \$164,4 billion; the monetary issuing cost, \$115,6 and, other expenses, \$112,7 billion. The latter include operating costs for \$76,5 billion and depreciations for \$35,8 billion.



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