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The Balance of Payments Problems of Colombia, 1955-1957

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During 1953-56, the Republic of Colombia incurred deficits in its balance of payments and in 1955 the deficit was especially large. The deficits in 1955 and 1956 were much larger than the country was able to finance out of its international earnings from export trade and other external transactions, and they were, in effect, financed largely by forced loans from foreign suppliers and/or foreign banks. The mechanism for exacting these loans was relatively simple; the Colombian central bank merely received the applications of Colombian importers to purchase foreign exchange at the greatly overvalued official rate of 2.51 pesos to the dollar and then delayed the furnishing of the foreign exchange to the importers.

As the exchange shortage increased, importers were forced to wait increasingly long periods to obtain foreign exchange. In early 1955, when the payments backlog first began to appear, the amount of arrears or exchange "owed" to importers was estimated at approximately $65 million and importers were forced to wait several weeks to receive foreign exchange at the official rate. By the end of 1956, the arrears amounted to $370 million and the waiting time had increased to 9 months. The amount of arrears reached a total of about $445 million on June 30, 1957.

In 1957, Colombia finally took action to fund the commercial arrears and set its economic house in order. The overvalued exchange rate was abandoned and a free exchange system was established. Internal monetary and fiscal measures, discussed below, were also adopted in an effort to stem inflation and stop the deterioration of the external and internal value of the currency.

The purposes of this paper are: (1) to examine the factors which led to the balance of payments deficit and the growth in the arrears; (2) to outline the measures taken by the Colombian Government prior to June 1957 in an effort to bring the balance of payments into equilibrium and to settle the commercial arrears; and, (3) to describe the exchange reforms of June 1957 and subsequent developments to the end of the year.

The main causes of the arrears

Overvalued import rate -- Approximately 81 per cent of total commodity imports during 1955-56 were purchased at the low official rate of 2.51 pesos to the dollar. In contrast, the free rate of exchange during 1955-56 averaged 4.5 pesos to the dollar. With the free rate dropping from 4 to 6 pesos to the dollar during 1956, the official rate became increasingly overvalued. Various devices were utilized in order to contravene the measures taken to shift imports from the official to the free market. For example, when heavy road building equipment was moved to the free market, contractors persuaded the Government to import the equipment at the official rate (since many government imports received the official rate), and then to rent it to them. Many finished products, such as radios, had to be imported at the free rate, but there was significant importing of the components at the official rate, simple assembly, and subsequent sale, either domestically or abroad. This overvaluation also stimulated contraband re-exports for which payment was, of course, received through the free market.

Partly because of the overvalued import rate, average monthly commodity imports (which in Colombia are largely raw materials and capital goods) jumped from $35 million (c.i.f. value) in 1951-52 to $45 million in 1953 and $56-58 million during 1954-56. Average monthly exports during 1954 were $56 million but in 1955-56 averaged only about $49-50 million. Except for 1952, the balance of payments on current account was negative during 1950-56.

The effect of these balance of payments deficits naturally was to depress foreign exchange reserves. From a post-war high of $257 million 1/ at the end of 1954, reserves declined to $140 and $132 million at the end of 1955 and 1956, respectively. Had Colombia not received foreign credit by means of the $370 million commercial arrears at the end of 1956, such heavy importing would not have been possible, and the formal devaluation of the peso, which finally occurred in June 1957, would undoubtedly have come much earlier.

Bank credit expansion -- Another factor abetting Colombia's overspending has been the significant credit expansion in recent years, part of which has spilled over into import demand. In addition to seventeen commercial banks, credit is granted by the Caja Agraria (government agricultural bank) and three government mortgage banks. Grouping all of these institutions together, there was a credit expansion of 26, 23, and 21 per cent in 1954, 1955, and 1956, respectively. Commercial bank credit to the private sector increased 25 per cent in 1955 and 28 per cent in 1956. In addition, credit expansion was aided by Stabilization Fund use of advance import deposits to finance state and municipal capital expenditures. 2/

From December 1953 to December 1956, the money supply expanded 56 per cent. In 1954, the latest year for which national accounts data are available, the monetary expansion (19 per cent) was about four times the expansion in real national income (4.6 per cent). The cost of living index for the middle class in Bogota, which probably understates real price increases, rose 10 per cent in 1955-56 and 15 per cent during the first nine months of 1957.

Credit expansion in Colombia is facilitated by practically automatic rediscount facilities and low legal reserve requirements against deposits. For the last several years, most banks have had ample freedom to expand their volume of rediscounts. The rediscount ceilings are so high 3/ that commercial banks even as late as January 1957 had only utilized about 57 per cent of their ceilings. In addition, reserve requirements for demand deposit liabilities have remained in a range of 14-20 1/2 per cent during 1954-56, and while marginal reserve requirements of 40 or 60 per cent were instituted at various times during 1954-56, they never remained in force long enough to effect a serious tightening of credit.

1/ Excludes Colombia's $12.5 million gold tranche contribution to the International Monetary Fund.

2/ Such use is limited to the first 142 million pesos of advance import deposits with the Fund, the law requiring any amounts above the 142 million to be sterilized in the central bank.

3/ Commercial banks are allowed rediscounts equivalent to 150 per cent of the first four million pesos of their capital and reserves and 120 per cent of the balance.

Another source of inflationary pressure has been the government deficits. During 1955 and 1956, the deficits were about 180 and 200 million pesos, respectively, with total expenditures of about 1.1 billion pesos. The deficits were financed chiefly by central bank credit, gross claims on the Government increasing from 344 million pesos at the end of 1954 to 504 and 671 million pesos at the end of 1955 and 1956, respectively, almost doubling in two years. One quarter of the Government's cash deficit in 1956 was financed by direct advances from the central bank, another three-fifths by by central bank purchase of government bonds, and the remainder from a reduction in government cash balances at the central bank.

Capital flight -- Another factor that has often increased the balance of payments difficulties has been the flight of short-term capital. During 1955 and 1956, there was a net outward movement of short-term capital of $37 million and $51 million dollars, respectively. The constantly depreciating exchange rate was a strong inducement to exchange speculation and capital flight. Also, the privilege of remitting certain types of capital at the overvalued official rate stimulated outward capital movements. Some old capital was even exported at the official rate and re-imported at the free rate in order to benefit from the depreciated free peso.

Drop in the volume and price of coffee exports -- Turning next to those factors which depressed earnings, probably the most outstanding were the general decline in coffee prices which began in mid-1954 and the over-all reduction in the volume of coffee exports after 1953. The price of manizales coffee in New York averaged 80 cents a pound during 1954 and reached a high of 91.4 cents a pound in March. During 1955, 1956, and 1957, the average annual price was 64.4, 74, and 64 cents a pound, respectively. During 1957, the average monthly price fluctuated in a range of 72-56 cents per pound, with a declining trend to October, and some firming after that.

Export earnings have also been affected by a general decline in the volume of coffee exports. Exports dropped off from 6.6 million 60-kilogram sacks in 1953, to 5.8, 5.9 and 5.1 million in 1954, 1955, and 1956, respectively. During 1957, 4.8 million bags were exported.

While the value of coffee exports since 1953 has been high compared to the early post-war years, there has been a downtrend since 1954. From a post-war peak of $550 million in 1954, coffee exports fell to $486 million in 1955 and $475 in 1956. The export outlook for 1957 was not encouraging with expected coffee earnings of about $400 million.

Contraband trade in coffee -- Another factor which aggravated Colombia's payments problem was the contraband trade in coffee. Precise figures are not available, but conservative estimates put this trade at $25 million in 1955 and $35 million in 1956, or about 6 to 7 per cent of total coffee exports. The effect of this contraband on exchange earnings is, however, reflected in the figures given in the preceding paragraphs, which cover only coffee legally exported. While such exports, of course, deprived the Government of much needed foreign exchange for the official market, they did serve at the same time as one factor in slowing the depreciation of the peso in the free market.

Slow rate of growth in minor exports -- Unfortunately, at a time when coffee exports were declining, so-called minor exports failed to rise significantly, amounting to $107, $96, and $124 million in 1954, 1955, and 1956, respectively. The principal product involved is petroleum; growing local consumption, coupled with no expansion in productive capacity, served to reduce the amount available for export after 1953.

Reduced capital inflow -- Because of the large spread between the official and free rates, capital inflow through the official market fell off since more pesos could be obtained by bringing in long-term capital through the free market, even though the right to repatriate the capital later through the official market was forfeited.

Measures taken to redress the balance of payments

After this short review of the problems and their causes, it seems advisable to examine the various measures taken by the authorities to remedy the situation. On the whole, these measures were aimed either at trying to bring the balance of payments situation under control by reducing import demand, or at funding the commercial arrears which had accumulated. Most of the measures taken relate to the former aspect, and for the sake of convenience, can be grouped into three categories: (1) partial devaluation, (2) credit restrictions, and (3) direct quantitative controls.

Partial devaluation -- During 1955-56, various measures were taken which in effect constituted partial devaluation. In February 1955, the authorities divided imports into five categories and instituted stamp taxes 1/ for the different categories ranging from 3 to 100 per cent. The stamp taxes had the effect of increasing effective import rates from 2.51 pesos to the dollar to a range of 2.59 and 5.01 pesos to the dollar. Effective import and export rates were also increased at three subsequent times during 1955-56. In May 1955, the last three of the five import categories were shifted to the free exchange market and exporters of "secondary" exports (i.e. all exports other than coffee, bananas, raw hides, platinum, and petroleum) were granted the free market exchange rate. At this time a system of export vouchers or certificates for "secondary" exports established in August 1952 was abolished. 2/ In October 1955, approximately $80 million of industrial capital goods imports were shifted from the official to the free market, and in April 1956 an additional $100 million of commodity imports, primarily raw materials, were shifted to the free market.

In a counter-measure to prevent the free exchange rate from depreciating too far, the authorities decreed on September 1, 1956, a fixed buying and selling rate of 4.50 and 4.52 pesos to the dollar, respectively, for pesos traded in the free market by all banking institutions and registered dealers. Though taken in an effort to end free market speculation, it still left a legal

1/ A tax on luxury imports had been raised from 40 to 80 per cent in October of 1954.

2/ This system required exporters to surrender to the central bank exchange accruing from the export of specified minor products at the rate of 2.50 pesos to the dollar; in turn, they were granted the right to import an amount, equivalent to the value of the exchange surrendered, of specified articles included in the prohibited list, the export vouchers being negotiable.

free market for unregistered exchange dealers. After the Government had supplied a small amount of dollars (estimated at about $9 million) to the registered free market, transactions in that market ceased, and the peso depreciated in the unregistered free market to 5.16 pesos to the dollar on October 17 when the measure was rescinded and banks were once more allowed to deal freely in foreign exchange.

In December 1956, an exchange certificate market, abolished in 1951, was reintroduced so that there then existed three separate exchange rates: the official rate, the certificate (or "titulos") rate, and the free market rate. The aim of this measure was to curb the outflow of domestic capital and prevent further depreciation of the peso by increasing the supply of non-official foreign exchange. To provide a supply of foreign exchange for the new certificate market, the coffee surrender price for exporters was raised from $95 per 70 kilogram bag to $105, but with $87.50 surrenderable at the official rate of exchange and the remaining $17.50 eligible to receive the rate of exchange in the certificate market. In effect this depreciated the coffee rate to about 3.10 pesos to the dollar at the time.

Credit restrictions -- In the area of credit restrictions, advance import deposit requirements, ranging from 20 to 60 per cent of the value of imported goods, were instituted in February 1955 and these requirements were approximately doubled in April 1956. It was also decreed in April that advance import deposits placed with the Stabilization Fund in excess of 142 million pesos would be sterilized in the central bank. While the April measures also included a new marginal reserve requirement of 60 per cent against increases in commercial bank deposit liabilities after April 11, 1956, this requirement was abolished in June and at the same time basic reserve requirements against commercial bank demand and time deposit liabilities were lowered from 18 to 14 per cent and from 8 to 5 per cent, respectively. A small degree of tightening occurred in November 1956 when commercial banks were forbidden to count foreign exchange holdings as part of their legal reserve requirements against peso deposit liabilities. Attempts to tighten rediscount facilities were also feeble, a November 1956 decree reducing the maturity of commercial paper suitable for central bank rediscounting from 150 to 90 days. The volume of rediscounts, however, continued to rise. In April 1957, the central bank froze rediscounts at their March 27, 1957, level, with rediscounts above those levels permitted only on an individual basis and with industrial, livestock, and agricultural paper being given preference. In May, this April 1957 decree was revoked and a new decree was issued which reduced the profitability of rediscounting by permitting only 60 per cent, instead of 100 per cent, of the rediscount quota to be utilized at a rate two percentage points below the rate stipulated on the rediscounted paper, the remaining 40 per cent to be utilized at a rate one percentage point lower.

Direct quantitative controls -- The third major weapon utilized by Colombian authorities consisted of direct quantitative controls. On October 10, 1956, the Office of Exchange Registry was closed, except for emergency imports, and remained closed for about four months while a new list of prohibited goods was being drawn up. In November, the first really significant quantitative restrictions in six years were imposed. While the published list of prohibited items incorporated about 44 per cent of all listed import items, the coverage in terms of value was only $70 million or about 11 per cent of commodity imports, based on 1956 imports. Since the Office of Exchange Registry remained closed for about four months, however, imports were reduced noticeably and foreign exchange reserves increased.

Reviewing all of the above measures, it was clear by the spring of 1957 that the official measures taken during 1955-56 to overcome Colombia's economic difficulties were, as already indicated: (1) too weak, (2) basically unsound, or (3) rescinded in those cases where they began to prove effective. In retrospect, it can be said that the only action that really improved the situation substantially was the sharp reduction in imports achieved near the end of 1956 as a result of closing the Office of Exchange Registry. The introduction of the certificate market in December probably was also helpful. Weak measures included increases in stamp taxes and the shifting of some import goods to the free market. Table 1 below indicates that these latter measures failed to reduce imports significantly, though the effect of closing the Office of Exchange Registry on October 10, 1956, is readily evident, and there was some reduction of imports in June-October of 1955 as a result of earlier measures. By the end of 1955, monthly imports had returned to the unusually high levels achieved in the last seven months of 1954.

Table 1

Colombia's Monthly Imports

(In millions of U. S. dollars, c.i.f. value)

Month	1953	1954	1955	1956	1957
January	39	43	61	61	39
February	32	48	52	56	27
March	38	47	67	56	26
April	37	39	56	61	33
May	39	59	64	60	32
June	42	53	51	62	31
July	47	65	49	66	40
August	40	57	47	62	45
September	42	59	51	51	54
October	39	60	51	49	
November	40	59	58	49	
December	42	58	60	33	

Source: International Financial Statistics, International Monetary Fund.

One basically unsound measure was the pegging of the "free" market rate at 4.50 pesos to the dollar, a step which clearly failed to achieve its stated purpose. A stronger move, which was rescinded too soon, was the imposition of a marginal reserve requirement in April of 1956. Pressures led not only to its removal in June, but also to a reduction in basic reserve requirements for both demand and time deposits. It would appear that there was a lack of determination on the part of the authorities to continue using strong monetary measures.

As the economic situation continued to worsen during 1955-56, there was a "flight into imports" as importers increased inventories in anticipation of a devaluation of the peso. With the spread between the official and free rate increasing, the exchange shortage problem was self-aggravated in that there was an increased demand for, and reduced supply of, exchange in the official market. In short, the basic problem remained unsolved because the majority of imports could still be brought in at an overvalued rate of exchange and because there was liberal bank credit to finance import operations.

Measures taken to settle the commercial arrears

Two attempts have been made to settle the commercial arrears, the second of which is still in progress. The first plan was inaugurated in the middle of 1956.

On June 22, 1956, the authorities announced a plan to solve the commercial arrears problem. Very briefly, importers who desired to pay debts accrued up to June 30, 1956, and who submitted applications under the proposed plan would receive U. S. dollars at the official rate of 2.51 pesos to the dollar for an amount equal to half the debt to be paid, provided they first purchased an equal number of dollars on the free market. Since the free rate was then about 4.80 pesos to the dollar, the importer's effective rate was 3.65 pesos to the dollar. Importers not choosing the plan faced a wait of about six months for their foreign exchange at the official rate.

Some importers did elect to settle their debts under the 50-50 plan, perhaps largely in order to retain the good will of their foreign suppliers. But most did not, feeling there was more to be gained in the long run by waiting, especially with the free peso depreciating. The net result of the 50-50 plan was to create two separate backlogs instead of one, and the plan was found so unacceptable to the public that it was rescinded four months later by the new Finance Minister who took office in October.

In the middle of January 1957, a new plan for the settlement of the commercial arrears was announced, and most of the important creditors ultimately agreed to the scheme. Under this plan, the arrears are being paid 60 per cent in cash and 40 per cent in 30-month 4 per cent bearer bonds. About $60 million of the arrears had already been paid by the individual importers by buying exchange in the free market, with the expectation of recouping the loss involved by selling the official exchange, when received, in the free market. Importers who had made such payments were offered the option of accepting reimbursement: (a) in pesos at a rate of 4.95 to the dollar, or (b) in exchange certificates for 25 per cent of the debt, and 4 per cent dollar bonds payable over a period of 30 months for the remaining 75 per cent.

From the exchange resources saved during the last four months of 1956, the Colombian Government was able to deposit $67.6 million in New York as its part of the 60 per cent cash requirement. Final agreement from all parties, including the United States Securities and Exchange Commission with which the bonds had to be registered, took many months, but during the first half of April the first payments under the settlement plan were made. Though unique, the plan at least appears to have been successful in funding the commercial arrears, although only with the help of supplementary financing from the Export-Import Bank and other sources provided in July. One aspect of the plan is that credit has been tightened somewhat by the "call-in" of the peso deposits required from the importers at the time of settlement.

The June reforms and subsequent developments

In June/ 1957, the Colombian authorities launched an extensive program of economic reform, with the following major provisions: (1) the official exchange rate of 2.50 pesos to the dollar was abolished and a new free certificate market was inaugurated for all trade items and some invisibles; (2) a 15 per cent dollar export tax was imposed on all exports, proceeds being earmarked to service the commercial arrears debt; (3) imports were subjected to a 10 per cent tax and were divided into three categories: freely permitted, prohibited, and those subject to license; (4) a one-time surtax of 20 per cent was levied on income, patrimony, or excess profits taxes paid in 1956 with an exemption for the first 5,000 pesos paid; and (5) commercial bank reserve requirements of 80 per cent were instituted against increases in commercial bank deposit liabilities after either the level reached on June 18, 1957, or the average of the previous 30 days, at the choice of the bank.

While it is still too early to determine whether the June reforms will be successful, recent developments leave room for a guarded optimism. On the favorable side, settlement of the over-all arrears has been proceeding well. In mid-December, the Government announced that arrangements for settlement of all outstanding commercial backlog accounts had been concluded. All European creditors, except Switzerland, have indicated their willingness to settle on the basis of Colombia's 20 per cent cash/80 per cent notes or coffee, offer, and it is likely a settlement will be reached soon for the estimated $1 million of open-account items due Swiss creditors.

Credit has been tightened considerably and the money supply declined 2.6 per cent from the end of July to the end of November. These developments have been reflected in a slower rise in the cost of living, prices having increased 3.2 per cent from July to November compared to 6.6 per cent from May to July.

Also encouraging has been the decrease in the volume of import authorizations. For October, November and December, $24.5, $29.0, and $26.2 million was authorized, respectively, considerably below the amounts of $49.1, $41.4, and $44.0 million authorized in July, August, and September. Presumably the lower volume of these authorizations has been brought about, not only by the increased cost of imports, but also by the Government's tight money policy which, among other measures, included an increase in advance import deposit requirements on September 25 from 20 to 100 per cent of the stated import value. Early reports indicate that for the first eleven and a hlaf months of 1957, exports totaled about $450 million and imports $400 million, leaving a surplus of $50 million.

Since the introduction of the new exchange system in mid-June of 1957, both the certificate and free rates have depreciated, but by late 1957 the rate in the free market had more or less stabilized. The rate in the certificate market was held at 4.80 pesos to the dollar in July and August by official intervention but was allowed to depreciate to 5.11 in September and October. In November and December, the rate moved to 5.22 and 5.42 respectively, apparently free from central bank intervention. The free (draft) market rate since July has fluctuated between 5.70 and 6.95, but in November and December stabilized at about 6.20. Pressure on the free rate was eased after October 23 when the Government's official surrender requirements on coffee exchange were altered. 1/

On the unfavorable side, the 1957 budget is expected to show a 200 million peso deficit, or 15 per cent of estimated total expenditures of 1,306 million. Though not yet officially published, the Government has announced budget expenditures of 1,463 million pesos for 1958. While much of the inflationary impact of the 1957 deficit has already occurred, prospects for avoiding deficit spending in 1958 do not appear good as Colombian authorities have shown little determination to achieve a balanced budget. 2/

Another unfavorable aspect is the prospect of additional inflationary pressures from the coffee valorization scheme agreed upon in Mexico City on October 18, 1957. Under this agreement Colombia is committed to exporting during the period from November 1, 1957 to March 31, 1958, only 80 per cent of the average quantities shipped during the same period in the previous two years. This amounts to 2,302,000 bags of coffee of 60 kilograms each. While it is very difficult to estimate accurately the amount of "additional" financing necessary to further the valorization plan, it can be roughly estimated that for the crop year ending September 30, 1958, about 400 million pesos of financing might be necessary.3/

Conclusion

While Colombia has made a good start on paying off the commercial arrears, there still remains a heavy debt burden in the coming two years. It is estimated that payments to U. S. firms, the Export-Import Bank and the International Monetary Fund will total about $111 million in 1958 and $120 in 1959. The peak of the payments will fall due during the first half of 1959 when $70 million will have to paid. Colombia will have to use approximately one-fourth of its foreign exchange earnings in order to meet these payments during 1958-59.

1/ Formerly coffee exporters were required to surrender $100 in foreign exchange for each 70 kilogram bag of coffee exported. But with coffee prices declining, exporters were forced to purchase dollars in the free market equivalent to the difference between their proceeds and $100. The October 23 regulation merely permits the exporter to pay 1 peso (the approximate difference between the official and free rates) for each dollar of difference between the actual sales price and $100, and only the dollars actually received have to be surrendered.

2/ This policy may possibly be altered by new finance minister, Dr. Jesús María Marulanda, who succeeded Alvarez Restrepo on December 18, 1957.

3/ In terms of 60 kilogram sacks, this assumes 1,600,000 bags on hand on September 30, 1957, and production of 6,700,000 bags during crop-year 1958. With domestic consumption of 800,000, clandestine exports of 250,000, and legal exports of 4,160,000 (i.e., 80 per cent of average exports for the past two crop years), an overall excess of 3,090,000 results. Assuming "regular" ending stocks of 1,600,000 on September 30, 1958, the difference of 1,490,000 amounts to 403 million pesos based on the Coffee Federation price of 564 pesos per 125 kilogram load.

Many factors, including a further decline in coffee prices, could cause the exchange position to deteriorate seriously, and government officials are already talking of funding the commercial arrears debt over a longer period. But if coffee earnings hold up well, and the imports are held below $30 million a month, the prospects are that Colombia will be able to pay off all of the arrears by 1959. Because of Colombia's heavy dependence on coffee and the market uncertainties for that product, the future is, to say the least, uncertain. However, progress has been made and if appropriate fiscal, monetary and exchange policies are maintained, Colombia should succeed in balancing its external transactions at an acceptable level.