

Colombia—Technical Memorandum of Understanding

1. This memorandum sets out the definition of concepts, specific performance criteria for March 31 and June 30, 2002, and the structural benchmarks for the remaining period of the program, as well as the assumptions that apply under the program supported by the extended arrangement.

I. Fiscal Targets

A. Performance Criterion on the Overall Deficit of the Combined Public Sector¹

	Ceiling ² (In billions of Colombian pesos)
Overall deficit of the combined public sector from January 1, 2001 to December 31, 2001 (indicative)	6,550
Overall deficit of the combined public sector from January 1, 2002 to:	
March 31, 2002 (performance criterion)	950
June 30, 2002 (performance criterion)	2,100
September 30, 2002 (indicative) ³	2,700

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

²Maximum cumulative deficit of the combined public sector. The ceilings for the quarters in 2002 are based on an annual deficit of Col\$5,356 billion.

³To be specified as performance criterion at the time of the program review scheduled for September 15, 2002.

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

The Combined Public Sector

$PS = NFPS^1 + FOGAFIN + \text{quasi-fiscal BR} + \text{net fiscal costs borne by the NFPS related to}$

bank restructuring

NFPS = general government (GG) + public enterprises (PE)

GG = central government (CG) + territorial governments (TG) + social security

CG = central administration + national decentralized agencies

TG = territorial government + territorial decentralized agencies

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

3. For any given calendar quarter, the overall **PS balance** is measured, in Colombian pesos, as the sum of: (i) its net domestic financing; (ii) its net external financing; and (iii) privatization proceeds, as defined below. Items denominated in foreign currency will be converted into Colombian pesos at the actual exchange rate of each transaction.

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

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

6. The **PS net external financing** is defined as the sum of (i) disbursements of project and nonproject loans, including securitization (titularización) of export receipts; (ii) proceeds from bond issues abroad; (iii) the net changes in short-term external debt including pre-payment of exports; and (iv) any change in arrears on external interest payments; minus (v) net increase in the financial assets held abroad by the PS; (vi) cash payments of principal on current maturities for bonds and loans; (vii) cash payment to settle any external arrears; (viii) any prepayment of external debt; and (ix) the value of any new leasing contracts entered into by the public sector during the program period, which is defined as the present value at the commercial interest reference rate (CIRR) (at the inception of the lease) of all lease payments expected to be made during the period of the lease contract excluding those that cover the operation, repair, or maintenance of the property. The local currency amounts of the net external financing transactions are calculated at the actual exchange rate of each transaction.

7. **Privatization** proceeds are defined as the cash payments received by the PS, converted to Colombian pesos at the actual market exchange rate of each transaction. Nonrecurrent fees (e.g.,

prepayments) received by the PS for concessions to operate public services, such as in the telecommunications sector, are treated as privatization proceeds. For purposes of the program, such fees will be accounted for over the concession period, distributed in equal quarterly amounts. Proceeds from the decapitalization of public enterprises will be considered as privatization. To the extent the purchasers of public enterprises assume their debts, the net financing used by these enterprises during the program period until their sale will be deducted from the net financing of the PS; if the PS assumes the debt, the net financing used by the enterprise during the program period before the sale will remain outstanding as part of the financing of the PS.

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

9. Adjustment

(i) The quarterly ceilings on the combined public sector deficit will be adjusted upward (larger deficit), and the ceiling on net disbursements of medium- and long-term external debt of the public sector (see below) will be adjusted upward by the full amount of any concessional loan disbursements in support of the "Plan Colombia." A loan will be considered concessional if it has at least a 35 percent grant element at the time of loan approval using the commercial interest reference rate (CIRR) as discount rate (Fund staff will provide data for the CIRR if required).

(ii) The cumulative quarterly ceilings on the combined public sector deficit will be adjusted downward by 130 percent of the revenue of the petroleum stabilization fund (FAEP), as currently defined in the law, in excess of the baseline set out in the attached Table.

II. Monetary Targets

10. Reflecting the BR's inflation targeting approach to monetary policy, quarterly targets for 2002 have been established for the 12-month rate of consumer price inflation, measured by the Índice de precios al consumidor (IPC) compiled by the Departamento Administrativo Nacional de Estadísticas (DANE). The authorities will complete consultations with the Fund (Executive Board) on the proposed policy response before requesting purchases from the Fund in the exceptional event that the observed quarterly inflation were to deviate by 2 percentage points or more from the quarterly baseline set out in the table below.¹ In the event that the actual inflation deviates significantly from the programmed target (within the 2 percentage point margin) in any calendar quarter, the BR staff will report to the IMF staff on the reasons for the deviation and the policy response adopted, if any.

Actual	Indicative	Projected ¹		
		Mar. 31	June 30	Sept. 30
September 2001	Dec. 31 2001	Mar. 31 2002	June 30 2002	Sept. 30 2002

Inflation target	8.0	8.0	7.8	7.2	6.7
¹ The projected path for inflation is based on the central bank's annual inflation target of 6 percent for December 2002.					

III. External Targets

A. Performance Criterion on NIR of the BR

Target¹
(In millions of U.S. dollars)

Outstanding stock as of:

September 30, 2001 (actual)	9,388
December 31, 2001 (indicative)	9,500
March 31, 2002 (performance criterion)	9,580
June 30, 2002 (performance criterion)	9,660
September 30, 2002 (indicative) ²	9,740

¹Minimum quarterly levels of NIR of the BR based on a projected annual accumulation for 2002 of US\$323 million. NIR is defined in Paragraph 10.

²Performance criterion to be specified at the time of the program review scheduled for September 15, 2002.

11. The **NIR** of the BR (reservas de caja) are equal to the balance of payments concept of net international reserves excluding accrued, but unpaid, interest on reserve assets and liabilities (causaciones); and are the U.S. dollar value of gross foreign reserves of the BR minus gross reserve liabilities. The net reserves are accounted for at the U.S. dollar value at the time of acquisition.

12. **Gross foreign reserves** of the BR comprise (i) gold; (ii) holdings of SDRs; (iii) the reserve positions in the FLAR and the Fund; and (iv) all foreign currency-denominated claims of the BR. Gross foreign reserves exclude capital participation in international financial institutions (including Corporación Andina de Fomento (CAF), IDB, IBRD, IDA, and the Caribbean Development Bank), the holdings of nonconvertible currencies, and holdings of precious metals other than gold. The pesos andinos are considered to be part of Colombia's gross foreign reserves. **Gross reserve liabilities** of the BR are defined as the sum of (i) all foreign currency-denominated liabilities of the BR with an original maturity of one year or less; (ii) liabilities to the Fund, (iii) any net position on foreign exchange derivatives, including forward (futures) contracts, with both residents and nonresidents undertaken directly by the BR or by other financial institutions on behalf of the BR; (iv) any purchases from the Latin American Reserve Fund (FLAR); (v) any increase in medium- and long-term external debt of the BR over and above US\$ 88.8 million, which is the level of the outstanding debt on August 31, 2001; and (vi) any foreign currency deposits in the BR by residents, including financial institutions. Options to sell foreign exchange to the central bank will be added to reserve assets in the net international reserves when they are exercised. The face value of outstanding options to buy foreign exchange from the central bank will be treated as a reserve liability and thus subtracted from the net international reserves.

13. Adjustment

(i) The quarterly NIR targets may be adjusted downward by up to US\$1.5 billion (about US\$650 million above the cumulative overperformance to September 2001 relative to the NIR targets since December 1999), as necessary, to help secure orderly foreign currency market conditions consistent with transparent rules of the central bank's foreign exchange interventions within its inflation targeting monetary framework.

B. Performance Criterion on the Net Disbursement of Medium- and Long-Term External Debt of the Public Sector^{1 2}

	Ceiling (In millions of U.S. dollars)
Cumulative net disbursement of external debt by the public sector from January 1, 2001 to December 31, 2001 (indicative)	2,680 ³
Cumulative net disbursement of external debt by the public sector from January 1, 2002 to:	
March 31, 2002 (performance criterion)	1,100
June 30, 2002 (performance criterion)	1,800
September 30, 2002 (indicative target) ⁴	2,400

¹The public sector includes the PS as defined above and the financial public sector, including second-tier banks. In calculating compliance with the ceiling, the use/accumulation of the public sector's assets held abroad will raise/lower net disbursements. The quarterly targets for 2002 are based on a total net disbursement of medium- and long-term external debt (including the use of public sector external assets) of US\$ 2,573 million during that year.

²Debt is defined in point 9 of the Guidelines on Performance Criteria with respect to foreign debt (Executive Board Decision No. 12274-00/85, August 24, 2000).

³It is expected that the first tranches of the fast-disbursing loans to be considered by the Board of the World Bank and the Inter-American Development Bank in late December 2001 (US\$200 million and US\$173 million, respectively) will be disbursed in early 2002. For purposes of the program, these loans will be accounted for in 2001.

⁴Performance criterion to be specified at the time of the program review scheduled for September 15, 2002

14. This ceiling applies to the net disbursement (gross disbursement minus amortization/redemptions) of debt of the public sector (financial and nonfinancial) of nonconcessional external debt of maturity of over one year. The changes in the external debt will be valued in U.S. dollars at the exchange rate prevailing at the time of each transaction.

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

C. Performance Criterion on Change in the Outstanding Stock of Short-Term External Debt of the Public Sector¹

Ceiling
(In millions of U.S. dollars)

Cumulative net disbursement of short-term external debt
of the public sector from January 1, 2001 to:

September 30, 2001 (actual)	80
December 31, 2001 (indicative)	180
March 31, 2002 (performance criterion)	180
June 30, 2001 (performance criterion)	180
September 30, 2002 (indicative) ²	80

¹Short-term debt defined as all debt with an original maturity of one year or less, excluding normal trade financing. Public sector includes the PS as defined above and the financial public sector except transactions that affect the reserve liabilities of the BR.

²Performance criterion to be specified at the time of the program review scheduled for September 15, 2002

IV. Structural Performance Criterion

16. The government will make public reform plans for the special pension regimes (exceptuados, not under collective bargaining agreements) that will reduce the actuarial deficit of these regimes taken as a whole in a proportion similar to that proposed by the government for the general regime, and raise additional cash savings.

V. Structural Benchmarks

17. To be completed by December 31, 2001:

- Present to congress a proposal for a second generation pension reform (modifying Law 100 of 1993).
- Final decision on the remaining elements in the plan to reduce the deficit of the ISS health system.
- Bring to the point of sale at least one public bank through a finding and a decision by the council of ministers that the bank is free of encumbrances and is ready to be offered for sale.

18. To be completed by June 30, 2002:

- Introduce reform of special pension regimes referred to above and consistent with the above requirements, if required by presenting legislation to congress.

- Invite bids for the sale of at least one public bank.
- Submit all legal issues to permit decisions by courts or tribunals with a view to liquidating or divesting all remaining public banks except Banco Agrario; and bring those that are to be divested to the point of sale.
- Introduce a draft fiscal responsibility law in congress.

19. **To be completed by Program Review Scheduled for September 15, 2002:**

- Final report of the Public Revenue commission to be made public.
- Complete the process of bringing provisioning standards of the financial institutions to international levels.
- Latest date for accepting the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement.

Table. Colombia: Baseline Assumptions for Oil Stabilization Fund Revenue (FAEP)

	Dec. 2001 ¹	Proj. 2002 ²		
		Mar.	Jun.	Sep.
(In millions of U.S. dollars)				
Revenue of FAEP	287	50	50	50

¹Cumulative since January 1, 2001.

² Cumulative since January 1, 2002.

¹The BR also will provide Fund staff with monthly information and analysis of inflationary developments and forecasts, as agreed, and keep the staff informed of all policy actions taken to achieve the inflation objectives of the program.