

Antecedentes históricos de la deuda pública colombiana. El papel de la deuda pública interna bajo escenarios macroeconómicos alternativos durante la segunda guerra mundial.

Historical background of the public debt in Colombia. The role of the internal public debt under alternative macroeconomic scenarios during World War II.

Por: Mauricio Avella Gómez¹

Resumen

Aunque Colombia no participó directamente en las hostilidades de la segunda guerra mundial, las consecuencias internacionales del conflicto ejercieron una clara influencia en las políticas macroeconómicas de la época. Este ensayo explora el papel jugado por la deuda pública interna en los diferentes escenarios macroeconómicos surgidos durante la guerra, así como en los primeros años de la posguerra.

Summary

Although Colombia was not directly involved, the economic consequences of World War II had a clear influence on the macroeconomic policies applied in the country during the international conflict, and in the first few years that followed. This essay attempts to explore the role of internal public debt policies in the different macroeconomic scenarios brought to light by the outbreak of the war in 1939, the persistence of hostilities up to 1945, and the economic consequences of the peace in the second half of the 1940s.

^{1/} Departamento de Estabilidad Financiera. Subgerencia Monetaria y de Reservas del Banco de la República. Bogotá, Colombia, julio de 2004. Las primeras notas para este ensayo fueron escritas en 1988 en la Universidad de Glasgow a partir de discusiones con Richard Portes, director del Centre for Economic Policy Research, CEPR, en Londres, y CEPREMAP en París, y David Vines de la Universidad de Glasgow y del Balliol College en Oxford. Originalmente se emplearon como parte de la argumentación histórica de los ensayos requeridos por la tesis doctoral. Este artículo es el octavo de una serie acerca de la deuda colombiana desde los 1820 hasta el año 2000. Esta versión del documento fue preparada como parte de la agenda de investigación para 2004 de la Gerencia Técnica del Banco de la República cuyo apoyo se agradece.

Historical background of the public debt in Colombia. The role of the internal public debt under alternative macroeconomic scenarios during World War II.

CONTENTS

	Page
A. The normalization of the internal debt service	1
B. The role of internal debt under alternative macroeconomic scenarios	6
1. The international coffee crises of 1937 and 1940	7
2. The economic consequences of the U.S. entry into the war	12
a. The collapse of imports and unintended accumulation of international reserves	14
b. Fiscal strains due to the fall of imports	17
3. Fiscal deficit, external surplus and high inflation. Policy options.	19
4. New macroeconomic conditions after the war	35

Historical background of the public debt in Colombia. The role of the internal public debt under alternative macroeconomic scenarios during World War II.

A long positive cycle of the internal public debt in Colombia goes from 1931 to 1950. Two subperiods can be distinguished in this long cycle. The first one coincides with the reflationary policies implemented during the first half of the 1930s, as described in Avella (2003). The second one corresponds with the time of World War II, and although the stock of internal public debt kept growing at rates over the historical rate until 1950, the major positive deviations from trend were reached during the years 1941-1944².

Although Colombia was not directly involved, the economic consequences of the international conflict had a clear influence in the macroeconomic policies applied in the country during and in the first few years after the war. This essay attempts to explore the role of internal public debt policies in the different macroeconomic scenarios brought to light by the outbreak of the war in 1939, the persistence of hostilities up to 1945, and the economic consequences of the peace in the second half of the 1940s.

A. The normalization of the internal public debt service.

In 1932 (February), the government announced the suspension of sinking fund payments on its external debt, and also the suspension of the amortization payments on the internal debt. This last measure particularly affected the Colombian Bonds of Internal debt which by 1932 represented 52% of total bonds sold by the national government, and 27% of total internal debt; these figures went up to 67% and 35% respectively, by 1935, when the reflationary policies of the time came to an end (Table 31 in Avella, 2003). Although the government defaulted on amortization payments, coupon payments were regularly fulfilled³.

Because since 1933 the external debt service was basically limited to payments on the scrips issued in 1933 and 1934, and on the short-term credit due to a syndicate of banks, the share of the internal debt service in the government budget largely exceeded that of

^{2/} In the description of the estimated cycles of internal public debt (Avella, 1988), it was observed how one of the explanatory variables, government expenditure, had increased well below their normal rate during the 1940s reaching the lowest rates of the whole series as of 1943-44. Since it was during these last years that internal debt grew well over its historical rate, the explanation for such behaviour of debt would have to be learnt from other variables. As it was noted, economic activity and imports were markedly depressed during the war period. Given its importance for fiscal revenues, the low profile of imports was a source of great fiscal strains during these years.

^{3/} Although regular amortization payments were the rule for securities different from the Colombian Bonds of Internal Debt, in some cases such as the 6% Coffee Subsidy Bonds of 1932, and the 6% Treasury Promissory Notes of 1930, payments were inadequate and irregular. Memoria de Hacienda, 1940, pp.130-31.

the external debt service. Thus, while the total debt service represented 15.5% of the national government expenditures between 1934 and 1938, the average share of the internal debt service reached the figure of 11%. It was based on figures like these that the Foreign Bondholders Protective Council (FBPC) sustained that the Colombian government had discriminated against foreign bondholders, and in favour of foreign commercial banks and domestic bondholders.

Since 1939 (Law 54), authorities had committed to regularize the service of both external and internal debt. The first step towards the normalization of the internal debt service was the conversion of old issues on most of which amortizations were not being made. As shown in Table 55, the conversion principally involved bonds issued during the reflationary period of 1932-33; they represented over 80% of the whole operation⁴. The new issue was called Bonds of the Unified Internal National Debt (UIND), and the exchange operations started in March, 1941. As seen in the table, by mid-1942 the old issues had been nearly fully exchanged by the new UIND bonds.

TABLE 55

Conversion of the Internal Debt

1941 - 1942

(Millions of Pesos)

Bonds to be Converted	Balances to be converted March 1941	Balances converted May 1942
A. Bonds issued during the reflation of 1932-1933		
Colombian bonds of 10%, 8%, 7%, and 6%	22.2	21.9
3.5% Colombian bonds	5.9	5.9
6%, Coffee subsidy bonds	3.3	3.3
6%, Treasury Promissory Notes	1.3	1.3
Subtotal	32.7	32.4

⁴/ Other bonds representing about 20% of the conversion were principally issued to finance developmental projects since 1938. Memoria de Hacienda, 1942, pp.41-42.

B. Development bonds	2.5	2.5
C. Other bonds	4.8	4.6
TOTAL	40.0	39.5

Source. Based on Memoria de Hacienda, 1942.

As in the case of the external debt, the settlement of the internal debt required a negotiation between the government and the bondholders. In this case however, negotiations were not carried out between representatives of ultimate small investors who purchased the bonds in the open market, and the government, but between the latter and the financial system. As explained in Avella (2003) above, as a result of the rescue operation of banks performed during 1932-33, and other reflationary policies, the Bank of the Republic and other commercial banks substantially increased their investments in government bonds. Consultations were made with the financial institutions which according to the minister of finance represented 85% of the 3.5%, 4%, 5%, 6% and 7% bonds in circulation. These financial institutions accepted the conversion operation including a reduction of 20% in the rate of interest, under the condition that the nominal value of the debt was not changed⁵.

Two different classes of UIND bonds were issued. The 6% Class A bonds redeemable in 30 years, for an amount of C\$20 million, and the 4% Class B bonds redeemable in 25 years, for an equal amount of C\$20 million. Some specific resources were earmarked to guarantee the punctual service of the bonds; they were the revenue of the tax on petrol and a fraction of the proceeds on salt mines. Since the different bonds subject to conversion exhibited different contractual interest rates, each bond was individually studied so as to obtain the 20% reduction in the interest burden. Thus, in the case of the old 7% bonds which represented 38% of total loans to be converted, holders were offered a C\$80 6% bond, and a C\$20 4% bond in exchange for every C\$100 bond.

By 1941, the public debt records registered the new UIND bonds after the conversion operation (Table 56). This was only a first movement, however, since a further conversion of a comparable magnitude took place during 1942. This time the focus was the government debt with the Bank of the Republic. Two important loans were considered. The first was the 1931 Salt Mines Concession Loan, which as discussed in Avella (2003) played a central role in the reflationary policies of 1932-34. Additional lending operations were charged to this loan in the second half of the 1930s, and by 1941 it reached a height of C\$18.9 million. The conversion operation consisted in transforming a government debt with the central bank into a financial investment of the central bank in long-term government bonds. It was just a change of position within the asset side of the central bank balance sheet which otherwise had the presentational

⁵/ Memoria de Hacienda, 1941, p.94

advantage of taking out of the credit accounts a long-term loan which itself is not an appropriate operation for a central bank.

TABLE 56
INTERNAL PUBLIC DEBT
1938 - 1950
(Millions of Pesos)

	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949	1950
I. BONDS													
A. Colombian Bonds													
10% Laws 23 and 58, 1918	0,4	*	*	*									
8%, 8.5% Laws 12, 20, 1928	0,3	0,1	*	*									
7%, Decree 711, 1932	14,2	14,9	15	0,5	0,1	0,1	*	*	*	*			
6%, Decree 711, 1932	7,2	7,2	7,2										
3.5%, Decree 2028, 1933	6,3	6,1	6	0,1	*	*	*	*	*	*	*	*	*
B. 4%, Patriotic Defence Loan, 1932	4,4	1,7	0,1	*	*	*	*	*	*	*	*	*	*
C. Development Bonds			1,5	0,6	*	*	*				9,7	10,7	10
D. Conversion Bonds (UIND)													
6%, Class A				19,5	19,6	19,3	19	21,7	36,1	35,4	34,7	33,9	33,1
4%, Class B				19,4	26	25,3	24,6	23,9	23,1	22,3	21,4	20,5	19,6
E. Salt Mines Conversion Bonds													
4%, Class A					16,3	16	17,6	17,3	16,9	28,9	28,1	27,4	33,7
3%, Class B					18,5	18,1	19,7	19,2	18,7	30,6	29,7	28,8	34,9
F. 6% National Economic Defense Bonds						58,2	57,8	55,9	47,3	40,1	35	30,4	25,7
(Continued)													
	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949	1950
G. Treasury Colombian Bonds													
6% 1944 bonds							25	24,6	24,4	24	23,6	23,3	22,8
6% 1945 bonds								35	49,4	48,8	48,1	47,4	46,3
H. Coffee Bonds													
6% Subsidy bonds, 1932	3,3	3,3	3,3	*	*	*	*	*	*	*	*	*	*
5% Coffee Premium bonds, 1940			3	4,4	4,2	4	3,7	3,4	3,2	2,9	2,5	2,2	1,9
3% National Coffee Fund bonds Class A, 1940			0,9	1,2	1,2	1,1							
4% National Coffee Fund bonds Class B, 1941				3	3								
4% National Coffee Fund bonds Class C, 1941				5,8	5,6	5,4							
I. Municipal Development Bonds													
Classes A-E, 1940-1944			1,6	3	3	3,1	3,6	3,5	3,4	3,3	3,2	3,1	2,9
Classes F-I, 1945-1948								2,6	8	11,9	18,5	18	17,3
J. Railway Bonds													
6% Railway Subsidy Bonds	0,4	0,2	1,1	0,8	0,7	0,7							
National Railway Bonds, 1942-1948					2	1,9	4,8	5,7	5,5	5,3	15	13,9	8,6
K. Housing Loans Institute Bonds													
								1,7	1,6	16,4	16,1	15,7	15,4
L. Agrarian Bonds													
					1,5	1,5	1,4	1,4	1,3	11,2	11	10,8	10,6
M. Other Bonds													
		0,3	1,2			0,1	0,3		6,5	6,2	11,6	9,7	8,8
N. Total - Bonds	36,5	33,8	40,9	58,3	101,7	154,8	177,5	215,9	245,4	287,3	308,5	295,8	291,6

(CONTINUED)

	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	1948	1949	1950
II. PROMISSORY NOTES													
A. 6 $\frac{1}{2}$ Treasury Notes, Laws 20, 56, 1930	2,1	1,8	1,3										
B. Other Promissory Notes	12,6	12,4	0,1	4	1,7	0,2	0,2	0,8	0,8	1,6	1,4	1	0,3
C. Total - Promissory Notes	14,7	14,2	1,4	4	1,7	0,2	0,2	0,8	0,8	1,6	1,4	1	0,3
III. FINANCIAL SYSTEM LOANS													
A. Bank of the Republic													
Salt Mines Concession, 1931	20,3	19,7	19,3	18,9									
Military Quota Tax Loan, 1933	0,2	0,2											
National Defence, Decree 578, 1934	0,9	0,9	0,9										
National Development Loan (Eximbank)			10,7	16,3									
Other loans	0,5	0,5	0,5	0,4		0,1	0,1	0,1	0,7	0,8	5,7	0,7	0,7
Total - Bank of the Republic	21,9	21,3	31,4	35,6		0,1	0,1	0,1	0,7	0,8	5,7	0,7	0,7
B. Other banks													
	1,4	3,8	3,6	4,2	4,4	5,7	7,6	7	14,6	14	13	13,1	13,5
C. Total - Financial System Loans	23,3	25,1	35	39,8	4,4	5,8	7,7	7,1	15,3	14,8	18,7	13,8	14,2
IV. FLOATING DEBT													
	25,1	14,6	14	17,5	15,9	15,5	19,5	19,1	22,2	28	38,3	46,2	53,4
V. TOTAL (I+II+III)													
	99,6	87,7	91,3	119,6	123,7	176,3	204,9	242,9	283,7	331,7	366,9	356,8	359,5

SOURCES. Informe Financiero del Contralor, annual report

figures less than 0.1

Promissory Notes also include Notes.

The second loan considered for conversion was the credit opened by the Bank of the Republic to the government for the amount of C\$17.5 million, based on the US\$10 million loan extended by the Export-Import Bank to the Bank of the Republic in 1940. Because of institutional restrictions on the loan operations of the Ex-Im Bank, it was not possible for this organization to directly grant the loan to the government. As shown in Table 56 III.A., the credit was gradually extended to the government through 1940 and 1941. As for amortization, it had been initially agreed that half of the debt would be added up to the outstanding balance of the Salt Mines Concession Loan to be amortized in 30 years, and that the other half would be repaid in 8 years. Authorities, however, changed their mind in 1942 due to the gloomy fiscal prospects of the time. It was then decided that the latter half of the debt would be amortized in a similar way to the former.

Both loans were transformed into a new bond, the Salt Mines Conversion Bonds, whose issue was divided in two classes: the 3% Class A bonds given in exchange for the old debt of the 1930s, and the 4% Class B bonds offered in exchange for the credit based on the Ex-Im Bank loan. Once the funding operation took place, the official accountancy registered the new bonds -Table 56 I.E- and discharged the loans of the Bank of the Republic to the government. As seen in Table 56 III.A., the outstanding government debt with the central bank was reduced to negligible amounts for the rest of the decade.

To sum up, the conversion operations of 1941 and 1942 went beyond simple accountancy changes. The issue of UIND bonds served the purpose of regularizing interest payments which were in default on a series of bonds since 1932. Under the agreement with bondholders, interest rates were reduced by 20%, to around 5%, a level higher than the 3% which dominated in settlements with external bondholders. As for the length of life of the new bonds, it was in average 27.5 years, slightly less than the 30 years agreed for the external debt.

Regarding the Salt Mines Bonds, they allowed the national government to extend the repayment of the rescue and reflationary policies of the 1930s as well as the first credit received from the Ex-Im Bank until the 1970's. It has to be recalled that the original contract in connection with the Salt Mines Concession (December 1931), established a

maturity period of 13 years from January 1932, but further arrangements during the 1930s -for instance the Law 7 of 1935- delayed the regular amortizations of the advance made by the central bank. Therefore, with the 1942 funding operation the Colombian government transformed an original 13-year loan into a 40-year loan. As for the first credit of the Ex-Im Bank, the Bank of the Republic who was the contractual debtor paid off the external debt by 1943, and the national government who was the beneficiary of that financing got 30 years to repay the internal debt to the central bank.

B. The role of internal debt under alternative macroeconomic scenarios.

As of 1935 the Colombian economy seemed to have entered into a period of relative stability. Economic activity and prices started rising at low rates after both the strong oscillations provoked by the great depression and the reflationary policies of 1932-34. Internally, the huge fiscal deficits of the late 1920s and early 1930s were followed by fiscal surpluses, and there was room for public debt reductions. Recovery was also felt in the financial markets where official banks played a leading role. Externally, the international reserves achieved stable levels, and in a context of free trading, the nominal exchange rate depreciated during 1934-35 reaching a steady height through 1936. The optimistic prospects based on these developments came to an end with the downturns of the world coffee prices in 1937-38 and 1940.

1. The international coffee crises of 1937 and 1940

Early in November 1937 Brazil took steps which indicated the eventual curtailment of government regulations of Brazilian coffee exports and prices⁶. The spot prices of coffee in New York dropped sharply. The Brazilian coffee (Rio No 7) price fell from an average of US\$9.2 cents per pound in the first half of 1937 to US\$6.2 cents per pound in December of the same year. Being Colombia the leading producer of mild coffee, and second to Brazil in the total production of coffee, its coffee (Manizales) price also fell, this time from an average of US\$12.2 cents per pound in the first half of 1937 to US\$9.0 cents per pound in December of the same year. Fearing potential adverse effects on the international reserves, Colombian authorities adopted measures which made the existing foreign-exchange control even tougher. It was decided that the amount of exchange permits granted in each week would be limited by the exchange acquired by the central bank during the preceding week⁷.

In order to reinforce the direct rationing of foreign exchange, imports were divided between "essential" and "non-essential", and a prior import deposit in Colombian currency was required. Following these decisions the exchange rate depreciated by 5%

^{6/} Among others, the measures included the reduction of the coffee export tax (from 45 milreis to 12 milreis per bag), the removal of the prohibition against exporting low-grade coffees, and the elimination of the requirement that coffee exporters should sell part of their foreign currency drafts to the central bank at a rate lower than the current exchange rate. Institute of International Finance, Bulletin No 98, 1938, p.6

^{7/} Memoria de Hacienda, 1940, p.46

in one month (November-December, 1937) but it gradually came back to the original rate (C\$1.75=US\$1.0) one year later. Further restrictive measures during the first semester of 1938 included the temporary prohibition of some imports, particularly textiles. In the meantime, world coffee prices recovered and the average spot prices for the Colombian coffee in New York reached the figure of US\$ 12.3 cents per pound during the second half of 1938. This recovery would be ephemeral though, since by December 1939 a new downswing brought about by the outbreak of war in Europe would characterize the movement of coffee prices.

The spot prices of the Colombian coffee fell to an average of US\$7.6 cents per pound during the third quarter of 1940. The average for the whole year was US\$8.4 cents per pound, the lowest at least since the beginning of World War I, and 20% lower than the average figure for 1933 when the lowest quotations after the great depression were reached. Once more, authorities decided to use quantitative restrictions to preserve external balance. Accordingly, the measures adopted in 1938 were reinforced: permits to transfer funds out of the country were only granted with regard to the amount of exchange available, and imports were classified into four groups with differential exchange rates between 1.75 and 1.95 pesos per dollar.

As for internal balance, the defence of the coffee industry played a central role. Since the outbreak of the war, the central bank had rediscounted increased bank loans to the coffee industry, but authorities still feared that a new debtors' problem could ensue if extraordinary measures to ease the financial burden on coffee growers -such as lower interest rates and extended amortization terms- were not promulgated. But also as in 1932, a public bond -the 5% 1940 Coffee Premium Bond- was issued to compensate the coffee industry for the collapse of external prices⁸. Further commitments of the internal debt with the coffee industry arose from governmental contributions to the National Coffee Fund, the institution created in 1940 (November), to fulfil the obligations of the country with the newly launched Inter-American Coffee Agreement. Those contributions were the National Coffee Fund Bonds of 1940 and 1941. As seen in Table 56 the public bonds issued in favour of the coffee industry represented the non-negligible amounts of 25% of total bonds in circulation, and 12% of internal public debt by the end of 1941.

A significant contributor to both external and internal balance was the US\$10 million loan of the Ex-Im Bank to the Bank of the Republic in 1940-41. It helped to maintain external balance since international reserves had already started flowing out of the country due to the lower coffee prices when the proceeds of the loan began to be gradually received by the central bank. It also helped to maintain internal balance indirectly, since as discussed before, it was the basis for a direct loan of the Bank of the Republic to the government. The C\$17.5 million credit to the government - corresponding to the US\$10 million loan to the Bank of the Republic- was destined to strengthen public investment in the financial sector and to finance infrastructure and

^{8/} To sustain coffee exporters' income, a specific premium of C\$2 per each exported bag (60Kg) was established. This premium was intended to last for eight months starting from May 1940 (Decree 831 of 1940). The Coffee Premium Bonds were issued to finance that financial support to coffee growers. The originally authorized issue -C\$3 million- was later increased to C\$4.6 million. Memoria de Hacienda, 1942, p.59.

public works⁹. By 1941, this extraordinary loan together with the coffee bonds represented 26% of the total internal debt.

The measures prescribed to ensure external balance were successful as far as the availability of foreign exchange was concerned. The average stock of international reserves for the critical years 1939-1941 -US\$24 million- was the same of the preceding 1936-1938 period¹⁰. Authorities managed to sustain a fixed nominal exchange rate but the decline of the domestic price level during 1940-41 caused the real exchange rate to depreciate over that period. At the same time, the measures adopted to defend coffee incomes, reactivate public works and consolidate investment banks were not enough to reverse the slowdown of economic activity and avoid price deflation during 1940-1941 (Tables 57 and 58). An annual average primary deficit during 1939-1941 followed half a decade of primary surpluses. On the income side public finances weakened by the deterioration of custom duties, while on the expenditure side, apart from the increased expenditures financed by the extraordinary loan of the central bank to the government, the tendency as of 1941 was to curtail government expenditures (Table 59).

TABLE 57
KEY MACROECONOMIC INDICATORS
1939 - 1950

YEAR	GDP1	INFLATION2	COFFEE PRICE3	NOMINAL EXCHANGE RATE4	REAL EXCHANGE RATE5 (1935=100)
1939	6.1	4.5	11.7	1.75	77.9
1940	2.2	-3.3	8.4	1.75	81.4
1941	1.7	-1.4	14.7	1.75	87.0
1942	0.2	8.7	15.9	1.75	88.4
1943	0.4	16.0	15.9	1.75	80.9
1944	6.8	20.4	15.9	1.75	68.5
1945	4.7	11.2	16.2	1.75	63.1
1946	9.6	9.3	22.5	1.75	62.4

^{9/} Out of the C\$17.5 million, C\$7 million were destined to finance the capital share of the government in a new section of the Caja Agraria intended to provide medium- and long-term agricultural loans. Other C\$2 million constituted the share of the government in the capital of a new institute for industrial development, the Instituto de Fomento Industrial. The remaining half of the loan was assigned to road -C\$3 million- and railroad -C\$5 million- projects, and other agricultural -C\$0.5 million- initiatives. Memoria de Hacienda, 1941, p.99

^{10/} Informe del Gerente a la Junta Directiva del Banco de la Republica (en adelante IGBR) (1966) Segunda Parte.

1947	3.9	18.3	30.1	1.75	60.0
1948	2.8	16.4	32.6	1.76	55.8
1949	8.7	6.7	37.6	1.96	57.5
1950	5.5	21.5	53.3	1.96	47.9

NOTES

- 1 Annual rate of growth of GDP.
- 2 Average of monthly annual inflation rates.
- 3 Average of monthly quotations of the Colombian coffee in New York.
- 4 Average of month-end quotations of the US dollar in terms of Colombian pesos.
- 5 Calculations based on the CPI of both Colombia and the United States.

SOURCES. As for Table 26 in Avella (2003)

TABLE 58
TRADE BALANCE AND EXTERNAL FINANCING
1939 - 1950
(Millions of US\$)

YEAR	(1) EXPORTS (FOB)	(2) EXPORTS :IMBURSEMEN	(3) IMPORTS (CIF)	(4) TRADE BALANCE (1)-(3)	(5) NET EXPORT :IMBURSEMEN (2)-(3)	(6) INTERNATIO RESERVES	(7) CHANGE IN INTERNATIO RESERVES	(8) NET EXTERNA FINANCING (7)-(2)+(3)
1939	101,1	69,7	104,7	-3,6	-35	24,2	-2,8	32,2
1940	95,8	61,1	84,6	11,2	-23,5	24,9	0,7	24,2
1941	100,4	65,9	96,9	3,5	-31	22,5	-2,4	28,6
1942	109,5	95	59,9	49,6	35,1	61,9	39,4	4,3
1943	125,1	115,2	83,9	41,2	31,3	113,4	51,5	20,2
1944	130,1	112,2	100	30,1	12,2	158,2	44,8	32,6
1945	140,5	121,6	160,5	-20	-38,9	176,8	18,6	57,5
1946	201,3	219,6	230,2	-28,9	-10,6	176,3	-0,5	10,1
1947	276,3	230	364,1	-87,8	-134,1	123,6	-52,7	81,4
1948	306,6	250,7	323,7	-17,1	-73	96,1	-27,5	45,5
1949	335,2	275,2	264,6	70,6	10,6	123,3	27,2	16,6
1950	395,6	338,2	364,7	30,9	-26,5	113	-10,3	16,2

NOTES.

Column (2) is equal to column (1) but excluding 80% of oil, 60% of gold and platinum and 50% of bananas. Ocampo (1987)

SOURCES. IGBR (1964)

TABLE 59

FISCAL INDICATORS

1938 - 1950

(Millions of Pesos)

YEAR	(1) CURRENT INCOME	(2) IMPORT TAXES AS % OF (1)	(3) CURRENT EXPENDITURE	(4) PRIMARY DEFICIT	(5) DEBT SERVICE	CHANGES IN PUBLIC DEBT			(9) TOTAL
						(6) BORROWING REQUIREMENT	(7) ONAL INTERNAL	(8) GOVERNMENT EXTERNAL	
1938	87	35,7	82,9	4,1	10,9	6,8	-1,2	0,9	-0,3
1939	100	40,6	91,7	8,3	10,4	2,1	-1,3	0	-1,3
1940	89,3	31	119,2	-29,9	12,7	42,6	4,3	-4,9	-0,6
1941	107,8	28,3	98,1	9,7	14,6	4,9	24,8	1,6	26,5
1942	115,1	16,2	138,2	-23,1	19,4	42,5	5,7	10	15,7
1943	131,5	16,5	90,4	41,1	18,2	-22,9	52,8	2,3	55,1
1944	135,2	19,2	157,9	-22,7	20,7	43,4	24,6	-1,6	23
1945	165,7	24,9	166,7	-1	32,6	33,6	38,5	4,4	42,9
1946	230,7	21,2	236,4	-5,7	45,5	51,2	37,6	-3	34,6
1947	305	21,5	324,3	-19,3	39,6	58,9	42,2	-5,4	36,8
1948	335,8	17,5	350,8	-15	61,3	76,3	24,9	2,8	27,7
1949	392	11	354,7	37,3	56,9	19,6	-17,9	-14,5	-32,4
1950	522,3	18,7	457,1	65,2	62,5	2,7	-4,6	-2,9	-7,5

SOURCES.

Informe Financiero del Contralor. Annual Report

The balance sheet of the central bank reflected the outcomes of external and internal policies (Table 60). The international reserves (in domestic currency) showed little variation during 1939-41 with a small contractionary effect during the last year. The net credit to the government was clearly expansionary coinciding with the extraordinary loan of 1940. To complete the picture, the net credit to the private sector showed expansionary effects in 1939 and also in 1941. Both events were related to increased rediscounts to the banking system; in 1939 the ultimate beneficiary of such credits was the coffee industry, and in 1941 the importers, who increased the scale of their normal operations in anticipation of future import difficulties associated with the participation of the United States in the war¹¹.

^{11/} Triffin, R (1944), p.21

TABLE 60
FINANCIAL INDICATORS
(1938 - 1950)

YEAR	MONEY SUPPLY C\$ Millions	MONEY SUPPLY (RATE OF GROWTH)	INTERNATIONAL RESERVES C\$ Millions	CENTRAL BANK NET CREDIT TO GOVERNMENT C\$ Millions	CENTRAL BANK NET CREDIT TO PRIVATE SECTOR C\$ Millions	LONG-TERM INTEREST RATE GOVERNMENT BONDS (%)
1938	141,7	10,7	47,2	9,8	16,3	5,6
1939	146,3	3,2	42,4	8,5	19,2	5,7
1940	158,3	8,2	43,6	21	19,6	5,7
1941	176	11,2	39,2	24,3	36,2	4,9
1942	231,9	31,7	108,1	-6	5	4,4
1943	312,7	34,8	198,3	-30,5	-25,2	5
1944	406,7	30,1	276,9	-30,9	8,4	5,1
1945	472,6	16,2	309,4	-64	9,2	5,3
1946	583,4	23,4	308,5	-52,6	13,3	5,4
1947	640,6	9,8	216,4	-30,8	28,7	5,3
1948	749,1	16,9	187,4	-9,1	122,7	5,3
1949	913,9	22	240,2	-4,8	152,4	5,3
1950	962,4	5,3	220,4	-27,4	218,5	5,2

SOURCES.

Based on Informe del Gerente del Banco de la Republica (1966)

2. The economic consequences of the U.S. entry into the war.

The strains caused by the coffee crises were followed by the external instability originated in the general expectation of an imminent entry of the United States into the war. During the first semester of 1941, the stock of international reserves steadily increased from US\$24.9 million in December 1940, to US\$32.9 million in May 1941. Such a level had not been reached since January 1930, and exceeded the authorities' target of avoiding the decline of foreign exchange. It was the result of the upturn of international coffee prices after the Inter-American Coffee Agreement; in fact, prices stabilized around US\$15.9 cents per pound in the third quarter of 1941, when exactly a year before they had only reached US\$7.6 cents per pound.

This upward turn of foreign reserves was to be totally reversed during the second half of the year. With the prospect of the U.S. entry into the war, and therefore of future shipment difficulties, there was a burst of imports which demanded the major increase of commercial bank loans and central bank rediscounts since the lending boom of the late 1920s¹². The accumulation of foreign exchange during the first half of the year was then spent during the second half and the stock of international reserves fell back to US\$22.5 million, the second lowest year-end result in the last five years.

^{12/} In nominal terms the average stock of loans of commercial banks during 1928-29, some C\$112 million was only recovered during the second semester of 1941. During that year, loans went up by 33%, and the average loans in the second half of the year exceeded those of the first half by 20%. The basic data is available in Informe del Gerente, IGBR (1966) Segunda Parte.

The sharp fluctuations of the foreign exchange supply during 1941, illustrated the precarious stability of international reserves. To strengthen the foreign position of the country, the government had negotiated a second loan with the Ex-IM Bank for the amount of US\$12 million. The contract was signed in July 1941¹³. The new loan was also intended to satisfy fiscal objectives. Given the fiscal dependence on custom duties, and the great uncertainty associated with those revenues during the war, government expenditure plans could not be fulfilled without increased government borrowing. In the economic conditions of mid-1941, the external credit appeared to be favourable to both internal and external balance¹⁴.

The expected stabilizing effects of the Ex-Im Bank loan were not to be felt during the second half of 1941 when international reserves were draining away, since most of the proceeds of the loan were received during 1942 and 1943, when foreign reserves accumulated at an unprecedented pace as we will see below. However, some public works were carried out in the second half of 1941, financed by the issue of internal debt. Promissory notes amounting to C\$4.0 million (Table 56 II.B) were issued to finance construction of public roads and other projects, which later were charged against the Ex-Im Bank loan¹⁵.

A crucial change in the macroeconomic scenario followed the U.S. entry into the war (December, 1941). Instead of the recession with price deflation of 1940-41, an example of stagflation -stagnation of economic activity combined with high inflation- was lived through 1942-43. Instead of the barely maintained level of rationed international reserves of 1939-41, the availability of foreign exchange multiplied by 7.9 between the end of 1941 and the end of 1945. Instead of a fixed exchange rate regime with real depreciation during 1940-42, a fixed exchange rate arrangement with substantial real appreciation dominated since the end of 1942 until after the war (Tables 57 and 58). The change of macroeconomic scenario took place while the international coffee prices were rather constant. As seen before, prices stabilized around US\$15.9 cents per pound as of the third quarter of 1941, and this quotation was the maximum value fixed by the U.S. government after entering into the war. This price remained unchanged until the end of hostilities.

a. The collapse of imports and unintended accumulation of international reserves.

Authorities observed a substantial drop of imports since the beginning of 1942. It was not only the German military campaign in the Atlantic, but also the "war economy" which restricted the access of Colombian importers to U.S. markets. In fact, the U.S. government rationed some tradeables and restricted certain maritime transport routes. In Avella (1988) it is showed that relative to trend, import growth rates during 1942-44 were comparably as bad as they had been over the depressed 1931-1933 period. The

^{13/} The negotiation of this loan created an important precedent for future external credits. First, the government was supposed to present a plan of investments to the Bank. Second, on the basis of approval by the Bank, the plan could be executed against an ad-hoc fund in the central bank. Finally, periodical reports of executed investments would be sent to the Bank to obtain the corresponding financing. Memoria de Hacienda, 1942, p.48.

^{14/} Speech by the minister of Finance before the Senate, 23-09-41, in Lleras Restrepo, C. (1983) Volume IV, pp.62-67.

^{15/} Memoria de Hacienda, 1942, p. 49-52

magnitude of the collapse of imports is clearly illustrated by the fact that in real terms, the annual average imports during 1942-1945 were a 30.2% less than during 1938-1941. This downturn coincided with a positive evolution of real exports, which exhibited an increase of 30.4% between both periods¹⁶. In contrast to the adverse effect on imports, circumstances created by the war turned out to be favourable to Colombia's coffee exports since reduced Brazilian shipments to the United States led to increases of quotas to other Latin American producers.

The downfall of imports during 1942-1945 for reasons which were independent from the market system necessarily led to an unintended accumulation of international reserves. This process was intensified by the upturn of exports during the same years. However, it has to be observed that this improved performance of exports cannot be confused with overall recovery of trade and income indicators. As commented in Avella (1988), the lowest growth rates of the terms of trade relative to the trend were reached precisely during 1943-1945. The experience of the purchasing power of exports was similar. Since this measure takes into account export volumes besides the terms of trade, the increased export trade of those years mitigated the downturn of terms of trade. Even so, the poorest growth rates with respect to the trend were reached during 1942-1945.

The accumulation of international reserves was also induced by capital inflows. Reserves accumulated at an annual average rate of US\$40 million during 1942-1945, being the difference between annual inflows of US\$160 million and outflows of US\$120 million¹⁷. Because the annual average export cash proceeds arrived to US\$111 million (Table 58), the excess of US\$49 million has to be explained by other sources. Since no new credit was given to the government by either commercial banks or credit suppliers (Table 47), the possible origins of those capital inflows were the Ex-Im Bank, foreign commercial banks through their credit to domestic banks, foreign investors, and other private sources. The external credit to banks was not a source of accumulating reserves since under war restrictions U.S. banks curtailed their credit to Colombian banks -the short-term external liabilities of banks fell from an average of US\$9.6 million during 1940-1942 to US\$3.0 million during 1943-1945 (Table 53)-.

The two Ex-Im Bank credits accounted for a relatively small part of the accumulated reserves. The US\$10 million loan to the Bank of the Republic was completely disbursed and repaid by 1943. The US\$12 million loan of 1941 to the national government, later increased to US\$20 million in 1943, was partially disbursed -some US\$13.7 million- by 1945. Altogether, the proceeds of these loans amounted to an annual inflow of US\$6 million during 1942-1945. A more important source of capital inflow was the foreign direct investment. Without including sectors as relevant as mining and petroleum, the Board of Exchange Control registered an annual inflow of US\$14 million during 1942-1945¹⁸. Since both the Ex-Im Bank credits and the foreign direct investment only amounted to an annual inflow of about US\$20 million, the remaining excess of US\$29 million would have to be accounted for by other private sources. The minister of finance explained the accumulation of international reserves not only by the reduction of

^{16/} Real imports declined from an annual average of US\$193.3 million in 1938-1941 to US\$134.9 million in 1942-1945. In the meantime, real exports went up from an annual average of US\$234.5 million in 1938-1941 to US\$306.0 million in 1942-1945.

^{17/} Calculations based on data about inflows and outflows of gold and foreign exchange of the central bank. Outflows are based on authorizations only. IGBR (1966) Segunda Parte.

^{18/} "La Inversion Extranjera en Colombia", DANE, Boletín Junio 1977, p.70

imports, but “by the continuous inflow of international capitals which find in our country a shelter from foreign more burdensome fiscal regimes”¹⁹.

b. Fiscal strains due to the fall of imports.

The decline of imports also created fiscal strains. Custom duties which during the previous five years had represented 35% of current government expenditures, collapsed during 1942. The magnitude of the downfall amounted to 43% of the average custom revenues of the preceding five years²⁰. Authorities sought to redress the adverse fiscal effects of weakening imports by creating new taxes -a sale tax which affected at the industrial level, goods such as textiles, beer, sugar and cement-, introducing some reforms to the income tax, and reducing some government expenditures. These changes were made on a temporary basis, subject to the future course of the war. Authorities anticipated that a prolonged international conflict could have devastating fiscal implications if a complete fiscal reform was not implemented. Such a reform was thought to imply a tax system less dependent on the external sector, and new channels to convey private savings to the financing of public services²¹.

As fiscal revenues weakened during 1942, the Treasury faced a continuous build-up of short-term liabilities. Authorities decided to consolidate these debts by the issue of a new bond, the "Treasury Bond of the Republic of Colombia", and earmarked the proceeds of the sale tax for its service. Additionally, the Bank of the Republic was authorized to open a new credit quota to the government equivalent to 40% of the Bank's capital and reserves, exclusively designed to satisfy shortages of the Treasury associated with current expenses²².

The fiscal pressures did not discourage the government to go ahead with public works funded by the second Ex-Im Bank loan, and on the contrary, the internal debt was also enlarged to finance housing projects and strengthen the financial capacity of public investment institutions. Specifically, a second issue of UIND 4% bonds for an amount of C\$7 million was launched (As seen in Table 56 I.D., the UIND Class B bonds outstanding balance was increased in the aforementioned amount during 1942). About 60% of the loan was destined to housing programs including a contribution to the capital of a public institution (Instituto de Credito Territorial) created for the implementation of popular housing projects. Another 35% was intended to increase the capital of public investment funds concerned with the industrial sector (Instituto de Fomento Industrial), and the agricultural and popular consumption sectors (Federacion de Trigueros y Fondo de Cooperativas)²³.

3. Fiscal deficit, external surplus and high inflation. Policy options.

^{19/} Memoria de Hacienda (1943) pp.18-19

^{20/} CEPAL (1957) Appendix, Cuadro No 54.

^{21/} Memoria de Hacienda, 1942, pp.160 y 169.

^{22/} Memoria de Hacienda, 1943, p.16. Triffin, R. (1944), p.20.

^{23/} Memoria de Hacienda, 1942, p.57

By the end of 1942, authorities felt that extraordinary measures were required to face a situation of simultaneous fiscal disequilibrium and piling up international reserves. Although the primary budget deficit was not as high as in other difficult periods (0.8% of GDP during 1940-1942 compared with 1.4% of GDP during 1926-1928 -Graph 13 in Avella, 1988), the collapse and unlikely recovery of custom revenues in the immediate future demanded from the government at least a medium-term financial solution to cope with the shortage of fiscal resources. On the other hand, the accumulation of foreign exchange exceeded any expectation. At the end of 1942 the stock of international reserves amounted to US\$61.9 million compared with the annual average value of US\$23.7 million of the preceding five years (Table 27 in Avella, 2003, and Table 58 above).

The problem for authorities was not only how to deal with a fiscal deficit combined with a substantial external surplus. The money supply (M1) was growing at an unprecedented rate since the foundation of the central bank (1923), and inflation had returned after two consecutive deflationary years. As for money growth, the 31.7% rate shown at the end of 1942 largely exceeded the annual average of 7.3% of the previous five years (Table 28 in Avella, 2003, and Table 60 above). This monetary upsurge was considerably due to the significantly increased share of international reserves (in Colombian pesos), in the balance sheet of the Bank of the Republic (Table 60). Regarding the inflationary revival, the quick monetary expansion of 1942 likely came to reinforce the already existing price-rising effects caused by the plummeting supply of imported goods.

The government's strategy was encapsulated in the so-called "Fiscal Plan" of late 1942 and "Economic Plan" of early 1943. The macroeconomic strategy consisted in transferring new savings in the hands of the private sector to the public sector. The coffee industry -coffee exporters and the National Coffee Fund-, the mining sector concerned with gold, silver and platinum, other exporters, and foreign investors who had found refuge for their capitals in Colombia since 1942, played a central role in the strategy. Because a fixed exchange rate arrangement was in force while international reserves were accumulating, exporters and foreign investors gained a higher monetary income, a sort of quasi-rent. The idea was to transfer part of this extraordinary monetary income to the public sector with the prime objective of financing the fiscal deficits of 1942 and 1943.

The mechanism applied to convey those extraordinary incomes to the public sector was a combination of internal debt and taxes, where the major job was to be done by a new bond, the 6% National Economic Defense Bond (NED) issued with a length of life of 30 years. The authorized issue amounted to C\$60 million, the proceeds of which were to be distributed as follows: C\$11.6 million to complete the financing of the deficit of 1942 (including the retirement of the "Treasury Bond of the Republic of Colombia" mentioned above), C\$24 million to finance the originally planned fiscal deficit for 1943, C\$19.7 million for new public work projects, and C\$4.7 million to liquidate debts of the national government with political subdivisions also originated in the execution of public works²⁴. In conclusion, besides the financing of budget deficits, the issue of NED bonds was intended to finance additional public works, in the non-negligible proportion of 40%.

^{24/} Memoria de Hacienda, 1943, p.11

In practice, authorities implemented a system of "forced saving" on direct tax payers, exporters and foreign investors. The former were required to pay a 50% surcharge on the tax payable for 1942 and 1943. Provided certain conditions of rapid payment were satisfied, the excess was returnable to the tax payers in the form of NED bonds. Exporters and foreign investors were required to "save" in NED bonds a proportion of the foreign exchange sold to the central bank. The discriminating figures were 5% for coffee exporters, 10% for other exporters, and 20% on capital imports and sales of gold, silver and platinum to the central bank. Additionally, the National Coffee Fund was compelled to invest 20% of its turnover for 1943 and 1944 in NED bonds. On the whole, 40% of the new bonds were to be acquired by the coffee sector, 17% by capital importers, another 17% by precious metal producers and other exporters, and 26% by direct tax payers. Finally, authorities resorted to increase the rates on direct taxes by 35% as a means of providing for the service of the new bonds²⁵.

By the end of 1943, the whole issue of NED bonds had been sold. The 43% increase in the stock of internal public debt during that year was thoroughly explained by the launching of those bonds. Since the government offered a 6% interest rate, the weighted average rate for internal long-term government bonds which had declined from 5.6% during 1935-1940 to 4.6% after the bond conversions of 1941-1942, went up again to 5% (Table 60). This development made the contrast between relatively low rates for the external debt -3.4% for the dollar debt as for 1943- and relatively higher rates for the internal debt, even more marked.

Apart from solving the fiscal imbalance for 1942-43, the combination of public debt and taxes served to bring about an important change in the relative proportion of custom and income taxes. It is significant that at the beginning of the war (1939) for every C\$1 of income taxes the Treasury was receiving C\$2 of custom duties, and at the end of 1943 the relationship was the opposite since for every C\$1 of custom duties the Treasury was receiving C\$2 of income taxes. The new proportion between the two taxes was not limited to the war period when custom revenues were weakened by constrained imports. It remained during the recovery of imports in the aftermath of the war, and in 1950 the actual proportion of income to custom revenues was 2.2. For this result to be obtained, income-tax revenues were stimulated by new increases in tax rates, as well as by the creation of new surcharges over individual tax payable amounts²⁶.

By overcoming the fiscal difficulties of 1942-43, authorities were half-way from solving the major macroeconomic problems. After showing negative figures in 1940-41 the inflation rate exhibited a positive trend along 1942. Although the annual average rate for 1942 was 8.7%, the inflationary trend became more evident by looking at the annual rates since the second quarter of the year. Accordingly, by the end of June, September and December, the annual rates were 6.7%, 11.4% and 13.9% respectively. And by March 1943, the inflation rate reached the height of 16.0%, a figure without

^{25/} In order to "stimulate" market for the NED bonds, financial institutions and industrial companies were compelled to invest in such bonds as follows: saving banks 20% of deposits received from the public, insurance companies 10% of their reserves, and industrial companies also 10% of their reserves. Memoria de Hacienda, 1943, pp.12-17.

^{26/} For data about custom revenues and income-tax revenues, CEPAL (1957) Appendix Cuadro No 54.

precedents since the reflationary policies of 1932-34. It was clear that through the compulsory investment in NED bonds, and the requirement that some financial institutions and industrial businesses should put a certain portion of their assets in NED bonds by acquiring them in the secondary market, the Fiscal Plan also contributed to stabilize aggregate monetary demand. But given the unprecedented rate at which foreign assets were being monetized by the central bank, a new set of actions were required to counterbalance its inflationary implications. These actions would make up the so-called Economic Plan.

The policy-menu offered three possible alternatives: first, to allow the automatic correction of the external surplus by means of a freely appreciating exchange rate; second, to defend a fixed exchange rate and allow the central bank to build up international reserves; and third, to maintain a fixed exchange rate, allow the central bank to build up reserves, and neutralize the monetary effects of the increased reserves by means of sterilization measures. The first alternative was thoroughly discarded by Colombian authorities as opposed to the interest of exporters. According to the minister of finance: "We find no advantage ... in resorting to the straightforward but hazardous method of reducing the exchange rate, since it would imply that coffee growers and miners who are responsible for our main exports would have to endure a grave sacrifice..."²⁷.

Exchange rate appreciation was not the preferred policy option in the Latin American context. According to a contemporary survey, "in general, Latin American currencies are still, in 1944, at a lower value in dollars than in 1937-1939"²⁸. Exchange rate appreciation became the general tendency since 1941 but only to a limited degree. Fears of discouraging export industries, and the preference of a currently undervalued national currency in order not to have to depreciate it after the normalization of international trade, restricted the actual importance of exchange appreciation²⁹.

Most Latin American countries followed the second option. Export industries were protected by fixed or slightly appreciated exchange rates while foreign reserves were building up. Monetary incomes were kept high while the supply of goods and services was curtailed by the downfall of imports. Attempts at sterilizing the monetary effects of the balance of payments surplus were of limited importance. Commenting on the Brazilian experience, Furtado (1963) highlighted the absence of policies destined to reestablish equilibrium between the enlarged flow of income and the restricted supply of goods and services. By allowing inflation rates to reach the figure of 86% between 1940 and 1944 while it had been 31% between 1929 and 1939, the author concludes that the policy of keeping high incomes to protect export industries ended up unleashing other processes which had the opposite effect³⁰.

Colombia followed the third alternative which aimed to exclude both exchange rate appreciation and domestic inflation. The way in which the country pursued these two objectives was known in contemporary U.S. academic and official circles as the "Colombia's technique". Colombia recognized the importance of accumulating reserves

^{27/} Memoria de Hacienda, 1943, p.19

^{28/} Harris, Seymour (1944b) p.184

^{29/} Harris, Seymour (1944a) pp.16-18

^{30/} During the 1940s domestic prices ended up rising more rapidly than external ones with adverse consequences for the Brazil's industrial development. Furtado (1963) p.236

so as to finance the recovery of imports after the war, but also the need of stabilization to protect export industries and develop industries for the domestic market. The measures adopted to achieve these objectives were condensed in the Economic Plan, which according to Seymour Harris represented "in many respects the most advanced anti-inflationary measures taken in the Americas"³¹.

Three central areas of action were considered in the Economic Plan. A new framework for foreign exchange operations, a set of monetary measures to neutralize the effects of piling up international reserves on the money supply, and a price control system. The former was intended to suspend or modify the exchange control regime, in order to reduce the process of monetization of increasing reserves by the central bank, during the remaining war period. An important condition imposed by the enabling legislation was that the concrete measures to be adopted should ease the attainment of an exchange rate favourable to the "legitimate interests" of exporters³². In this context, new capital imports were subjected to the Exchange Control Board approval, and existing regulations which tended to discourage merchandise imports were lessened or eliminated³³. Capital exports were strengthened particularly through granting foreign exchange for the repatriation of public external debt -Nation, Departments and Municipalities- as well as for the repatriation of equity shares of Colombian businesses. Finally, the financial system was authorized to open foreign exchange accounts, and the central bank was authorized to issue certificates in exchange for gold³⁴.

The sterilization measures affected the issue of money by both the central bank and commercial banks. The Bank of the Republic was authorized to issue a non-negotiable 4% security convertible after two years into gold, United States dollars or domestic currency at the option of the investor. The new security was known as the Certificate of Deposit, which by definition constituted a non-monetary liability in the balance sheet of the central bank. The Certificate of Deposit was the specific instrument by which liquidity excesses in the hands of the public, banks and business houses were to be sterilized. Business units were required to invest 20% of their profits and 50% of their depreciation reserves in the new certificates for a period of two years. Importers were compelled to invest 5% or 10% (according to certain conditions) of the value of their imports in the same certificates, although this measure was later abolished in order to stimulate imports.

Bank reserves played a central role in the sterilization program, since banks were ordered to gradually double their cash reserves during the second semester of 1943, and to keep that higher level of reserves for a two year period -from June 1943 to June 1945-. These increased reserves should also be invested in Certificates of Deposit, although this time bearing 3% interests. As seen, the sterilization process through the banking system was to produce a double contractionary effect, since not only the money multiplier was to be reduced, but also the monetary base was to be reduced by the

^{31/} Harris, Seymour (1944b) p.187

³² Memoria de Hacienda (1943), p.22

^{33/} As seen above, in order to prevent the issuance of import licences which were not exercised, the Exchange Control Board required (November 1937) from applicants to deposit Colombian currency equivalent to 5% of the value of the proposed imports. This requirement was eliminated. Additionally, because there were differential exchange rates allocated to imports according to "essentiality", the rates in force were reduced to lower the cost of merchandise imports.

^{34/} Decree No 736 of 1943 and Resolutions No 118 and 119 of 1943 in "Medidas Economicas y Fiscales del Gobierno". Revista del Banco de la Republica, Suplemento, May 1943

investment of the increased bank reserves in Certificates of Deposit -a non-monetary liability of the central bank-

The final piece of the antiinflationary policy was the organization of a price control system. The enabling legislation authorized the government to establish wartime price control. The contemporaneous U.S. experience in the area was to be applied in Colombia with the assistance of a U.S. Price Control Mission. The government as well as the mission saw direct price control as a partial weapon particularly useful to strike down price increases in certain speculative situations³⁵.

Although the three pieces of the Economic Plan were companion devices to eliminate the inflationary pressures, the sterilization measures were the crucial instrument. This instrument was conceived in a way that "as dollars come in and are converted into pesos, pesos are sterilized *pari passu*"³⁶. In practice, however, the strength of these actions was to be substantially weakened in less than six months. A fierce opposition led by chambers of commerce in the midst of an unsettled political situation brought about a series of regressive measures. The amount of profits that businesses had to invest in certificates was reduced from 20% to 10% and other various conditions substantially lessened.

What happened with the bank reserve measures? They were supposed to be doubled between June and December, 1943, and by September, a 28% of the bank reserves had been invested in Certificates of Deposit. Also by September, however, the originally planned reserve increases on demand deposits were suspended by the government and the liquidity ratio was back to its normal level. The initially strong measure was replaced by increases of reserves which could fluctuate between only 15% and 30%, but also these figures could be reduced and even abolished³⁷.

Once the sting of the sterilization measures was significantly reduced, the government turned to internal indebtedness as the last resort mechanism to save the contractionary monetary policy. Based on the success of the NED bonds, authorities opted for issuing a new bond which was to be allocated following the same compulsory method used with the NED bonds. The new security, the "6% 1944 Colombian Bond of the Treasury", was issued in the amount of C\$25 million and sold to direct tax payers, exporters and foreign investors, as in the case of the NED bonds. Later, the government was authorized to issue the "6% 1945 Colombian Bond of the Treasury" for the amount of C\$50 million. The 1944 issue was fully sold during that fiscal year, and 1945's was completely sold by 1946. In this last year, the Treasury Colombian Bonds represented 30% of total bonds and 26% of internal public debt (Table 56 I.G.)³⁸.

Some partial data are illustrative of the relative success of the antiinflationary plan. As seen above, the annual rate of inflation moved from 6.7% to 16.0% between June 1942 and March 1943. The antiinflationary plan was adopted later in June 1943, and the

^{35/} Lewis and Beitscher (1944).

^{36/} The expression between quotation marks is taken from Harris, S (1944b), who added: "This is indeed a remarkable bit of legislation and goes far in the direction of offsetting inflationary effects of the favourable balance of payments" pp.187-88

^{37/} Triffin, R (1944) p.26.

^{38/} Law 35 of 1944. Diario Oficial No 25733, January 1945. The first issue of the bonds was authorized in June 1945 by the Decree No 1587, Diario Oficial, Ibid.

annual inflation rate stabilized around 15% during the second half of the year. The inflation rate speeded up again along 1944 when the "siphoning" legislation had already been substantially dismantled. When the Treasury Colombian Bonds (1944) were issued, the annual average inflation rate had surpassed the figure of 20%. A general outlook of the magnitudes reached by the monetary expansion during 1942-1946 is offered in Table 60. As seen, the years of rapidly accumulating international reserves (1942-1945) were accompanied by a negative net credit of the central bank to the government, and a low net central bank credit to the private sector. However, as the figures for the increased stock of reserves suggest, their expansionary monetary effect clearly outstripped the contractionary impact of the central bank credit retrenchment. There was then a favourable context for ongoing high inflation rates.

A closer look at the factors of monetary expansion during the 1942-1946 period is provided in Table 61. The major increases in M1 -between June 1942 and June 1944- corresponded to the highest changes in the monetary base (section A). During June 1942-June 1943 the large increase in the monetary base was reinforced by a significant increase in the multiplier. The Economic Plan was adopted only until June 1943, and during its first year the reduction of the money multiplier just partially offset the substantial increase of the base during that year. The money multiplier fell as a result of a combined increase of the currency-to-deposit ratio, e , and the banks' reserve-to-demand deposits ratio, r . Also, the average banks' reserve-to-deposit ratio, c , increased. Both r and r^* went up although the credit restrictions of the time were progressively lessened, and it can be hypothesized that e went up in anticipation of further stronger restrictions on the availability of credit.

TABLE 61
FACTORS OF MONETARY EXPANSION
1942 - 1946 (Junes)
(Millions of Colombian Pesos)

A. MONEY SUPPLY, BASE AND MULTIPLIER

YEAR	M1	B	m1	dM1/M1	dB/B	dml/ml	e	r	r*
1941	172,6	120,6	1,431				1,008	0,395	0,242
1942	192	138	1,391	11,2	14,4	-2,7	1,056	0,422	0,244
1943	271,9	176,3	1,542	41,6	27,8	10,9	0,836	0,354	0,247
1944	373,6	258,7	1,444	37,4	46,7	-6,4	0,91	0,412	0,278
1945	430,6	291,9	1,475	15,3	12,8	2,1	0,821	0,413	0,286
1946	520,4	325,1	1,602	20,9	11,4	8,6	0,758	0,339	0,227

B. SOURCES OF VARIATIONS IN THE MONETARY BASE

CHANGES IN:	PERIOD 1942-1944		PERIOD 1944-1946		PERIOD 1942-1946	
		%		%		%
International Reserves	189,9	100	44,2	33,2	234,1	97,1
Net Credit to Government	-16	16,3	-41,1	100	-57,1	100
Net Credit to Private Sector	-48,8	49,8	55,7	41,9	6,9	2,9
Other Net Assets	-33,1	33,9	33,1	24,9	-	
Expansionary Changes	189,9	100	133	100	241	100
Contractionary Changes	97,9	100	41,1	100	57,1	100
Monetary Base	92		91,9		183,9	

SOURCES.

Based on IGBR, annual reports.

Regarding the significant increases of the monetary base, the question is about the actual relevance of the sterilization measures. Some evidence is indicative of it. As for the importance of the investment in Certificates of Deposit, it can be mentioned that between June 1943 when the Economic Plan was adopted and December 1944, the international reserves of the Bank of the Republic increased by C\$119.1 million, or 75%. During the same period, the compulsory investment in certificates reached the height of C\$46.8 million, equivalent to 39.3% of the increase in international reserves. Concerning the contractionary role of the Treasury Colombian Bonds, of the whole amount -C\$75 million- compulsory sold, C\$55.4 million were deposited in the Bank of the Republic between June 1944 and June 1946; since the increase in international reserves amounted to only C\$44.2 million during that period, the monetary effect of the enlarged reserves was entirely neutralized.

The changes in the aggregate composition of the monetary base for the period June 1942-June 1946 are shown in Table 61 (Section B). As seen, 80% of the expansionary effect of international reserves occurred during June 1942-June 1944. During these two years, 52% of the monetary effect of the augmented reserves was sterilized through the contractionary behaviour of private and public sectors. But it was the contractionary net

credit to the private sector and the contractionary balance of other net assets -which included the Certificates of Deposit- which explained most of the actual sterilization.

Things were different during June 1944-June 1946. As far as the antiinflationary legislation was diminished, and practically dismantled during the first half of 1945, the net credit to the private sector and the balance of other net assets were no longer the main source of contraction, but on the contrary, the main expansionary cause. Arithmetically, the nominal contraction and expansion reflected in these accounts were practically equivalent, and therefore the actual sterilization of the first two years turned back into circulation in the last two. The dismantling of the contractionary measures imposed on the private sector was carried out when the Treasury Colombian Bonds were already being sold, the inflation rates were falling -from an annual average of 20.4% in 1944 to 11.2% in 1945- and the international reserves were accumulating at a lower pace -the stock of reserves increased by 11.7% in 1945, compared with 39.6% in 1944, and 83.4% in 1943-.

During 1944-1946, the contractionary net credit to the government nearly neutralized the expansionary effect of the international reserves; as mentioned above, such contraction resulted after the proceeds of the Treasury Colombian Bonds were deposited in the Bank of the Republic. Although this use of the proceeds of the bonds reinforced the contractionary monetary role of the net credit to the government, an important fiscal objective of the bonds was to help finance the public debt service. The public accountancy of the time suggests that 92% of the annual average borrowing requirement of the national government during 1942-46 originated in the debt service accounts (Table 59).

To close this discussion, some evidence is presented regarding the relative gravity of the Colombian inflationary problem in the Latin American context. Data about the United States is also presented as a reference. To use the language of the time, "the ravages of wartime inflation" were unequally distributed. As shown in Table 62, the average inflation rate for 1940-45 varied between the extremes of 4.2% for the United States and 21.1% for Bolivia. Brazil, Chile and Mexico exhibited relatively high inflation rates around 15%, while Argentina, Uruguay and Venezuela got the lowest rates in Latin America, about 5%. Between these two groups, Colombia managed to reach a position within the countries with one-digit inflation. The U.S. entry into the war divided the inflationary experience in Latin America in two different periods. The Colombian case had extreme features since after being the country with the lowest inflation rate in the Americas during 1940-1942, it exhibited the largest relative increase of average rates in 1943-1945. During this period, Colombia's inflation rate was only surpassed by those of Brazil and Mexico, and exceeded those of Chile and Bolivia who managed to significantly lower their inflation rates against the general trend in Latin America.

TABLE 62
 FLATION RATES
 SAMPLE OF AMERICAN COUNTRIES
 1940 - 1945

YEAR	ARGENTINA	BOLIVIA	BRAZIL	CHILE	COLOMBIA	MEXICO	PERU	UNITED STATES	URUGUAY	VENEZUELA
1940	2	34	5	12,3	-3,3	1	7	0,1	4,8	-5
1941	3	28,1	11,4	15,1	-1,4	3,4	9,3	4,1	-0,1	-0,1
1942	5,7	29,9	11,1	26,3	8,7	15,7	12	10,8	2,8	9,9
1943	1	22,2	15,4	16,2	16	30,7	9,2	6,2	5,4	9,9
1944	0	6,6	27,3	11,4	20,4	25,7	14,7	1,7	2,5	15,6
1945	19	5,5	21,5	8,9	11,2	7,4	11	2,5	14,9	0
1940-42	3,6	30,7	9,2	17,9	1,3	6,7	9,4	5	2,5	1,6
1943-45	6,7	11,4	21,4	12,2	15,9	21,3	11,6	3,5	7,6	8,5

SOURCES.
 Based on United Nations, Statistical Yearbook (1948).

4. *New macroeconomic conditions after the war.*

The end of international hostilities opened up a new macroeconomic scenario. The external constraint on imports was no longer in force, and the industrial sector highly dependent on imports of capital goods found the opportunity for a greater expansion. The upsurge of imports is illustrated by the fact that during 1946-50 the annual average imports (US\$309 million) tripled the figure (US\$100 million) reached during 1941-1945. Exports also boomed -for every US\$1 of reimbursed exports during 1941-1945, the country received US\$2.6 during 1946-50- led by rapidly increasing coffee prices; in fact, the fixed quotation of US\$15.87 cents per pound imposed by the U.S. government during the period 1942-1945 was followed by an average of US\$31.3 cents per pound in 1947-1948 and a monthly average of US\$53.3 cents per pound in 1950 (Tables 57 and 58).

The excess of imports over exports was financed by a substantial reduction of international reserves. The piling up stock of the war years reached its maximum in the first quarter of 1946, steadily declined along this year, and sharply fell during 1947-48. At the end of 1948, the stock of foreign reserves had fallen by 46% compared with its level at the end of 1946³⁹. The withdrawal of the exogenous constraint on imports was accompanied by a relaxation of internal restrictions. The wartime liquidity controls on the private sector were dismantled, and there was a revival of bank lending. As shown in Table 60 the exiguous net credit of the Bank of the Republic to the private sector during the war period was followed by large increases of credit during 1946-50. This central bank credit expansion to the private sector was unprecedented since the creation of the Bank of the Republic in 1923⁴⁰. The main channel of this credit expansion was

³⁹/ International reserves peaked in February 1946 -US\$187.3 million-, and fell down to their minimum point in April 1949 -US\$75.6 million-, a reduction equivalent to 60% of the highest accumulated value of international reserves. Though import controls and devaluation measures were adopted in late 1948, reserves continued falling until April 1949, and a steady recovery only started in May. IGBR (1966) Segunda Parte.

⁴⁰/ The net credit to the private sector represented 8.7% of the monetary base in 1946, 20% in 1947, 28% in 1948, 35% in 1949, and 41% in 1950. Balance sheets of the Bank of the Republic at June of each year. IGBR (1948) Segunda Parte.

the rediscount of commercial bank loans, which jumped from an annual average of C\$9.9 million in 1941-45 to C\$73.2 million in 1946-50.

The expansionary impetus was checked by authorities by the end of 1948. In order to stop the drain on the country's foreign reserves, import controls were reestablished, and the nominal exchange rate devalued. This rate had been fixed at US\$1=C\$1.75 since the late 1930s, and by 1948 the actual overvaluation of the exchange rate had reached the figure of 45% (Table 57). The 1948 devaluation had an ephemeral and limited effect, since by 1950 the percentage of overvaluation had exceeded the figure of 50%. The imports upsurge was controlled by 1948 and a temporary but non-negligible reduction of imports of about 20% in 1949 allowed an also temporary recovery of international reserves. Expansion was also checked at the level of government finances. Although import duties recovered with the imports revival, and income tax revenues rose at the same pace during 1946-50, current expenditures (excepting interest payments) rose at a higher pace during 1946-48. A policy of government expenditures retrenchment was then applied between 1948 and 1950.

What was the role of internal public debt in the aftermath of the war?

To the succession of expansionary and contractionary periods, it has to be added that this was a time of social and political turmoil. These especial circumstances determined that not only the amount but the composition of internal public debt changed during these years. During the expansionary years, new issues of UIND bonds -C\$15 million in 1946-, the last tranche of the Treasury Colombian Bonds -C\$15 million in 1946- and a new issue of Salt Mines Bonds -C\$25 million in 1947-, helped to finance the fiscal deficit. Since 1948, extraordinary social expenditures demanded internal bond finance: Housing bonds, Agrarian bonds, Development bonds, and also Railway and Municipal Development bonds. The importance of the "social" component of public debt is illustrated by the fact that in 1950, this sort of new bonds represented 26% of total bonds, while in 1945 the comparable figure had been 8.5% (Table 56 I.)

References

Periodicals and official reports.

- DANE. Boletín Mensual de Estadística. Bogotá Colombia.
 Informe del Gerente a la Junta Directiva del Banco de la República. (1923-1950) Anual. Bogotá.
 Informe del Superintendente Bancario. Publicación Anual. Varios Años. Bogotá.
 Informe Financiero del Contralor. (1927-1986) Edición Anual. Bogotá.
 Institute of International Finance. Bulletin No 98, 1938
 Memoria de Hacienda. Imprenta de la Nación. Varios Años. Bogotá.
 Revista del Banco de la República.(1927-1950) Mensual. Bogotá.
 The Council of Foreign Bondholders. Annual Report. London.
-

The Council of Foreign Bondholders. Correspondence files on Colombia (Unpublished) London.
 The Council of Foreign Bondholders. Extracts from newspapers. Colombia.
 The Council of Foreign Bondholders. Minutes (Unpublished) London.
 The Stock Exchange Yearbook.(Various years) London.
 U.S. Department of Commerce (1976). Historical Statistics of the United States. Washington.

Books and articles.

Avella Gómez, M. (1988) “Stylized Facts on Public Debt in Colombia and related issues”. Mimeo, University of Glasgow, Glasgow, United Kingdom.
 Avella Gómez, M. (2003). Antecedentes Históricos de la Deuda Colombiana. El papel amortiguador de la deuda pública interna durante la gran depresión, 1929 – 1934. Borradores de Economía No. 270 Subgerencia de Estudios Económicos, Banco de la República, Bogotá.
 Cepal (1957). Análisis y proyecciones del desarrollo económico: El desarrollo económico de Colombia. México.
 Furtado, C. (1963). Economic Growth of Brasil.
 Harris, S. (1944) Economic Problems of Latin America. New York, London.
 Lewis and Beitscher, (1944).
 Mitchell, B. (1993) International historical statistics: the Americas and Australasia. Detroit.
 Triffin, R. (1944) “La moneda y las instituciones bancarias en Colombia”, Suplemento de la Revista del Banco de la República. Revista del Banco de la República, octubre de 1944, Bogotá, Colombia.