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Chapter 7

The 1965–66 Liberalization Episode

In this chapter an examination will be made in some detail of the Colombian attempt during 1965–66 to eliminate administrative controls over imports and other transactions that entail purchases of foreign exchange. In earlier chapters I have already touched upon not only the Phase III episode itself but also its background and its aftermath. Here I will highlight aspects of that experience which have not been discussed earlier or which are particularly important to an understanding of the reasons why, shortly after imports had been almost fully liberalized, in October 1966, a return was announced, late the next month, to the drastic import and exchange controls characteristic of Phase II.

In previous chapters some key relationships in the Colombian economy were quantified that provide a useful framework for analyzing particular cyclical situations. However, nothing has been done so far to quantify the dynamics of Colombian inflation, a quantification which is also part of the necessary framework for short-run analysis. This will be my first task in this chapter. I will then proceed to discuss the relevant background to the 1965–66 liberalization episode, the episode itself, and its sweet-sour aftermath.

THE DYNAMICS OF INFLATION

As in almost all countries, developed and developing, Colombian balance-of-payments policies have interacted with those in the monetary and fiscal fields, which are aimed at obtaining steady growth near "full capacity" and without undue inflation. Programs for reducing the rate of inflation have been typically accompanied in Colombia by policies to strengthen the balance of payments and improve economic efficiency by reduced reliance on administrative controls over imports or foreign-exchange transactions. Desirable policies, particularly regarding greater exchange-rate flexibility, have frequently been avoided or attacked on grounds of their alleged inflationary impact. It is therefore important to obtain some idea about the major factors influencing Colombian inflation, and about whether inflation during key cycles was more or less "normal" in the sense of following patterns established for the whole period.

The approach pioneered by Arnold C. Harberger in the study of inflation dynamics[1] will be useful here. That approach uses multiple regression analysis to explain percentage rates of change of different measures of the price level as a function of rates of change in several other variables assumed to be independent. The latter typically include measures of the money supply or total banking credit, wages, the exchange rate, and real supplies. Alberto R. Musalem has applied this technique for the Colombian case, with interesting results.[2] What follows builds on his work, although modifying it to better suit the purposes of this chapter and covering a different period.

This methodology has some weaknesses, mainly related to its reliance on a single equation which assumes one-way causation from the independent variables onto the dependent variable, the inflation rate. There have been circumstances in Colombia (as elsewhere) when monetary expansion could have been said to accommodate rather than cause price increases, which may have originated in sectoral maladjustments or in the foreign sector. Under those conditions a failure to accommodate price increases would have led to declines in output rather than to a severe reduction of inflation. But the construction of a simultaneous monetary model for Colombia is beyond the scope of this work, and the results of the single-equation regressions may be taken as little more than a descriptive summary of past links among the included variables, leaving the question of causation undecided. The best results obtained after considerable, but far from exhaustive, experimentation are presented in Table 7-1. The basic data, sources, and elaborations are given in the appendix to this chapter.

Note first that the dependent variables are quarterly percentage changes; the money, wage, and supplies variables represent yearly changes; and the import exchange rate represents a quarterly change also. The lagged money and supplies variables represent nonoverlapping yearly changes, and the lagged exchange-rate variable represents a quarterly change. In other words, to explain, say, the change in the cost-of-living index between the first quarter of 1958 and the last quarter of 1957, the relevant regression uses both the changes in money plus quasi money between the first quarter of 1958 and the

TABLE 7-1

Regressions for Quarterly Percentage Increases in Colombian Price Levels, 1958–69
(*t* statistics in parentheses)

	Cost-of-Living Index	Wholesale Price Index	Wholesale Price Index Excluding Foodstuffs
Constant	−2.87	−2.20	−0.78
	(1.81)	(2.01)	(0.83)
Money plus quasi money (yearly change)	0.08	0.08	0.01
	(1.22)	(1.75)	(0.15)
Lagged money plus quasi money	0.02	0.05	0.10
	(0.37)	(1.03)	(2.59)
Average import exchange rate (quarterly change)	0.08	0.08	0.11
	(1.52)	(2.24)	(3.32)
Lagged average import exchange rate	0.13	0.13	0.12
	(2.45)	(3.50)	(3.96)
Wage rates (yearly change)	0.19	0.12	0.05
	(4.60)	(4.16)	(2.20)
Real supplies (yearly change)	−0.03	−0.04	−0.06
	(0.87)	(1.89)	(2.92)
Lagged real supplies	0.01	−0.01	−0.03
	(0.44)	(0.67)	(1.61)
First-quarter dummy	1.41	0.52	0.61
	(1.48)	(0.79)	(1.09)
Second-quarter dummy	3.43	2.18	0.71
	(3.66)	(3.38)	(1.28)
Third-quarter dummy	−3.02	−0.72	0.65
	(3.14)	(1.08)	(1.15)
R^2	0.75	0.72	0.71
DW statistic	1.97	1.42	1.71
F statistic	10.98	9.71	9.12

SOURCE: See appendix to this chapter.

first quarter of 1957 and the change in the same variable between the first quarter of 1957 and the first quarter of 1956. It also uses both the change in the import exchange rate between the first quarter of 1958 and the last quarter of 1957 and the change for that variable between the last and the third quarter of 1957. It is not surprising that the different independent variables show varying lag structures; further experimentation would probably yield even greater differentiation.

The variables are mostly self-explanatory. Money plus quasi money worked better than just money or total credit. The wage rates refer to average hourly money wage rates in manufacturing. The real supplies variable is somewhat unusual, as it includes only merchandise imports plus agricultural and livestock output excluding coffee. The combination of these two strategic supply sources performed better in the regressions than others relying on more aggregated variables, such as the gross domestic product.

The fits are sufficiently good for our purposes, even though the regressions do not attempt to take into account expectation variables. Trends in the *world* price level are also ignored, with some justification for the period analyzed. As in the Musalem results, the story told does not support either extreme "monetarist"[3] or extreme "structuralist" explanations of the Colombian inflation. The regressions also show that changes in the import exchange rate do significantly influence changes in the price level. That influence is also quick (yearly changes for the exchange rate performed much worse than the quarterly ones) and quantitatively important. A 10 per cent devaluation would be expected to increase prices by about 2 per cent, ceteris paribus, according to these equations. It is noteworthy that when the 1956–58 period is included in the regressions, the importance of the exchange-rate variable declines. For reasons that are not completely clear,[4] the very large devaluations of those years affected the price level less than devaluations of later years. At any rate, even the 1958–69 results show that the extreme claims often heard in Colombia, which imply a value of 1.0 for the sum of the exchange-rate coefficients, are exaggerated. The combination of short lags for the price effects of devaluations, somewhat longer ones for wage-rate changes, and much longer (and less clear) ones for money, in turn influenced by fiscal and monetary policies, suggests an explanation for the popular but exaggerated identification of devaluations with inflation.

A clearer idea of the results presented in Table 7-1 may be obtained by asking what would be the net impact on the price level of a 10 per cent devaluation *and* a policy of liberalization that resulted in a permanent rise in imports also of 10 per cent, ceteris paribus. In the accompanying tabulation of the time profile of price changes (in percentages), each of the coefficients in Table 7-1 is taken at its face value; it is assumed (realistically) that imports make up 40 per cent of the real supplies variable; and devaluation and liberalization are started at an arbitrary quarter I.

Quarter	*Cost-of-Living Index*	*Wholesale Price Index*	*Wholesale Price Index, Excl. Foodstuffs*
I	0.68	0.64	0.86
II	1.18	1.14	0.96
III	−0.12	−0.16	−0.24
IV	−0.12	−0.16	−0.24
V	0.04	−0.04	−0.12
VI	0.04	−0.04	−0.12
VII	0.04	−0.04	−0.12
VIII	0.04	−0.04	−0.12
IX	0	0	0

If each of the price indices shown stood at 100 before devaluation plus liberalization, by the time the lagged effects had worked through the system (the ninth quarter), they would stand at 101.8, 101.3, and 100.9. Thus, the assumed import liberalization would not be sufficient to offset the price increases generated by the exchange-rate changes. According to the regression for the wholesale price index excluding foodstuffs, in which supplies have the most potent deflationary effect, it would take a sustained increase in imports of about 16 per cent to offset the inflationary impact of a 10 per cent devaluation by the ninth quarter. Even in this case the time profile, with early price increases and later declines, may mislead some into regarding the whole package as inflationary.

THE 1962 DEVALUATION: REVIEW OF SOME BACKGROUND

It will be recalled that the severe balance-of-payments crisis faced by Colombia after the collapse of the coffee boom of 1954–56 was handled by a combination of a sharp devaluation, tightened import controls, and implementation of austere fiscal and monetary policies. Between the first quarter of 1957 and the first quarter of 1959, the average import exchange rate rose by a remarkable 175 per cent, while money plus quasi money rose by a modest 23 per cent. Money wage rates, in turn, rose by 29 per cent. Thanks to the spartan fiscal, monetary, and wage policies, price increases were kept far below exchange-rate variations, yielding a substantial change in relative prices. The percentage increases in prices from the first quarter of 1957 to the first quarter of 1959 were as follows: cost of living, +32.4; wholesale price index, +31.9; and wholesale price index, excluding foodstuffs, +36.3.

It is worth remembering that while Colombia's stabilization effort was regarded sympathetically by foreign creditors, in those years there were no foreign credit facilities as flexible as the "program loans" available after 1961, nor access to Eurocredits as during the early 1970s. A good deal of civic enthusiasm, which now (middle 1970s) looks almost naive, more than made up for the scarcity of foreign assistance. The debt problem at that time involved primarily short-term suppliers' credits, which could be expected to be cleared up by a vigorous once-and-for-all effort. For the period 1957–60, changes in Colombian gross foreign-exchange reserves very closely followed movements in the balance of the merchandise trade account, which after a deficit of U.S. $106 million in 1956, yielded an accumulated surplus of U.S. $147 million during the three years 1957–59, in spite of the fall in coffee prices.

By 1959 there was an eagerness to resume a faster pace of growth; real GDP during 1958 was less than 5 per cent above that reached in 1956, indicating a fall in per capita product. Merchandise imports during 1958 were nearly 40 per cent below the 1956 levels. Inevitably, development-minded Colombians pressed for more expansive public policies. The new chapter (volume?) in inter-American relations that started with the triumph of the Cuban revolution had just been opened, and there were high hopes in Colombia for a large amount of aid from the United States.

It has been noted that, in spite of the substantial increase in the real import exchange rate between 1956 and 1959, administrative controls over imports were strengthened. In January 1959, in fact, a new law institutionalized the revised controls. In May 1959 a new customs tariff was also put into effect, intended to capture for the public treasury some of the premiums accruing to receivers of import licenses. The new tariff also included protectionist features. During 1957 and most of 1958 an essentially flexible exchange-rate policy was followed. However, after about August 1958, the certificate import rate was kept at 6.4 pesos per dollar, while the "free" rate fluctuated slightly around 8 pesos, as many influential voices called for "consolidating" monetary stability by adopting less flexible exchange rates. Indeed, as a result of changes in the average mix of certificate and free rates charged to importers, the average de facto import exchange rate *appreciated* by almost 8 per cent in the first quarter of 1959 compared with the second quarter of 1958.

By the end of 1959 this premature consolidation and appreciation of the average nominal import exchange rate had carried it to the level of the pegged certificate rate, 6.4 pesos. The expansionary fiscal and monetary policies were thus launched just as the import rate was being pegged.

Much to his credit the then Minister of the Treasury, Hernando Agudelo Villa, quickly saw the dangers of that combination, and during March 1960 he and his colleagues began experimenting with what later was to be called a "crawling peg," moving the certificate rate by less than 5 per cent to 6.7 pesos. Unfortunately, this wise policy was met by heavy opposition, particularly from the then Senator Carlos Lleras Restrepo, who, ironically, was to institutionalize the "crawling peg," under his presidency during 1967. He was already regarded as the Liberal politician most knowledgeable in economics, and had been the main author of Law 1 of 1959, institutionalizing the new import and exchange-control system. In a remarkable and friendly debate, on April 4, 1960, Lleras Restrepo and Agudelo Villa discussed this and other aspects of the government's economic policies.[5]

Lleras Restrepo challenged the notion that large imports during the first quarter of 1960 indicated the need for further devaluations. He warned against unifying the certificate and "free" rates by raising the certificate rate to the level of the latter (which was then only about 6.9 pesos), and said such action would be "incomprehensible." Hardly mentioning minor exports, he expressed the fear that the new policy would lead to gradual devaluations which would grow ". . . as the poet Jorge Rojas says, more or less insensibly, like the roses."

The reply by Agudelo Villa reads on the whole quite well, particularly in light of what came later. But politically the debate was finished after the Lleras blast. The certificate rate was to remain at 6.7 pesos until November 1962, when after much fruitless and wasteful resistance it was raised by more than 34 per cent to a new pegged level of 9 pesos. Proposals for greater flexibility were again rejected.

THE IMPACT OF THE 1962 DEVALUATION

The failure of the policies adopted in November 1962, early in the presidency of León Valencia, to achieve their objectives can be easily summarized by the following indicators, showing percentage increases between the third quarter of 1962 and the third quarter of 1963:

Cost of living	35.4
Wholesale price index	29.9
Wholesale price index, excluding foodstuffs	27.0
Average nominal import exchange rate	34.3
Money plus quasi money	21.0
Hourly wage rates	40.6

The price level increased roughly in the same proportion as the nominal devaluation, in sharp contrast to the 1957–59 experience. Based on this unfortunate incident many in Colombia reached the conclusion that devaluation "could not work." It may be worthwhile to look with greater detail at this inflationary episode, using the regressions developed in Table 7-1.

Table 7-2 contains actual and predicted quarterly price changes from 1960 through 1964; the predictions are from the regressions in Table 7-1. It may be seen, first of all, that the period from 1960 through 1962 was one of relative price stability, in spite of the more expansionary policies adopted since 1959. Real GDP rose by 4.3, 5.1, and 5.4 per cent in 1960, 1961, and 1962, respectively. Note, however, that by 1962 all three regressions were forecasting higher-than-realized rates of inflation; that was the year when attempts to maintain the 6.7 pesos rate became most intense.

When devaluation came in November 1962, the inflationary burst, following an apparently mild price response in December 1962, was concentrated in the first half of 1963, after which the rate of price increase declined sharply. Note that most, but not all, of that price explosion is predicted by our "normal" regressions. For the whole of 1963 the regressions still slightly underestimate the actual increase in the price level.

A rough indication of the explained and unexplained sources of the inflationary burst of the first half of 1963 is given by Table 7-3, in which predicted price increases are decomposed according to the current and lagged values of the independent variables. The three equations yield similar predictions of the amount of absolute inflation to be expected from the change in the nominal import exchange rate, all falling within a range of inflation of 6.1 to 6.5 per cent (the higher *share* in Table 7-3 for the inflationary contribution of the exchange rate to the increase in wholesale prices excluding foodstuffs is partly compensated by the lower inflation rate shown by that index). Clearly, other factors aggravated the inflationary pressure, although for wages and monetary expansions (particularly the former) the different regressions yield different quantitative estimates.

During both 1961 and 1962 government expenditures rose relative to GNP; the sum of all current expenditures of the general government plus public fixed capital formation rose from 10.4 per cent of GNP during 1960 to 11.7 per cent in 1961 and to 12.3 per cent during 1962. Current revenues of the national government, which in 1960 were 95 per cent of expenditures, fell to 77 per cent of expenditures in 1961 and to 72 per cent in 1962. Net banking credit to the government, which at the end of 1960 represented 20 per cent of all credit, accounted for 33 per cent of the *increase* in all such credit between the end of 1960 and the end of 1962. The deficit financed by net banking credit amounted to 0.7 per cent of GNP in 1961 and 2.2 per cent in 1962.[6] In the

TABLE 7-2

Actual (A) and Predicted (P) Quarterly Changes in Colombian Price Level, 1960–64
(per cent; averages for whole year in parentheses)

	Cost-of-Living Index		Wholesale Price Index		Wholesale Price Index Excluding Foodstuffs	
	A	P	A	P	A	P
1960 I	1.99	1.42	0	0.59	0.33	1.10
II	2.71	3.45	2.59	2.12	1.33	1.59
III	−0.88	−0.47	0.19	0.76	0.89	1.92
IV	1.77	1.62	1.45	0.80	0.83	0.59
(1960)	(1.40)	(1.51)	(1.06)	(1.07)	(0.85)	(1.30)
1961 I	3.48	3.91	2.05	1.90	1.19	1.48
II	7.71	5.64	3.69	3.38	2.13	0.93
III	−3.91	−2.08	−0.41	−0.02	0.67	1.07
IV	−0.81	1.37	0.05	0.90	0.57	0.32
(1961)	(1.62)	(2.21)	(1.35)	(1.54)	(1.14)	(0.95)
1962 I	1.64	2.67	0.27	1.63	0.97	1.08
II	1.61	5.42	1.49	3.91	1.43	2.13
III	0	−1.38	−0.09	0.67	1.41	2.03
IV	1.59	3.90	2.09	3.56	2.32	3.62
(1962)	(1.21)	(2.65)	(0.94)	(2.44)	(1.53)	(2.22)
1963 I	13.54	10.48	11.51	8.24	12.79	8.19
II	13.99	13.72	12.20	10.30	8.09	7.27
III	3.02	4.13	1.71	4.32	1.79	3.65
IV	7.23	5.39	4.18	3.98	1.93	2.64
(1963)	(9.45)	(8.43)	(7.40)	(6.71)	(6.15)	(5.44)
1964 I	3.28	4.26	4.97	2.89	2.15	1.86
II	10.23	5.49	6.11	4.29	1.66	1.79
III	−6.80	−1.32	0.21	1.19	1.76	2.34
IV	−1.63	1.76	−0.12	1.63	1.14	1.33
(1964)	(1.27)	(2.55)	(2.79)	(2.50)	(1.68)	(1.83)

SOURCE: Table 7-1.

TABLE 7-3

Share of Actual Increases in Price Level During First and Second Quarters of 1963 "Explained" by Variables in Regressions of Table 7-1
(per cent of actual total increases)

	Regression for:		
	Cost-of-Living Index	Wholesale Price Index	Wholesale Price Index Excluding Foodstuffs
Money plus quasi money	12.3	18.3	21.6
Import exchange rate	22.4	25.8	31.0
Wage rates	53.8	38.9	20.1
Real supplies	2.5	2.3	2.6
Seasonal factors plus constant	−3.3	−7.2	−1.2
Total: predicted inflation as per cent of actual inflation	87.8	78.1	74.1
Actual inflation (sum of first and second quarters)	27.5	23.7	20.9

SOURCE: Table 7-1.

context of weak monetary policy tools, described in earlier chapters, such fiscal policy was a key factor in the expansion of 42 per cent registered in money and quasi money between the last quarter of 1960 and the last quarter of 1962.

A legitimate preoccupation at a time of devaluation is how much the burden of adjustment will fall on the employed working class via decreases in real wages. Our wage rate series shows an upward trend in *real* wage rates (nominal rates deflated by the cost-of-living index) throughout 1960, 1961, and 1962. In spite of the devaluation, the upward trend continued during the early months of 1963. For the whole of 1963, *real* wage rates were 7 per cent above those for 1962, although toward the end of 1963 a downward tendency was visible, which continued in 1964. For the whole of 1964, real wages were 3 per cent below those of 1963, and about 2 per cent above those of 1962. Public policy, under intense trade union and political pressure, had something to do with at least the timing of these movements.

Early in the discussions about a new devaluation, the government had pledged to raise wages. Wages were in fact increased abruptly by a national law during the first quarter of 1963, with Congress going beyond the wage concessions suggested by the executive. The quarterly percentage changes in nominal hourly wages during 1962 and 1963 evolved as follows:

1962	I	2.1	1963	I	14.1
	II	4.1		II	12.4
	III	5.0		III	2.4
	IV	7.1		IV	3.0

The wage legislation also provided for an escalator clause, which was later abandoned with the apparent approval of the trade unions.

According to our regressions, declines in real supplies during early 1963 contributed (slightly) to the inflationary burst. Import licensing had been severely restricted during late 1962. As a result, during the first half of 1963 the dollar value of merchandise imports was 20 per cent below the corresponding period in the previous year. The noncoffee rural GDP practically stagnated (it rose by 0.7 per cent) between 1962 and 1963 because of bad weather, thus decreasing per capita agricultural supplies. It is quite possible that our clumsy way of taking into account rural real supplies leads to an underestimation of the inflationary impact of declines in supplies during early 1963. Real GDP as a whole rose between 1962 and 1963 by 3.3 per cent, only slightly faster than population growth.

It should be added that many have reported weather as being unfavorable during early 1963, and that hurt mainly the output of key foodstuffs.[7]

As noted in Table 7-3, the actual inflationary burst went beyond that predicted by the regressions. One may speculate as to the reasons for this overshooting. A first consideration, totally ignored in the regressions, is the timing of changes in a host of government-regulated prices not only for electricity and public transportation but also for a number of "basic necessities" (milk, sugar, cigarettes) ordinarily subject to price controls and other agricultural commodities for which minimum prices are ordinarily set. During 1962 the government held a strict line on these prices, which may partly explain the size of the residuals of the regressions for 1962. Right after the devaluation, and under advice from international lenders, most of these prices were abruptly readjusted upward. Early in 1963, for example, public transportation fares were increased between 50 and 75 per cent; and gasoline prices, by 20 per cent; and price ceilings on cement, cigarettes, milk, and sugar went up between 15 and 20 per cent.

More difficult to quantify is the inflationary impact, via expectations, of the *manner* in which the government went about the devaluation. As is not unusual when it comes to moving an adjustable peg, before the November 20 decision there was considerable discussion of the forthcoming devaluation, and a clear signal of what was to come was given on November 7, when all imports were temporarily placed on the prohibited list. A politically weak government publicly discussed options as to whether and how to devalue, before November 20, adding to the climate of uncertainty and speculation.

While the regressions take into account changes in monetary conditions, the peculiar way in which money plus quasi money expanded late in 1962, at the time of devaluation, may have had greater-than-average inflationary impact because of the expectations it generated. Beginning in November 1962, as part of its agreement with the IMF, the government liquidated its sizable floating debt with domestic creditors by using bank credit. As a result, of the total net increase in money plus quasi money between the end of 1961 and the end of 1962, an astounding 78 per cent took place during the last two months of 1962. In other words, while money plus quasi money rose by 5.3 per cent between December 31, 1961, and October 31, 1962, it rose by 17.4 per cent between the latter date and the end of 1962.

After this sketchy review of the 1962 devaluation it can easily be seen why memories of its impact were a major obstacle facing those attempting after that date to use a more flexible exchange rate as a policy tool. The argument that that event was a textbook example of how *not* to manage a devaluation made little impression. The feelings of most Colombians were accurately reflected by the then President León Valencia, who throughout 1963 and 1964 would warn his economic advisers not to mention the abominable word in his presence, in spite of continuing balance-of-payments difficulties.

THE 1965–66 LIBERALIZATION EPISODE: ORIGINS AND IMPLEMENTATION

The years 1963 and 1964 were melancholy ones for foreign trade policy in Colombia. The nominal import exchange rate was pegged and obviously overvalued once again, while that for minor exports, one peso higher, shared those two features (until the last quarter of 1964). Not surprisingly, foreign-exchange difficulties continued to plague the economy, while real GDP grew at an average rate of only 4.3 per cent per year during 1963, 1964, and 1965.

In the new cycle following the devaluation of the basic import rate in November 1962, the expected relaxation of import controls did not last long because that stabilization program failed significantly to change relative prices. The prestige of licensing as *the* tool to repress imports rose as that of exchange-rate devaluation sank. Imports on the free list as a share of total registered imports fell from 60 per cent in 1960–61 to about 35 per cent in late 1964 and lower still in early 1965. The time taken to decide on import requests lengthened, and during the last half of 1964 it reached, on average, nearly three months. Prior import deposits were kept in the central bank longer than usual, often for more than ten months. By late 1964 about 35 per cent of all license applications were being refused, and bitter and severe criticisms were again levied at beleaguered import control authorities. In December 1964 the free list was suspended, at first for 90 days, but then until September 1965, and prior exchange registration was made more difficult, resulting in a new piling up of commercial arrears. Early in 1965 prohibitions were extended, and licensing became increasingly slow and difficult, particularly for capital goods. Fresh attempts were made to divert both private and official imports toward bilateral partners, particularly with capital goods such as agricultural and construction machinery, elevators, tractors, trucks, and other vehicles. Some Colombian trading partners that felt injured by these practices, particularly the United States and the West German Federal Republic, made their displeasure known directly and indirectly.

Throughout 1964 the draining of exchange reserves for supporting the "free rate" at 10 pesos per U.S. dollar became more burdensome. It will be recalled that the rate for minor exports was pegged at that 10-peso level right after the November 1962 devaluation of the certificate import rate, under the pressing advice of the IMF, among others. Indeed, and quite incredibly when viewed in retrospect, the IMF urged at that time and throughout 1963 that the rates should be unified *at 9 pesos,* arguing that the 10-peso rate gave minor exports a privileged position and an unjustified subsidy, while generating inflationary pressures! It should be noted that at that time some Colombian officials in the executive branch apparently *agreed* with the IMF, but tried to blame Congress for the higher rate legislated for minor exports. As can be seen in Table 2-10, during 1963 the net real exchange rate applied to minor exports was below both what it had been in 1962 and what it was to be in 1970; the 1962 and 1970 rates were 15 per cent higher than the 1963 rate. As can be seen, in turn, in Table 4-7, the nominal purchasing-power-parity exchange rate applied to imports in 1958 was 24 per cent above that for 1963, while the 1970 rate exceeded it by 22 per cent.

Most cautiously, late in 1964 members of the Junta Monetaria began hinting to an embattled President the need to reconsider exchange-rate policy. At that time the President was troubled not only by memories of the 1962 devaluation, but also by a very serious political situation, which included rumors of an imminent coup d'etat. Devaluation advice was severely rebuffed. Nevertheless, in October 1964 the central bank stopped supporting the pegged free rate, apparently then less politically sensitive than the certificate rate. The free rate depreciated quickly and more or less steadily, going from an average of 10 pesos in October 1964 to a high of 19.2 pesos in August 1965. By late 1964 the IMF was also advising devaluation, and had given up at last its opposition to a dual system including a higher rate for minor exports.

While during the second and third quarters of 1965 the purchasing-power-parity effective exchange rate applied to minor exports reached, thanks to the freeing of the "free" rate,[8] high levels not reached either before or after, by the second quarter of that year the purchasing-power-parity nominal import exchange rate fell to its lowest point since early 1957. At that time, the rate was about one-third below the (almost identical) averages for 1958 and 1970. Import control administrators recall with horror the chaotic conditions of licensing during the first six months of 1965; delays and rejections of applications were at levels not seen since 1956–57. During April 1965, for example, average delays in handling import requests were said to have reached six months. The zooming free-market rate reflected widespread speculation and capital flight, also stimulated by severe political unrest. At this time, however, the increase in the price level was not particularly severe; in the third quarter of 1965, the cost-of-living index was 4 per cent above its level in the same period in 1964. The corresponding figure for the wholesale price index was 8 per cent; for the index excluding foodstuffs, the increase was 11 per cent.

At the end of June 1965, gross foreign-exchange reserves were down to their lowest levels since 1957, and were, at $56 million, only a little more than half of what they had been a year earlier. In that climate, both official and public attention first focused on the wild goings-on in the free exchange market. At the end of June 1965, in a controversial move allegedly motivated by fears of inflation, the rate applicable to minor exports was divorced from the free rate and set at 13.5 pesos, representing a sharp appreciation for minor exporters. The inflation argument was related to the obligation of the central bank to buy dollars earned by minor exports at the rate ruling the previous week in the free market to cover its commitment to importers in the certificate market. The loss from buying dollars at 18.8 pesos (the average free rate in June 1965) and selling them at 9 pesos was covered by simply printing pesos. This move, at a time when the need to stimulate new exports was obvious, can only be understood in terms of the severe political constraints under which economic policymakers operated and the weakness of monetary policy tools.

Perhaps the best thing that can be said for the 13.5-peso rate for minor exports is that, once it was created, it provided a "plausible" and sound alternative to both the 9-peso certificate rate (note that it was exactly 50 per cent higher) and the eye-catching but thin free market. As noted in Chapter 1, allegedly the President was finally persuaded to go along with the de facto gradual devaluations of the average import exchange rate, started together with the import liberalization program in September 1965, by the argument that relative to the free-market rate the move toward a rate of 13.5 pesos was really a *revaluation* which would also bring down the free rate. The fixation of public opinion with the antics of the free rate had become so intense that one cannot be sure whether the acceptance of that thesis represented economic wishful thinking or the wiles of a subtle politician with a short-term horizon. In fact, between August and October 1965 the free rate appreciated from 19.2 pesos to 17.8 pesos.

On September 2, 1965, following the advice of the Junta Monetaria, the certificate market was divided into a preferential and an intermediate section, with rates of 9 and 13.5 pesos, respectively. The preferential group included commodities such as foodstuffs, chemicals, and pharmaceuticals. Imports were to be transferred gradually from the first to the second section, with the less "essential" imports going first, while simultaneously freeing them from administrative controls. Capital goods were also quickly placed in the intermediate market, on the grounds that payments on such imports are spread out over a period of time.

The original liberalization plan called for removal of prior licensing on about half of all imports within six months, and eventually including 65 per cent of all imports. It was expected that imports of capital goods for industrial plants would be kept under control as part of the mechanism for investment planning.[9] In fact, the pace of liberalization went even faster. The free list was expanded on each of the following dates: September 8, November 11, 1965; January 27, February 22, February 28, March 17, July 29, and August 21, 1966. By this last date nearly all imports had been reclassified to the intermediate exchange rate; most imports were now either prohibited or on the free list, although some remained subject to prior licensing. Furthermore, starting in October 1965, advance import deposits were reduced every month by 5 percentage points from the rates in force on September 30. The plan called for continuing this rhythm for twenty months until those deposits were eliminated. In late August 1966, however, it was announced that the 5 per cent cuts were to be made quarterly, not monthly, starting in November 1966. It will be recalled that between September 1965 and August 1966 numerous modifications, mainly upward, were also introduced in the tariff, in principle to harmonize it with import liberalization. The temporary maintenance of a prohibited list was justified primarily on protectionist grounds. Of all registered imports during 1965 only 15 per cent had been on the free list; the corresponding figure for 1966 was 56 per cent. By October 1966 the free list covered 80 per cent of all registered imports.

Because of the lack of candor and clarity with which the liberalization plan was launched, a number of points remained ambiguous, and were to haunt policymakers a year later. In particular, the issue of raising the 13.5-

peso rate was left fuzzy. In September 1965 such fuzziness on future devaluation was used to sell the package and avoid inflationary expectation, as in 1963; but by September 1966 this was to become a source of irritation between Colombians and international creditors. Among the latter, some were convinced in 1965 that Colombian authorities had committed themselves to depreciating the intermediate rate if necessary, in line with a policy of exchange flexibility, rather than stop or reverse import liberalization. In fact, they expected such further devaluations to be necessary, suspecting that the 13.5-peso rate was too low. Other architects and sponsors of the plan, one may speculate, probably assumed that import liberalization would inevitably drag the authorities, unable to reverse liberalization, into further devaluations in the future whether or not they were willing to consider such a possibility in September 1965. By this time, it should be noted, the Monetary Board had been given the power to make exchange-rate adjustments at any time and of any size. The free rate was still allowed to fluctuate freely, and some hoped that eventually an upward crawling intermediate rate would reach and merge with the free rate. The progressive liberalization of import controls would test the appropriateness of the 13.5-peso rate, which was to be raised if the import surge proved to be too great. A species of "chicken" game was set up. On such shaky foundations was based the most systematic attempt at import liberalization attempted in Colombia since World War II.

Regardless of how a 13.5-peso rate looked in September 1965, the inflationary burst of late 1965 and the first half of 1966 robbed the gradual nominal devaluation of a good share of its real effect, although matters were much better in this respect than following the 1962 devaluation. By the time the new President, Carlos Lleras Restrepo, assumed office, in August 1966, virtually all import payments were being made at 13.5 pesos per dollar and nearly all (nonprohibited) imports were on the free list. The price level during the third quarter of 1966 was, however, substantially above that for the third quarter of 1965 (21 per cent according to the cost-of-living index, 17 per cent according to the wholesale price index, and 19 per cent according to the index of wholesale prices excluding foodstuffs).

Changes for 1965–69 in the actual price level and as predicted by the regressions of Table 7-1 are shown in Table 7-4. It may be seen that there were sharp price increases in the last quarter of 1965 and the first half of 1966, which were, however, quite "normal" in the sense that they were predicted to a very large extent by the regressions. This may be more clearly seen in Table 7-5, in which also shares of the observed inflation are attributed to the different independent variables according to their coefficients and concurrent and lagged actual changes.

As in the predictions for the first half of 1963, the three regression equations forecast similar absolute inflation rates—7.6, 7.6, and 8.1 per cent—

TABLE 7-4

Actual (A) and Predicted (P) Quarterly Changes in Colombian Price Level, 1965–69
(per cent; averages for whole year in parentheses)

	Cost-of-Living Index		Wholesale Price Index		Wholesale Price Index Excluding Foodstuffs	
	A	P	A	P	A	P
1965 I	2.09	3.29	0.56	2.37	1.98	2.85
II	3.42	4.81	3.90	4.11	2.51	3.80
III	0	−0.92	3.16	1.76	5.40	4.02
IV	5.79	4.81	5.69	5.19	6.23	6.49
(1965)	(2.83)	(3.00)	(3.33)	(3.36)	(4.03)	(4.29)
1966 I	7.81	6.83	5.02	6.03	4.90	6.13
II	7.97	5.18	5.25	3.78	3.28	2.22
III	−1.34	−2.08	0.45	0.17	3.08	1.70
IV	2.04	0.88	1.91	0.91	2.57	1.31
(1966)	(4.12)	(2.70)	(3.16)	(2.72)	(3.46)	(2.84)
1967 I	2.67	2.41	1.44	1.30	1.78	1.76
II	3.25	4.63	1.58	3.40	1.95	2.56
III	−0.63	−1.10	1.58	0.88	2.06	2.77
IV	1.27	2.22	1.31	1.88	0.90	2.08
(1967)	(1.64)	(2.04)	(1.48)	(1.87)	(1.67)	(2.29)
1968 I	2.50	3.23	1.60	2.16	1.47	2.17
II	2.44	4.42	2.93	3.28	1.72	1.67
III	−1.19	−2.03	0.17	0.55	0.48	1.55
IV	1.81	0.90	0.37	1.20	1.40	1.03
(1968)	(1.39)	(1.63)	(1.27)	(1.80)	(1.27)	(1.61)
1969 I	2.37	2.82	1.64	2.16	2.53	2.53
II	6.47	4.77	3.25	3.31	2.96	1.94
III	1.95	−1.59	1.23	0.46	2.32	1.89
IV	1.76	1.82	2.82	1.65	1.59	1.55
(1969)	(3.14)	(1.96)	(2.24)	(1.90)	(2.35)	(1.98)

SOURCE: Table 7-1.

stemming from the change in the average import exchange rate, most of which occurred during the last quarter of 1965. Inflationary monetary factors appear more important than for the first half of 1963, while increases in nominal wage rates are less so.

Contrary to the case of the 1962 devaluation, national government finances do not appear to have been the major culprit for the hefty rates of

TABLE 7-5

Share of Actual Increases in Price Level During Last Quarter of 1965 and First Half of 1966 "Explained" by Variables in Regressions of Table 7-1
(per cent of actual total increases)

	Regression for:		
	Cost-of-Living Index	Wholesale Price Index	Wholesale Price Index Excluding Foodstuffs
Money plus quasi money	27.4	45.0	44.2
Import exchange rate	35.1	47.2	56.2
Wage rates	36.2	30.5	15.3
Real supplies	−3.2	−4.4	−5.7
Seasonal factors plus constant	−17.5	−24.4	−7.1
Total: predicted inflation as per cent of actual inflation	78.0	93.8	102.9
Actual inflation (sum of three quarters)	21.6	16.0	14.4

SOURCE: Table 7-1.

expansion in money and quasi money observed in late 1965 and early 1966. Current revenues accounted for 87 per cent of government expenditures in 1964 and for 91 per cent in 1965. As liberalized imports rose, custom revenues (particularly from duties on autos) expanded sharply, and during 1966 the central budget showed a small surplus. Monetary expansion, which during the first quarter of 1966 ran 19 per cent above a year earlier, can be blamed primarily on the imperfect tools available to the monetary authorities for restraining banking credit to the private sector. Such imperfection arose in part from the power of private banks practically to ignore reserve requirements imposed by the central bank.[10] It also includes the power of the Coffee Growers' Federation to obtain credit and the effects of a coffee policy encouraging such pressures. During 1966 while the domestic coffee price was fixed, the dollar price was falling. This, together with a good crop and the desire to withhold some of it to prop up the dollar price, led to credit demands that the lame-duck Valencia government was unable to resist.

Increases in money wage rates were not encouraged by public policy during 1965–66 and were in fact modest. Real hourly manufacturing wages *declined* by 4 per cent between the first three quarters of 1965 and the following three quarters, in spite of rising imports and output. If the first three quarters of 1965 are compared with those of 1966, a decline of 5.5 per cent is observed in real wage rates. No wonder that the abrupt death of the liberalization episode in November 1966 evoked few tears from the working class.

Seasonal factors were more favorable than in 1963, and the effect of changes in real supplies was to dampen inflation, contrary to its behavior in the previous major devaluation. As may be seen in Table 3-3, merchandise imports reacted vigorously to the liberalization beginning in the first quarter of 1966; during the first half of that year the dollar value of imports was 30 per cent higher than the corresponding value for the same period in 1965, and 43 per cent higher than during the second half of 1965. Noncoffee rural output rose by 2.8 per cent in 1965 and by 3.9 per cent in 1966, figures not far from normal trends.[11] Over-all real GDP was expanding during 1966 at higher-than-trend rates, finishing that year with a 5.4 per cent increase over 1965.

During 1965–66 the large gap between the free-market rate and the rate applicable to merchandise imports was blamed by some for creating expectations contributing to inflation. As shown in Table 7-5, that gap is unnecessary to explain the behavior of wholesale prices. Its contribution to increases in the cost of living is also doubtful: a variable showing the ratio of the two exchange rates during 1958–69 was found insignificant in regressions of the type shown in Table 7-1.

In August 1966 it appeared that the liberalization program was firmly established. The new President had pledged to continue it and early in his administration, on August 21, 1966, took measures to complete the transfer of imports from the 9- to the 13.5-peso rate. The import surge was expected to abate once pent-up import demand had spent itself. According to the price dynamics of Table 7-1, the most inflationary phase of the devaluation-liberalization episode had been passed, and a net deflationary effect could be expected from the current *and lagged* effects of the expansion of real supplies, driven mainly by the import surge. Thus, taking the regression for the wholesale price index (excluding foodstuffs) of Table 7-1, the *net* percentage effect on price changes of the observed movements in the exchange rate and real supplies variables was as follows: 1965IV, +4.25; 1966I, +3.34; 1966II, −0.34; 1966III, −0.80; and 1966IV, −0.49.

BLOWUP

As already noted, back in September 1965 it was the understanding of the IMF (and some others) that if the balance-of-payments situation remained precarious after the transfer to the 13.5 peso rate had been completed, further adjustments would be made in the exchange rate. It was further understood by the IMF that the Colombian government had agreed, in its "letter of intention" of 1965, to use quarterly targets in gross foreign-exchange reserves as objective indicators of the state of the balance of payments which would, if not met, trigger automatic devaluations. At the end of September 1966 the reserve target was not met. Indeed, Colombian *net* reserves were deep in the red.

During the first three quarters of 1966, merchandise imports (dollar c.i.f. values) had run at 44 per cent above the corresponding period for 1965, while registered merchandise exports had declined slightly (by 1 per cent). The export outlook was not very promising; coffee prices had been declining since April 1966 and minor exports were sluggish and certainly below trend. For the whole of 1966 the change relative to 1965 was as follows:

Merchandise imports (dollars, c.i.f.):	48.7%
Recorded merchandise exports (dollars):	−5.8
Coffee exports (dollars)	−4.5
Registered minor exports (dollars):	1.6
Crude petroleum exports (dollars):	−20.0

Gross foreign-exchange reserves at the end of the third quarter of 1966 stood at $52 million, or $11 million less than a year earlier, and represented only 8 per cent of 1966 imports.

Under these circumstances the IMF pressed for an immediate devaluation as a condition for releasing the last credit tranche of the standby agreement signed in 1965 and renewing the standby agreement. The Colombian government, i.e., primarily President Lleras and his Minister of the Treasury, argued that such a move was not necessary at that time. Among younger government economists and technicians opposition to devaluation was not as strong. Indeed, some members of that group had argued for devaluation since early September, before the IMF recommended such a move. The higher Colombian authorities argued that both the fall in coffee and in minor export earnings reflected basically exogenous declines in world commodity prices and were to blame for the failure to achieve the reserve target. In particular, the link between the poor performance of minor exports in 1966 and the decline in the real minor export exchange rate between 1965 and 1966 was rejected. The government also insisted that the import surge had peaked and that a decline in imports could be expected. It pointed out that the liberalization program had been carried out at a faster pace than had been agreed in 1965. It rejected the idea of rigidly linking exchange-rate movements to changes in the reserve situation, using arguments similar to those used by the French in the 1973 discussions of international monetary reform. It denied that either explicitly or implicitly a commitment had been made to that notion in

September 1965, a denial supported by Colombian officials who participated in those negotiations. The government went on to say that the circumstances called not for devaluation, but for an expanded volume of concessionary aid flows to Colombia to support the liberalization program during those difficult circumstances. The critical breathing space to be purchased by aid referred not only to that needed to face allegedly temporary balance-of-payments difficulties, but also that required by the new government (inaugurated in August 1966) to get a firm hold on domestic policy tools, particularly monetary ones.

The new government was very eager *not* to repeat the performance of that other new administration which four years before, in November 1962, had undertaken a devaluation under pressure from the IMF and aid-granting organizations. Indeed, the new President was very conscious that, whether justly or not, he was being attacked as having been one of the key architects of the 1962 devaluation.

In October and November 1966, there was intense shuttling of national and international civil servants between Washington and Bogotá. The Colombian government hoped that the IMF did not represent the position of other credit institutions, such as the IBRD and AID. It also argued that it did not necessarily oppose the idea of eventual devaluations; it simply did not regard October 1966 as the right time. It noted that it had no intention of freezing the free market, then used mainly for capital and some "invisible" transactions (as well as smuggling), and which stood at about 16.4 pesos in September 1966, below the rates of a year earlier. It reaffirmed its intention of making sure that fiscal and monetary policies were under control and noninflationary *before* further devaluing the certificate rate.

The leverage which foreign aid agencies could exert on the Colombian government was still substantial in 1966. As already noted, Colombian foreign-exchange reserves were particularly low. The Colombian foreign debt, while not reaching the extraordinary levels of some other less developed countries, had been rising. Interest and amortization on that debt amounted to 12 per cent of exports of goods and nonfactor services in 1962; by 1966 that debt burden indicator had increased to more than 16 per cent.[12] It will be recalled that at that time the Washington aid agencies as a group had a virtual monopoly of medium- and long-term credit vis-à-vis countries such as Colombia, not only because of the flows they controlled directly but also because of the strong influence their judgments had on U.S. and European private banks. The competitive forces and new options generated by the Eurocurrency market were still in their infancy. Faced by a liquidity crunch, Colombia had either to give in to the combined aid agencies or take drastic austerity measures.

Things came to head late in November, apparently triggered by the announcement of AID and the IBRD to Colombian officials that their aid would be conditioned on a Colombian agreement with the IMF, including firm commitments to a devaluation timetable. The IMF-AID-IBRD group charged that the Colombian government lacked a balance-of-payments policy, and said that under those conditions they could not go on lending money to it. The Colombian government claimed to have been surprised by this collusion among foreign creditors and acted decisively. The apparently new AID position was first heard by Colombian officials on November 27 (a Sunday), and again the next day, together with that of the IBRD. A cabinet meeting showed most younger economists in favor of immediate devaluation, but the influential Minister of the Treasury opposed any such move. On November 29 (Tuesday), President Lleras went on television to announce the breakdown of the negotiations with foreign lending agencies, the elimination of the free market rate, and the imposition of rigorous import and exchange controls. Devaluation was out of the question. The import liberalization program had lasted slightly more than one year. Before attempting to draw lessons from this episode and its spectacular end, it is important to review what followed.

SISYPHUS AND LAW 444

The energetic preparation of a new comprehensive law on foreign trade and payments began about a month after the dramatic presidential announcement. Discreet contacts were also re-established with foreign creditors. On the latter front, foreign personalities more diplomatic than those who had conducted earlier negotiations, drawn particularly from the IBRD, began an important role as "honest brokers" between the Colombian government and the international lending group.

The preparation of what eventually became Decree Law 444 of March 22, 1967, absorbed most of the creative forces of the Lleras administration starting in December 1966. The new law codified and rationalized existing regulations and practices in the field of foreign trade and payments, and made a number of important innovations, as noted in Chapter 1. The more flexible exchange-rate policy, which should not have been abandoned in 1958, was reinstated. Very cautiously, moves toward import liberalization were started once again, from square one. As of early 1974, however, the import administrative regime, including both licensing and prior deposits, had not regained the freedom reached in October 1966. Since 1967, a year when imports had to be cut back drastically and the rate of growth of real GDP was below trend (at 4.2 per cent), Colombia has experienced an expansion in production and exports which by 1974 was without parallel in duration in the post-World War II period. In the next chapter, I will explore the extent to which this remarkably happy ending to the 1966 blowup was due to exogenous and endogenous factors; here, it will be sufficient to state that the new policies, particularly the crawling peg, by successfully breaking the stop-go cycles of earlier years, deserve much of the credit for the performance.

It should nevertheless be pointed out that the new policy course, now clear in retrospect, was not obviously foreseeable in March 1967 either by Colombians or by the foreign lending agencies. Those agencies were apparently caught off guard and embarrassed by the November 1966 Colombian moves, which had a very favorable political impact within Colombia and widespread repercussions and acceptance throughout Latin America. Throughout December IBRD officials had active conversations with Colombian representatives, and by February 1967 a new IMF mission was in Colombia to negotiate a fresh standby agreement that was finally signed in spite of the uncertainty regarding the *pace* at which the crawling peg was to be moved. On this score President Lleras clearly won his argument and obtained the resumption of aid without committing himself to a particular pace or timing of depreciation.

Officially, the post-March 1967 Colombian exchange rate is supposed to be the result of a reasonably free play of supply and demand, akin to "dirty floating." In fact, it is a crawling peg set daily by the government via associated banks. The peg is changed every few days. As noted in Chapter 4, there does not appear to have existed any rigid post-1967 formula for determining the pace of the crawl.

QUESTIONS AND LESSONS FROM THE 1965–66 LIBERALIZATION EPISODE AND ITS AFTERMATH

As conventionally measured, the performance of the Colombian economy since 1967 has been better than its average for the rest of the postwar period. Could all that *plus* the benefits of the import liberalization reached in October 1966 have been obtained by avoiding the November 1966 blowup? Assuming that this is the case, and leaving until Chapter 8 the discussion of exactly *how much better* performance would have been under those circumstances, the obvious question centers on the responsibility for the blowup.

With the help of hindsight, and of tables 2-9 and 4-8, it may be seen that key exchange rates were overvalued during the third quarter of 1966 (unless one wishes to argue that 1970 rates were *undervalued*). Thus, the PPP-EER for minor exports was at that time 17.6 per cent below the 1970 average; it was also below the averages registered for 1961, 1962, and 1965. The PPP-NER for

TABLE 7-6

Selected Colombian Annual Growth Rates, 1964–70
(per cent)

	1964	1965	1966	1967	1968	1969	1970
Gross domestic product	6.2	3.6	5.4	4.2	6.1	6.4	6.7
Gross domestic fixed capital formation	12.5	−5.6	8.0	6.6	15.0	2.5	13.1
Manufacturing output	5.9	4.7	6.6	3.6	6.2	7.3	8.3
Registered minor exports	18.9	35.8	0.6	17.4	34.8	21.5	1.5
BCST exports	−11.3	32.4	−11.3	56.2	27.3	2.7	−1.2
Manufactured exports	71.2	19.9	22.5	4.8	32.7	24.6	−15.6
Miscellaneous minor exports	17.0	93.2	−19.0	−25.1	75.2	69.6	42.8

BCST = bananas, coffee, sugar, and tobacco.

SOURCE: National accounts data from BdlR-CN: they are in constant market prices. Minor export data from Table 2-3: they are in dollar values at current prices.

imports in the third quarter of 1966 was 16.3 per cent below the 1970 average and below the 1958–59 rates. As dollar prices for coffee and other Colombian exports were, as claimed by the government, particularly weak during 1966 (see Table 2-5), the ex post case for declaring the 1966 exchange rates overvalued is strengthened.

The issue of the *timing* of the needed devaluation, however, is something else. Both political and economic considerations suggest the soundness of the Lleras reluctance to devalue until monetary and fiscal instruments were well under control. Foreign pressure to devalue during October and November 1966 was not only insensitive but also economically dangerous, given monetary conditions. The latter had been made more explosive by the automatic release of funds previously frozen by prior import deposits. During the first half of 1966 this had been offset by the sharp increase in imports, but during the second half it threatened to add substantially to monetary expansion.

Most observers now agree that by October 1966 stocks of imported goods were bulging, and a downturn in imports (even at the existing exchange rate) was imminent. A good share of the increase in imports during 1966 had been motivated by a speculative desire to take advantage of a liberalization not expected to last long. It can be plausibly argued that the maintenance of the external credit flow for at least a few more months would have saved the liberalization program *and* given the new Lleras administration time to prepare a noninflationary setting for the needed gradual devaluations. The decline in the GDP and manufacturing growth rates registered during 1967, as shown in Table 7-6, would presumably have been avoided.

If that had been done, would the pace of devaluations after 1966 have been as fast as that actually observed? Would the crawling peg have been maintained? It would be pleasing to answer these questions with a clear yes. Yet serious doubts must remain. As noted earlier, President Lleras, who participated in the Bretton Woods conference of 1944, had in 1960 called for an end to a short-lived experiment with the crawling peg. Six years after Decree Law 444 had been promulgated, in March 1973, former President Lleras called for an end to or at least a slowdown in the creep of the crawling peg as a way to fight inflation and eliminate excess profits in some exporting activities benefiting from the world commodity boom.[13] It seems difficult to argue that without the 1966–68 pressure of foreign creditors Colombian exchange-rate policy, particularly the pace of devaluation, would have been the same as that actually observed.

There are some fairly straightforward lessons from the 1965–66 Colombian experience. A government that does not want to be caught between the alternatives of being pushed around by public or private foreign creditors (with good or bad will is irrelevant here) or instituting drastic trade and payments policies it does not regard as desirable should avoid launching import liberalization programs with low foreign-exchange reserves *and* a commitment to a pegged import exchange rate.

The 1965–66 devaluation-plus-liberalization episode lasted little more than a year, from September 1965 to November 1966. Nearly full liberalization lasted about two months (September and October of 1966). It can be argued that such time spans only show the transitional problems of the program and few of its benefits. Nevertheless, it is worth noting that, contrary to what some of the most enthusiastic champions of liberalization have claimed in the past, there was in 1966 a dramatic upsurge neither in minor exports, nor in investment, nor in over-all growth rates. As shown in Table 7-6, the 1966 GDP, investment, and manufacturing growth rates were above postwar averages (shown in Table 1-1), but below those registered in many subsequent years. The somewhat erratic evidence on the then still thin flow of minor exports indicates no dramatic response to liberalization, apart from the response to changes in the effective exchange rate documented in Chapter 2.

It is also worth noting that a return to harsh import controls late in 1966 did not prevent substantial minor export expansion during 1967, 1968, and 1969. The Colombian experience indicates that drastic import liberalization is neither a necessary nor a sufficient condition for export growth.

The large output gains to be obtained by avoiding stop-go cycles, and the need to coordinate foreign trade and payments policies with those in the fiscal and monetary fields to avoid such cycles, are also lessons emerging from the Colombian experiences of the 1960s and early 1970s. And had the peso exchange rate been kept flexible, as it was in 1957 and early 1958, and again since March 1967, the growth and balance-of-payments performance during 1958–68 would have been clearly better. But more on this in the next chapter.

Finally, it may be noted that the circumstances surrounding Colombian trade and payments policy during the 1960s were so unique as to make it difficult to link them neatly with the Bhagwati-Krueger phases. Devaluation, stabilization, and import liberalization policies were all either carried out or promised late in 1962 and in mid-1965; so those events can be clearly labeled as Phase III episodes. The events of November 1966 through March 1967 just as clearly mark a return to Phase II. But the new phase started in March 1967 is more difficult to define. Perhaps it is best characterized as a slow-motion Phase III, which has carried Colombia almost imperceptibly (growing like a rose?) into Phase IV, which can be said to describe the last years covered in this book.

APPENDIX

The percentage changes used in the regressions of Table 7-1 are shown here in tables 7-7 and 7-8. The sources of the basic variables are as follows:

1. Cost-of-living index. Obtained from IMF-IFS, without further changes.

2. Wholesale price index, with and without foodstuffs. Obtained from BdlR-RdBdlR, without further changes.

3. Money plus quasi money. End-of-month data obtained from IMF-IFS. *Centered* quarterly series were obtained by averaging four of these end-of-month observations. The user should be warned that starting with the April 1974 issue of IMF-IFS, substantially revised monetary data appear for Colombia.

4. Average import exchange rate. Obtained by dividing the value of merchandise imports in pesos by their value in U.S. dollars. It corresponds to the rate shown in Table 4-8.

5. Average hourly wage rates in manufacturing. Refers to nominal wages in manufacturing. Basic data from DANE-BME. There is a discontinuity in the methodology used to report such average wage data in DANE publications of May 1962 or thereabouts. Where they overlap, the old series is about 14 per cent lower than the new one. That percentage was applied to earlier observations to obtain a homogeneous series.

6. Real supplies. Expressed at 1958 peso prices. Includes noncoffee gross domestic *agricultural* product plus merchandise imports. The former series is available only annually, from the BdlR national accounts. It was

TABLE 7-7

Quarterly Percentage Changes in Dependent Variables Used in Regressions Shown in Table 7-1, 1958I–1969IV

	Cost-of-Living Index	Wholesale Price Index	Wholesale Price Index Excluding Foodstuffs
1958 I	2.09	2.71	3.06
II	6.33	3.16	3.53
III	−0.97	2.11	4.82
IV	0.97	1.53	1.70
1959 I	3.86	1.61	0.96
II	2.94	4.75	2.16
III	−2.86	1.56	3.35
IV	0.93	−0.25	0.33
1960 I	1.99	0	0.33
II	2.71	2.59	1.33
III	−0.88	0.19	0.89
IV	1.77	1.45	0.83
1961 I	3.48	2.05	1.19
II	7.71	3.69	2.13
III	−3.91	−0.41	0.67
IV	−0.81	0.05	0.57
1962 I	1.64	0.27	0.97
II	1.61	1.49	1.43
III	0	−0.09	1.41
IV	1.59	2.09	2.32
1963 I	13.54	11.51	12.79
II	13.99	12.20	8.09
III	3.02	1.71	1.79
IV	7.23	4.18	1.93
1964 I	3.28	4.97	2.15
II	10.23	6.11	1.66
III	−6.80	0.21	1.76
IV	−1.63	−0.12	1.14
1965 I	2.09	0.56	1.98
II	3.42	3.90	2.51
III	0	3.16	5.40
IV	5.79	5.69	6.23

TABLE 7-7 *(concluded)*

	Cost-of-Living Index	Wholesale Price Index	Wholesale Price Index Excluding Foodstuffs
1966 I	7.81	5.02	4.90
II	7.97	5.25	3.28
III	−1.34	0.45	3.08
IV	2.04	1.91	2.57
1967 I	2.67	1.44	1.78
II	3.25	1.58	1.95
III	−0.63	1.58	2.06
IV	1.27	1.31	0.90
1968 I	2.50	1.60	1.47
II	2.44	2.93	1.72
III	−1.19	0.17	0.48
IV	1.81	0.37	1.40
1969 I	2.37	1.64	2.53
II	6.47	3.25	2.96
III	1.95	1.23	2.32
IV	1.76	2.82	1.59

SOURCE: See appendix to this chapter.

simply divided by 4 to obtain quarterly estimates. Merchandise imports are available quarterly, but quantity estimates are shaky. The quarterly series in 1958 pesos was obtained by multiplying the quarterly import data at *current* dollars by 7.06, the average import exchange rate for 1958. During 1958–69 the variation in average dollar import prices appears to have been small.

TABLE 7-8

Percentage Changes in Independent Variables Used in Regressions Shown in Table 7-1, 1957I–1969IV

	Money Plus Quasi Money (yearly changes)	Average Import Exchange Rate (quarterly changes)	Wage Rates (yearly changes)	Real Supplies (yearly changes)
1957 I	12.33	0	25.32	−25.04
II	8.40	0.40	27.16	−22.83
III	14.95	112.35	39.29	−9.33
IV	6.25	7.69	34.83	−6.33
1958 I	7.30	12.89	23.23	15.95
II	5.79	14.66	20.39	3.40
III	8.33	−2.69	7.69	−15.67
IV	16.41	−1.66	5.83	−18.02
1959 I	14.27	−3.38	4.92	−10.52
II	16.06	11.21	8.07	6.17
III	13.87	−16.23	8.73	14.96
IV	12.64	0.16	12.60	9.28
1960 I	10.89	−0.16	12.50	20.74
II	6.26	3.75	10.45	12.89
III	8.85	0.90	20.44	10.72
IV	10.66	0	18.18	13.58
1961 I	12.00	0	20.14	0.05
II	16.25	0	18.92	6.37
III	17.17	0	10.91	1.16
IV	19.73	0	12.43	6.30
1962 I	23.23	0	12.14	12.82
II	20.09	0	14.77	2.77
III	15.79	0	15.85	8.14
IV	18.32	8.96	19.47	−8.61
1963 I	15.01	23.29	33.51	−16.01
II	13.73	0	44.06	−1.17
III	20.97	0	40.57	−2.11
IV	18.78	0	35.24	11.60
1964 I	24.58	0	22.01	21.80
II	31.43	0	11.68	6.31
III	25.52	0	11.75	8.19
IV	23.79	0	11.40	3.49
1965 I	19.75	0	10.44	−8.52
II	16.95	0	9.85	−4.70
III	17.54	4.11	11.11	−11.81
IV	17.85	30.31	11.99	−8.81

TABLE 7-8 (*concluded*)

	Money Plus Quasi Money (yearly changes)	Average Import Exchange Rate (quarterly changes)	Wage Rates (yearly changes)	Real Supplies (yearly changes)
1966 I	18.90	1.72	13.75	12.52
II	17.58	2.09	15.13	15.36
III	15.03	3.55	13.78	29.89
IV	13.16	3.05	12.53	25.34
1967 I	13.09	−1.55	11.34	8.82
II	13.78	2.70	10.46	−9.86
III	12.28	4.83	9.74	−13.94
IV	14.93	4.95	9.98	−8.94
1968 I	17.97	3.92	10.63	7.45
II	19.33	2.05	10.79	22.83
III	23.32	1.88	10.39	19.02
IV	22.63	1.48	9.49	16.93
1969 I	19.74	1.70	9.00	−2.59
II	19.24	1.43	8.55	3.68
III	20.58	1.65	9.80	13.43
IV	23.27	2.02	10.02	9.58

SOURCE: See appendix to this chapter.

NOTES

1. See Arnold C. Harberger, "The Dynamics of Inflation in Chile," in Carl Christ et al., eds., *Measurement in Economics: Studies in Mathematical Economics and Econometrics in Memory of Yehuda Grunfeld* (Stanford, Calif.: Stanford University Press, 1963). For the Argentine case, the method has also been applied by Adolfo C. Diz, "Money and Prices in Argentina, 1935–62" (Ph.D. diss., University of Chicago, 1966), and by me, most recently in *Essays on the Economic History of the Argentine Republic* (New Haven: Yale University Press, 1970), Essay 7, pp. 366–377.

2. See Alberto R. Musalem, *Dinero, Inflación y Balanza de Pagos: La Experiencia de Colombia en la Post-Guerra* (Bogotá: Talleres Gráficos del Banco de la República, 1971), Chapter II.

3. "Monetarist" is used here to refer to those who would explain variations in the price level exclusively as a function of changes in the money supply. There is, of course, a neomonetarist view which argues that devaluation of the exchange rate works *only* insofar as it reduces the real value of cash balances, which requires a devaluation-induced increase in the price level. The neomonetarist view, however, typically assumes devaluation occurs from a position of equilibrium in the balance of payments and neglects the case where devaluation is accompanied by relaxation of import controls.

4. A purely numerical reason may be involved: data on the average import exchange rate for those years are likely to exaggerate the abruptness of the real transition between the old rate of 2.50 pesos per dollar, and the newer rates, which are higher. The unusual political circumstances

of 1956–58 may have also induced a restraint on the part of the importing community difficult to obtain under more normal and less euphoric circumstances.

5. The banquet at the Tequendama Hotel, sponsored by the Economic Society of Friends of the Country, where the Lleras-Agudelo exchange took place, was fully reported in the issue of April 5, 1960, of *El Tiempo* of Bogotá. Quotations in the text are from this source; translations are mine.

6. Data on general government current expenditures, public fixed capital formation, and GNP were obtained from the national accounts published by BdlR. All basic data were expressed at current market prices. Data on banking credit and on the budget of the national government were obtained from IMF-IFS, 1972 Supplement.

7. Between 1962 and 1963, output indices of some key foodstuffs fell much more than over-all noncoffee rural output; the percentage figure for rice was −6.0; beans, −6.4; corn, −1.8; potatoes, −34.2; and wheat, −44.5.

Given its importance in the diet of the Colombian masses, and its special import difficulties, the decline in the potato output is particularly noteworthy. These figures suggest that the construction of a more refined index of supplies, as suggested by Miguel Urrutia, may be desirable. (Basic data are from BdlR, National Accounts.)

8. The Banco de la República apparently intervened somewhat in the free market until April 1965, after which date it withdrew almost totally. Throughout the 1950s and early 1960s the free rate, generated by a thin market, was influenced not only by expectations and other usual factors but also by special circumstances, particularly conditions in neighboring Venezuela. Unregistered Colombo-Venezuelan transactions played an important role in the fluctuations of the free rate; they still have great influence on the black-market rate. The free rate, eliminated in November 1966, acted as a safety valve for the import control system; generally, authorities looked the other way if imports were financed through the free market.

9. Some authorities justified strict licensing of capital goods imports with the curious argument that they would simply lead to higher demand for imported raw materials in the future. Some observers thought that import restrictions weighed more heavily on capital goods than on raw materials and even consumer goods during 1963 and 1964.

10. Law 7 of 1973 finally strengthened the power of the Junta Monetaria to punish banks effectively for their failure to meet reserve requirements.

11. Output indices of key foodstuffs were as follows (with 1964 = 100):

	1965	*1966*		*1965*	*1966*
Rice	114	114	Potatoes	103	113
Beans	90	75	Wheat	125	169
Corn	90	92			

12. Debt service ratios obtained from IBRD, *An Appraisal of the Development Program of Colombia,* Report WH-119a, June 21, 1962, Annex I, p. 16; and IBRD-IDA, *Annual Report,* various issues. The 1962 IBRD report contained the following judgment: "The present ratio of 12 percent is already very high and a ratio of 15 percent must be considered unsafe, particularly in view of the great uncertainties about the world coffee situation" (p. 16). The 1966 debt-service ratio was the highest recorded during the 1960s.

13. As reported in *El Tiempo,* March 23, 1973. It must say something about the Colombian political system that the same ministers of the Treasury and Development who in 1960 received the Lleras criticism against exchange-rate flexibility were to receive the new criticism in 1973. The only difference was that in 1973 Agudelo Villa was Minister of Development whereas Rodrigo Llorente, who in 1960 was Minister of Development, was in 1973 Minister of the Treasury.