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The Mechanism for Containing Imports: The System During 1971 and a Retrospective Look at Its Evolution (Tariffs, Prior Deposits and the Exchange Rate)

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CENTER DISCUSSION PAPER NO. 154

THE MECHANISMS FOR CONTAINING IMPORTS: THE SYSTEM DURING 1971 AND A RETROSPECTIVE LOOK AT ITS EVOLUTION (TARIFFS, PRIOR DEPOSITS AND THE EXCHANGE RATE)*

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Chapter IV

The Mechanisms for Containing Imports: The System during 1971 and A Retrospective Look at its Evolution (Tariffs, Prior Deposits and the Exchange Rate)*

In Chapter II an "import function", based on historical data, was derived, emphasizing the power of authorities to limit imports according to foreign exchange availabilities. This chapter will start taking a closer look at the different mechanisms used specifically to contain imports. Those mechanisms have been mainly four: the tariff, import deposits, the exchange rate applicable to imports, and import licensing. Naturally, the manipulation of other more general policy variables, such as credit, have also been influenced by a desire to limit ex-ante import demand, but this chapter will concentrate on the first three specific import-repressing mechanisms, treating the fourth in a separate chapter.

Since The Great Depression, it has been the typical assumption of Colombian policy-makers that the dollar value of the quantity of imports demanded by Colombians would exceed the foreign exchange available to finance those imports. At the exchange rates, tariffs and other import charges which prevailed during most of the period, this was indeed the case, so that available foreign exchange ended up being rationed, in addition to the instruments already mentioned, by a system of import licensing. The burden carried by each of the import-repressing or rationing mechanisms, as the authorities struggled to bring the demand for imports into line with exchange availabilities, changed from year to year, and there has been a constantly fluctuating mix of those four instruments in use throughout post war II. In retrospect, the authorities appear to have had a vague desire that no single instrument should bear an "excessive" burden in the task of repressing imports. In other

words, when pressure on licensing authorities became great, i.e., when delays and rejections of import and exchange license requests were above their average historical level, there was a tendency to devalue the import exchange rate, or to raise tariffs and surcharges, or to increase prior import deposits. On the other hand, if the exchange rate was considered adequate, surges in import demand tended to be met by tighter licensing procedures, higher duties, etc.

Much of this balancing among instruments was done "by ear", and in different ways as among types of imports, so that it is very difficult to trace historically with precision the exact import-repressing weight carried by each policy in a given year. It is clear, however, that the ultimate weapon, not always brought into play at the opportune time, was import and exchange licensing, based, in turn, on the actual and expected exchange availability. It is also clear that in practically all years under study (1950 through 1970), the import and exchange controls had a bite, in the sense that the exchange rate, tariffs and import deposits left an ex-ante demand for imports higher than what the authorities thought could be financed.

The reasons given in Colombia for relying on several import-repressing mechanisms rather than just on one (e.g., the exchange rate, perhaps coupled with a uniform across-the-board tariff) are several. The most interesting rely on the instability of world coffee market, and the Colombian burden of adjusting to that exogenous fact. Consider, for the sake of simplicity, just a non-coffee exchange rate, assumed to be flexible, and licenses. Without a licensing mechanism and with domestic "full employment" policies, a sudden and unexpected drop in world coffee prices will, ceteris paribus, lead to a devaluation. It is argued that even in the medium run, price

elasticities are such that the exchange rate would have to fluctuate as much as world coffee prices,[1] and that such instability would not only have unfavorable resource allocation and welfare effects, but also impart an inflationary bias to the economy. Sudden increases in the world coffee price would also have disruptive effects, although not perfectly symmetrical with those following coffee price declines. Larger Colombian foreign exchange reserves would be an alternative to a totally flexible exchange rate, but it is argued that import and exchange licensing is a cheaper way of tackling the problem. The possibility that either domestic or foreign stabilizing speculators would take up the burden of offsetting coffee price gyrations is not taken very seriously (with good reason).

Note that in this argument import and exchange licensing are closely interlinked, a lesson painfully learned during 1956-58. Granting import licenses freely and holding back later on permits to buy foreign exchange obviously lead to a piling up of commercial arrears, and to the transformation of private debts to suppliers into part of the national foreign debt, as the external credit of the country becomes damaged by payment delays and pressure is exerted by foreign creditors on Colombian authorities. There are, of course, other reasons for maintaining exchange controls, particularly to regulate the capital account of the Balance of Payments, and also some service items in the current account (e.g., profit and royalty remittances, tourism, etc.).

Furthermore, there is in Colombia, as elsewhere, skepticism regarding the ability of prices to regulate quantities demanded; in particular, the long duration of import controls and ill-fated brief liberalization attempts,

have generated the myth of an irrepressible import and exchange demand, which cannot be curbed short of extravagant prices.

The arguments for tariffs, not always consistent with those given above, are those found elsewhere. Nobody nowadays seems willing to defend prior import deposits in principle; as with the Vietnam war, it is alleged that no one is quite sure why they got started, and that the problem is how to wind them down without harming other targets, such as monetary stability.

This chapter and next will go into some detail into the mechanics of the different import-restraining policy instruments, particularly import licensing. Emphasis will be placed on how they operated circa 1971, with retrospective glances whenever data warrant them. These two chapters will be heavy on description, leaving a good share of the discussion on the effects of these policy instruments on resource allocation, growth, income distribution and employment to the last chapter.

The Tariff

The universal debate between protectionists and free-traders took Colombian root quite early in the nineteenth century, and has never been resolved (as elsewhere).[2] Historically, transport costs from the Colombian coasts to its central highlands, where most of the population lives, have been high, providing a significant (but declining) natural protection. To this, the tariff has added further protection of a variable magnitude.

It has been argued that the primary function of the Colombian tariff during the 1920s was to provide the central government with revenue.[3] A completely new tariff schedule was adopted in 1931, using as a partial

justification balance of payments considerations. David Chu has found that although Colombian nominal tariffs rose, the median level of effective protection fell slightly, from 19 to 17 percent, in ad-valorem equivalents, for a sample of non-traditional industries between 1927 and 1936. The ranking of industries according to effective protection also changed little between those two dates. The average of nominal tariff rates for all imports was 23 percent in 1927, 25 percent in 1936 and 15 percent in 1945. During the second world war years the 1931 tariff modifications, based on specific taxes, became less effective, and multiple exchange rates were introduced in part as an alternative to tariffs.

Major revisions of the tariff schedule took place again in 1951 and in May 1959, both of which are regarded as protectionist in intent.[4] Average nominal duties, in ad valorem equivalents, for items not in the prohibited list, were 17 percent in the 1951-59 tariff and 48 percent in the tariff of May 1959. The tariff increase was greater for manufactured consumer goods, going from 18 to 53 percent in ad-valorem equivalents, than for intermediate inputs into industry, which went from 22 to 40 percent. The tariff at both dates included specific as well as ad-valorem duties; as late as 1962, 30 percent of the value of assessed tariffs came from specific duties.[5]

In December 1964, a new Tariff schedule was decreed, adopting the Brussels nomenclature and containing only ad-valorem duties. However, since that date, and acting under special powers, the government introduced a bewildering number of changes in the Tariff, particularly during the import liberalization episode of 1965-66, and again during 1968 through 1971. Many items have seen their duty rates changed several times between 1964 and 1971, under special

laws by which Congress granted the Executive, or the latter assumed, the power to carry out those changes without Congressional approval, but for limited periods of time. Just between January 1965 and December 1966, it is estimated that nearly one thousand tariffs were changed (mostly increases); there were also temporary surcharges, for 3 or 4 years, on many consumer goods and even on intermediate and capital goods, aimed at smoothing the liberalization process. The Executive powers to carry out such changes without Congressional approval became extinguished in 1971, but the government quickly requested from Congress a new general law allowing for frequent (although limited) rate changes.

A first attempt at systematic quantification of the impact of the Tariff is presented in Table IV-1 showing the de facto "average tariff" and the share of central government tax revenues accounted for by collected duties, during 1943 through 1970. The most striking fact emerging from this table is the repeated pattern of gradual declines followed by abrupt increases in both percentages, without an obvious overall trend for the whole period. The abrupt increases (in 1951, 1959-60, and 1965-66) coincide with tariff reforms.

The evolution of collected duties as a percentage of import values (the "average tariff") during 1951 through 1970 can be explained statistically quite well as a function not only of years elapsed since the last tariff Reform, but also of import level and composition. The best results of attempts at explanation are presented in Table IV-2. It can be argued that, once adjustment is made for years elapsed since the last tariff Reform, as indicated by the always significant dummy, increases in the "average tariff"

Table IV-1

Import Duties Collected as Percentages of Peso Value of Merchandise Imports, and of Central Government Tax Revenues, 1943-1970

	Duties Relative to Imports	Duties Relative to Central Government Tax Revenues
1943	14.8	26.1
1944	14.9	24.4
1945	14.7	29.2
1946	12.2	27.2
1947	10.3	26.1
1948	10.0	20.8
1949	8.3	13.5
1950	12.7	21.2
1951	21.8	36.8
1952	18.9	32.1
1953	18.3	35.7
1954	20.0	36.9
1955	16.1	25.8
1956	13.4	20.6
1957	8.7	17.7
1958	6.9	13.5
1959	12.8	22.4
1960	16.6	29.2
1961	15.1	28.2
1962	14.1	26.9
1963	12.6	19.2
1964	12.7	16.7
1965	15.0	15.9
1966	22.5	31.9
1967	15.1	15.2
1968	13.0	15.9
1969	14.2	15.5
1970	15.3	19.0

Sources and Method: Basic data obtained from DANE-AGDE, several issues, and BdlR-RdBdlR, several issues.

reflect import liberalization. Thus, there is a significant and positive link between the average tariff and the level of imports whether measured in absolute or relative terms. Significant links also exist with the share of consumer goods in the import bill (positive, as these goods are taxed higher than average) and with that for capital goods (negative, as these goods are taxed below average). No such links were found with the share for raw materials and intermediate products. The negative trend of the first equation in Table IV-2 can then be said to reflect both the gradual decline in the share of consumer goods in the import bill as well as the increase in that for capital goods. These conclusions are also supported by a regression, not shown, making the average tariff a function of the shares of consumer, intermediate and capital goods in the import bill, without a constant term. The implied "average tariffs" for each of those groups according to this regression, are 72, 10 and 7 percent respectively. But only the coefficient for the share of consumer goods has a t-statistic larger than two.

At first glance, it may be thought that the gradual erosion in tariff revenues following reforms may be due to the presence of specific duties within a world wide inflationary setting; the pattern, however, has been present even following the 1965 conversion of all duties into ad valorem rates. The predicted values for recent years from equations (1), (4) and (5) in Table IV-2 are as follows:

	Actual	Predicted by (1)	Predicted by (4)	Predicted by (5)
1965	15.0	16.6	15.1	14.3
1966	22.5	19.4	18.9	20.4
1967	15.1	13.8	14.1	13.1
1968	13.0	15.0	15.2	14.9
1969	14.2	14.1	15.6	15.5
1970	15.3	15.5	15.3	14.8

Table IV-2

Regressions "Explaining" Import Duties Collected as Percentages of Peso Value of Merchandise Imports, 1951-70

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Constant	11.10	8.70	19.64	5.19	9.96	12.65	5.28
	(5.5)	(3.7)	(4.8)	(2.2)	(2.7)	(6.0)	(2.1)
Dummy for Tariff Reform	-1.59	-1.48	-1.67	-0.97	-0.89	-1.28	-0.91
	(7.5)	(6.5)	(6.9)	(4.9)	(4.7)	(5.1)	(4.6)
Absolute Import Level	0.021	0.011	0.020	----	----	----	----
	(5.1)	(2.6)	(4.3)				
Relative Import Level	----	----	----	0.096	0.123	----	0.12
				(4.0)	(6.3)		(5.8)
Trend	-0.26	----	----	----	----	----	----
	(3.3)						
Share of Consumer Goods in Imports	----	0.45	----	0.24	----	0.60	----
		(2.8)		(1.5)		(3.4)	
Share of Capital Goods in Imports	----	----	-0.26	----	-0.13	----	----
			(2.3)		(1.7)		
R^2	0.81	0.79	0.77	0.85	0.86	0.70	0.83
F-test	23.5	20.3	17.7	30.9	31.7	20.2	41.8
DW	1.9	2.3	1.5	1.5	1.2	2.4	1.2

Sources and Method: Basic data as in Table IV-1 and Table II-4 (BdlR). The dummy for Tariff Reform was given the following values:

1951 = 0	1961 = 2.5
1952 = 1	1962 = 3.5
1953 = 2	1963 = 4.5
1954 = 3	1964 = 5.5
1955 = 4	1965 = 0
1956 = 5	1966 = 1
1957 = 6	1967 = 2
1958 = 7	1968 = 3
1959 = 0.5	1969 = 4
1960 = 1.5	1970 = 5

"Absolute Import Level" refers to total merchandise imports, in current U.S. dollars. "Relative Import Level" refers to a given year's total imports divided by the average imports during the previous two years. Average values for the variables were as follows:

Collected duties as percentage of imports	15.2
Absolute import level	559.2
Relative import level	108.2
Share of consumer goods in imports	10.7
Share of capital goods in imports	40.3
Dummy for Tariff Reform	3.1

It may be noted that the unusually high tariff revenues in 1966 are generally credited to the larger imports of heavily taxed automobiles.

A more plausible and general explanation for the power of the dummy in Table IV-2 is the tendency for tariff reform to involve, for fiscal reasons, an increase in the rates charged to intermediate and capital goods, plus those on a few luxury consumer durables, as well as a tightening of loopholes and abolition of ad-hoc exemptions. As on balance these measures, favored by the Treasury, lower the effective protective rates for most existing industries (as in most cases direct competitors are kept out by prohibitions and the licensing mechanism), the reform faces shortly after its inception a relentless gnawing by special interests, who seek lower input rates and exemptions, until that process goes so far as to arouse fresh demands for tariff reforms.

Table IV-3 shows the extent of exemptions from import duties shortly after the tariff reform of December 1964. In the key categories of other intermediate and capital goods, making up nearly 60 percent of all imports, the gradual expansion of exemptions can be seen. Besides the "Plan Vallejo", discussed in Chapter III, other total or partial exemptions include those relating to imports from Andean and other LAFTA sources, those for "basic industries" (e.g. sulphur, pig iron, coal, chemical pulp, fishing, etc.), some imports for the public sector, imports financed with AID credits, plus other ad-hoc exemptions. These are not always automatic; many require applications subject to review and approval. By 1967, 30 percent of all imports were exempted from duties; more than half of those of capital goods paid zero tariffs. A rough estimation places exempted imports at 33% of the total in 1969.

Table IV-3

Relations Among Duties Collected, Dutiable Imports and All Imports, 1965 through 1967

Categories	Tariff Collections as Percentages of Dutiable Imports in Each Category			Dutiable Imports as Percentages of All Imports in Each Category			Average Share of Each Category in All Imports
Categories	1965	1966	1967	1965	1966	1967	1965-67
Automobiles	228	51	85	71	71	71	2.2
Other Consumer Goods	28	28	24	81	84	70	3.4
Foodstuffs	20	10	17	99	9	22	4.2
Other Raw Materials	14	15	17	100	100	100	4.1
Intermediate Goods for Agriculture	3	13	6	99	100	100	2.0
Other Intermediate Goods	17	25	24	93	93	88	34.0
Transportation Equipment	23	42	27	90	85	74	6.0
Capital Goods for Agriculture	3	8	5	80	82	78	3.1
Other Capital Goods	17	13	16	61	57	48	24.8
Unclassified	20	49	12	62	87	63	16.2
Total	19	28	22	79	79	70	100.0

Sources and Method: Unpublished estimates of DANE and Contraloría.

Other tariff loopholes arise from the practice of levying different rates for the same product, depending on its final use. For example, an automobile which allegedly is to be used as a taxi ("public service") will pay a much lower duty than an identical car imported for private use, explaining why one finds cars painted as taxis which do not seem to stop for any customer. That practice also lends itself to the setting up of special tariff sub-categories benefitting powerful interests; the knowledgeable can tell why input X bears a tariff of only 10 percent if used in producing product Y, while bearing one of 50 percent "for other industries". Clearly, the tariff is not a purely independent variable in the Colombian socio-economic system.

To obtain a more detailed, and yet manageable, view of the Colombian tariff structure as it stood in 1971, the rates for a sample of 125 important products, first chosen for 1962 by Santiago Macario,[6] have been analyzed. This will allow us, inter alia, to examine net changes occurring between 1962 and 1971. The regime to which each of the products is and was subjected in the import control mechanism, e.g., whether the product is placed on the free, prior license or prohibited list, was noted. Finally, the prior deposit relevant for each product in 1971 was also recorded. This information is summarized in Table IV-4; note that it is based on rates and information read off the tariff books, so that it refers to non-exempt items.

Consider first the tariff as it stood in 1971. The rates, on the whole, look quite "reasonable", particularly for items not in the prohibited list. There are few extravagantly high duties. As shown in Table III-7, however, the tariff schedule by itself is capable of generating very high ERP's, which fluctuate a good deal among activities. It may be seen in Table IV-4

Table IV-4

Colombian Duties and Other Restrictions on Selected (non-exempt) Imported Products from non-LAFTA Sources, 1962 and 1971

	Ad Valorem duties, in percentages		Ad Valorem prior deposits, in percentages, in 1971	Number of items in the group subject to each regime	
	1971	1962		1971	1962
Unprocessed foodstuffs	60	185	99		
-Prohibited	76	272	130	8	8
-Previous license	35	23	50	5	4
-Free List	--	145	--	0	1
Industrial raw materials	21	37	72		
-Prohibited	44	68	130	1	3
-Previous license	20	20	66	9	3
-Free List	--	27	--	0	4
Capital goods	26	19	35		
-Prohibited	--	30	--	0	1
-Previous license	23	26	43	22	12
-Free List	36	12	9	6	15
Semi-manufactured products (including processed fuels), other than products of traditional industries	29	30	69		
-Prohibited	34	200	130	2	1
-Previous license	28	30	62	26	14
-Free List	32	20	89	4	17
Processed foodstuffs	103	359	111		
-Prohibited	111	426	120	8	10
-Previous license	94	218	97	6	3
-Free List	--	250	--	0	1
Durable consumer goods	76	114	93		
-Prohibited	84	114	100	1	4
-Previous license	75	93	92	10	6
-Free List	--	175	--	0	1
Other current consumer goods (including semi-manufactured products of traditional industries)	99	149	102		
-Prohibited	180	247	130	5	10
-Previous license	65	44	93	11	4
-Free List	54	37	66	1	3
Total	53	107	76		
-Prohibited	104	265	125	25	37
-Previous license	41	49	66	89	46
-Free List	36	31	43	11	42

Table IV-4 (continued)

Sources and Method: Data for 1962, as well as the classification scheme and product list, were obtained from Santiago Macario, "Protectionism and Industrialization in Latin America", Economic Bulletin for Latin America, Vol. IX, No. 1, March 1964, pp. 61-101 (United Nations). Data for 1971 obtained from República de Colombia, Arancel de Aduanas (Editor, Alfonso Valderrama A.).

Figures for each category, as well as for the total, represent simple arithmetic averages. When an item (say, forklifts) had been subdivided into various classes, each with its own duty or prior deposit, (sometimes depending not on the nature of the product, but on its final use) again a simple average was taken. The predominant regime was usually taken for each item; in cases of doubt, the more liberal regime was used as representative.

Import duties include, besides the standard tariff ad valorem rates, consular fees and across-the-board surcharges. During 1971 these were as follows:

Consular fees:	1% ad valorem
Surcharge to finance PROEXPO:	1 1/2% ad valorem
Surcharge for Coffee Fund:	1 1/2% ad valorem
Total	4% ad valorem

(Promotion laws, of course, exempt many imports from all duties. This is not taken into account in the table.)

that duties on industrial raw materials, capital goods and semi-manufactured products were substantially lower than those for processed foodstuffs and all kinds of consumer goods. The average duties for industrial raw materials and capital goods on the previous license list are 20-23 percent, a level which is unlikely to, at best, exceed by much the degree of overvaluation of the peso.

When one averages the duties in 1971 for the 367 items which make up Chapter 84 of the Colombian tariff (non-electrical machinery), the simple mean obtained, 27 percent, is similar to that in the sample. The corresponding figure for the 161 items of Chapter 85 (electrical machinery) is somewhat higher, 38 percent.

Francisco Thoumi has called attention to another feature of the tariff which frequently makes it more protectionist than it appears at first sight, and always more distortive, involving the treatment of used goods, particularly used durable consumer goods. Thus, many second-hand goods are supposed to be valued when imported as if they were new, on the feeble grounds that otherwise valuation would be difficult to ascertain exactly, which, it is alleged, would open the door to all sorts of "irregularities". The tariff legislation explicitly states, for example, that used automobiles are to be valued at the prices those

vehicles had when they came off fresh from the factory. When these regulations are applied to capital goods not produced in Colombia, they tend to reduce the effective protection given to their users, while discouraging a more efficient use of the nation's foreign exchange availabilities (and probably of its labor force also).

Duties on capital goods in the free list exceed clearly those for capital goods under the previous license regime, but the corresponding gap is narrower for semi-finished products. There appears to be at least two conflicting considerations in establishing interactions between tariffs and import controls; on the one hand "essentials" tend to be treated more softly by both instruments, while "luxuries" are punished by both, as witnessed by the redundant high duties on items in the prohibited list. On the other hand, some attempts have been made, particularly during 1965-66, to raise tariffs on items in the free list and those transferred from previous license to the free list, consciously coordinating the use of both tariffs and import controls. While that coordination is assured on paper, the fact that two different bureaucratic organizations decide on tariffs and import control regimes, respectively, means de facto that except during periods of major policy changes, when high authorities are very conscious of this issue, each policy variable is handled without much regard to how the other is being manipulated.

As a member of the Andean Common Market, Colombia has agreed to bring its tariff schedule in line with the Andean Minimum Common External Tariff (AMCET) by 1975 and adopt the Andean Common External Tariff (ACET) by 1980. The AMCET agreed upon by the member countries in December 1970 is in fact fairly close to the Colombian tariff schedule, but with a lower average tariff and less unequal rates (less spread)[7]. It is far from clear, however, what the final ACET, to be decided by December 1973, will look like.

Table IV-5

Average Ad Valorem Duties in 1962 and 1971 of Selected Imported Products

According to Their Level of Duties in 1972

1962 Duties	Number of Items in 1962	Average Duty in 1962	Average Duty for Same Items in 1971	Number of Items in Each Rank in 1971
100% and higher	39	280	97	18
From 70 to 99%	11	79	57	5
From 40 to 69%	13	47	41	30
From 20 to 39%	26	26	32	44
From Zero to 19%	37	7	20	29

Sources and Method: As in Table IV-4.

The net changes in the tariff between 1962 and 1971, according to Table IV-4, may be summarized as follows: a lowering of average rates, mainly by the reduction of very high rates for items in the prohibited list, and a narrowing of the spread of duties, not only by the elimination of extravagantly high ones, but also by the increase of very low ones. This may be seen more clearly in Table IV-5; items which in 1962 had duties higher than 39 percent, by 1971 had seen their duties reduced, on average, while those having 1962 tariffs lower than 40 percent witnessed, on the whole, increments. These changes are most dramatic among goods which in 1962 had duties above 99 percent and below 20 percent. By 1971, of the total sampled items, 59 percent had duties within the 20 to 70 percent range; in 1962 that percentage was only 31 percent. Table IV-6 complements this information, showing the the most arithmetically significant tariff cuts occurring among items which both in 1962 and '71 were in the prohibited list, and to a lesser extent among those transferred from the 1962 prohibited list to the 1971 previous license list. The few items which in 1971 remained in the free list had duties higher than those they paid in 1962; the increment is most noteworthy in those goods which were in the free list both in 1962 and 1971.

The trend between 1962 and 1971, then, has been toward the rationalization of the tariff, and a diminution of its distorting effects. Although far from most economists' ideal, the tariff in 1971 was probably one of the most sensible among LDC's tariffs. The changes of the last decade, furthermore, leave Colombia with a tariff schedule which would require relatively few changes if one fine day import controls were abolished, particularly if ad-hoc tariff exemptions were also eliminated.[8]

Table IV-6

Changes in Regime and Average Duties between 1962 and 1971 for Selected Imported Products

Regime in 1962	Regime in 1971	Number of Items	Average Ad Valorem Duty in 1962 (Percentages)	Average Ad Valorem Duty in 1971 (Percentages)
Free List	Free List	5	8	24
Free List	Previous License	36	32	32
Free List	Prohibited	1	88	24
Previous License	Free List	6	42	45
Previous License	Previous License	40	46	38
Previous License	Prohibited	0	--	--
Prohibited	Free List	0	--	--
Prohibited	Previous License	13	137	73
Prohibited	Prohibited	24	334	100
Total		125	107	53

Sources and Method: As in Table IV-4.

It should be added that the Colombian sales tax also contains protectionist elements, as its rates bear more heavily on imports than on domestic production for a (small) number of commodities, such as alcoholic beverages, canned goods and clothing. The "Musgrave Report" recommended abolishing the use of the sales tax as a supplementary instrument of protection, as well as a better coordination of tariffs with luxury taxation, but as with most of its recommendations, Congress has failed to act as of 1971.[9] Indeed, during December 1970 Congress levied a heavy sales/consumption tax on foreign cigarettes, which led to a drying up of registered imports of those goods, to a dramatic increase in contraband, which became a subject of scandalized public discussion during August/September 1971.[10]

Another institutional fact of some interest refers to the frequent complaints of law-abiding importers regarding the actual management of some customs, which allegedly impose not only normal tariff burdens on some, but also costly delays and petty nuisances, while freeing luckier or less scrupulous importers from their taxes. Even with the best will confusion can arise over product specification, but it is not unusual for an importer to face a hostile stance from custom officials. Furthermore, warehouses and other facilities in major ports are said to be in poor shape, inducing losses.[11] These circumstances, of course, are also widespread in other countries, and are hardly unique Colombian features.

Prior Import Deposits

Before an importer can even apply to obtain the necessary import license, he must deposit with the Banco de la República a given amount, expressed as a percentage of import values, which must remain deposited, earning no interest and eroded by inflation, until some time after the merchandise in question clears

Colombian customs. The advance deposit is calculated at present on the f.o.b. value of imports, at the average exchange rate for the previous month. The time which elapses between deposit and its return has varied from period to period; it was about 6 or 8 months during 1964, with free list imports typically involving shorter deposit periods than those approved under the previous license regime. Earlier, in 1963, import deposits were sterilized for an average of 10 months. During 1958 the lag began to be deliberately stretched, with a decree stating that deposits would not be returned to the importer until 60 days after the goods had reached a Colombian port. By 1966 the corresponding figure was estimated at 9 months. More recently, the lag averages roughly 7 or 8 months.

Beginning in 1964, advance deposits have also been required for obtaining the foreign exchange needed to pay for the imports, once they have cleared customs. The advance payments deposit must be equivalent to 95 percent of the import value, and must be placed with the Banco de la República at least 20 days prior to the issuance of the exchange license needed to obtain the foreign currency.

Prior deposits were originally introduced as one more mechanism to repress imports, but their increased use during the balance of payments troubles of the second half of the nineteen fifties, particularly since mid-1957, turned them into a critical tool of monetary policy. By 1960, as it may be seen in Table IV-7, the stock of import deposits reached 24 percent of the import flow for that year, and 16 percent of the stock of total domestic credit (and 22 percent of the money supply). At least since that time, prior deposits became a widely disliked institution, by both businessmen and policy-makers. Only the weakness of more orthodox monetary tools, such as reserve requirements

Table IV-7

Prior Import Deposits as Percentages of Imports and Domestic Credit

	As Percentages of Imports	As Percentages of Domestic Credit
1950	5.3	4.1
1951	4.6	4.3
1952	3.4	2.9
1953	3.4	3.3
1954	4.3	4.1
1955	7.4	5.5
1956	10.1	5.7
1957	10.2	5.9
1958	15.9	10.2
1959	21.2	12.9
1960	23.9	16.0
1961	20.0	12.6
1962	22.0	11.1
1963	21.2	11.1
1964	20.7	10.6
1965	25.8	9.3
1966	14.6	8.8
1967	14.0	5.8
1968	12.7	6.7
1969	13.3	7.0
1970	12.0	

Sources and Method: Data for prior import deposits and for domestic credit refer to average stocks during the year. The former were obtained from Alberto Roque Musalem, Dinero, Inflación y Balanza de Pagos: La Experiencia de Colombia en la Post-Guerra (Bogotá, Colombia: Talleres Graficos del Banco de la República, 1971), p. 153; and from BdlR-RdBdlR, several issues. Peso values for imports and total domestic credit obtained from IMF-IFS.

and rediscounting, arising from the power of commercial banks and some other private groups, such as the Coffee Federation, vis-à-vis the Central Bank, assured the continuation of the use of prior deposits. Nevertheless, the importance of prior deposits has been declining, on the whole, since 1960, although that trend has not been smooth.

As a tool of monetary policy, prior import deposits are clumsy and inflexible, and can lead to serious conflict between the goals of import liberalization and monetary stability. For example, the reductions in prior deposit rates adopted beginning in October 1965, as part of the import liberalization program, resulted, with a lag, in an undesired increase in the money supply, particularly after June 1966, and in spite of the import surge. Fears of undesirable monetary repercussions still keep authorities from totally eliminating prior deposits; as late as 1968 a plan to eliminate those deposits within a year was abandoned for that reason. On the restraining side this tool has on occasion become the only available instrument capable to rapidly stem excessive monetary expansion, as during 1962.

The effectiveness of prior import deposits in repressing imports is relatively weaker than its potency as a monetary tool. The exact opportunity cost of the sterilized balances, including the relatively unimportant advance payments deposits, expressed as ad-valorem tariff equivalents, is difficult to establish exactly, and given capital market imperfections it is likely to differ considerably among firms. Some companies may obtain foreign suppliers' credits for such purpose (it has even been argued that the 1959-60 increases in prior deposits led to an inflow of "hot money" into Colombia), others can obtain credit from their banks, but, particularly smaller ones, may suffer severe hardships in raising the needed cash. Colombian businessmen, who complain constantly about shortages of working capital,

find the prior deposits particularly obnoxious. Alberto R. Musalem has estimated the ad-valorem equivalent incidence of prior import and payments deposits at 11 percent, on average, for 1960 through 1967.[12] For more recent years the corresponding figure is smaller, and probably below 5 percent. An across-the-board tariff increase of a few percentage points, or a slightly faster rate of exchange depreciation seems like small prices to pay for the elimination of prior deposits, whose regressive incidence accentuates the concentration of economic power in Colombia.

Prior import deposits during early 1971 (until May) went from 1 to 130 percent ad valorem. As shown in Table IV-4, on average items in the prohibited list bore the highest rates (as with tariffs), and on balance those in the free list had the lowest rates. As noted when discussing the tariff, the tendency to punish "luxuries" and encourage "necessities" frequently prevails over the policy of choosing between alternative, non-duplicating instruments to restrain imports. The spread in prior deposits is somewhat narrower than with tariffs, and the ranking by incidence on different commodity categories is also slightly different. Capital goods, for example, whose tariff rates are roughly in line with those for industrial raw materials and semi-manufactured products, bear much lower prior deposits on average.

As with tariffs, there are many exemptions from prior import deposits, including AID-financed imports, those made by the government and public entities, some capital goods, imports from LAFTA, most nonreimbursable imports, etc. Prior import deposits are regulated by the top monetary authority, the "Junta Monetaria", presumably in coordination with the "Consejo de Política Aduanera", which is in charge of the tariff, and with INCOMEX, which manages

import controls. In fact, many inconsistencies exist among the use of these instruments; for example, there are cases for which the prior deposit for inputs is higher than for finished products using those inputs, while the tariff situation is more normal. Those cases are reviewed on an ad hoc basis, as producers complain of the situation to the "Junta Monetaria".

The Average Exchange Rate Applicable to Merchandise Imports

By 1971 the exchange rate applied to imports had reached, in real terms, its highest sustained postwar II levels, as can be seen in Table IV-8 Its basic single nominal rate had also become unified with those applicable to minor exports (excluding CAT), and to capital transactions; minor statistical discrepancies show up nowadays only because of timing differences in the recorded transactions. As indicated in the third column of Table IV-8, the real rate has been also quite stable around a gently rising trend since the reforms of March 1967.

Matters were not always this tranquil and neat. There were times, as during the 1956-66 liberalization episode, when two major rates were applied to imports: a preferential rate of 9 Pesos per U.S. dollar (the old rate), and a new intermediate rate of 13.50 Pesos, to which gradually all imports were transferred, while most private capital transactions took place in an uncontrolled free market. Going further back in time, the switch from the precarious exchange stability of the mid-1950s, to more realistic levels after mid-1957 can be observed also in Table IV-8.

The crucial hesitations in exchange policy which occurred during 1958-59 can also be seen in this table. During late 1957 and 1958 a relatively high effective import rate was achieved by a fluctuating basic "certificate" rate, combined with, for most imports, a 10 percent remittance tax; after

Table IV-8

Average Exchange Rate Applied to Merchandise Imports

	Average Effective Rate (Pesos Per One U.S.$)	Real Rate (1963 Prices)	Instability Index for the Real Rate
1948	1.75	5.64	---
1949	1.95	5.58	---
1950	1.95	5.13	---
1951	2.36	6.43	---
1952	2.50	6.74	---
1953	2.50	6.25	---
1954	2.50	5.87	2.61
1955	2.50	5.77	0.98
1956	2.50	5.39	2.59
1957-1	2.50	5.10	2.31
-2	2.51	4.64	3.89
-3	5.33	9.26	28.24
-4	5.74	9.80	28.90
1958-1	6.48	10.80	31.16
-2	7.43	11.79	31.19
-3	7.23	11.30	7.34
-4	7.11	10.77	7.06
1959-1	6.87	10.36	5.46
-2	7.64	11.02	4.76
-3	6.40	9.10	8.07
-4	6.40	9.03	7.09
1960-1	6.40	9.01	6.20
-2	6.64	9.22	5.19
-3	6.70	9.31	1.08
-4	6.70	9.18	1.23
1961-1	6.70	9.02	1.61
-2	6.70	8.59	2.22
-3	6.70	8.59	1.98
-4	6.70	8.59	1.63
1962-1	6.70	8.59	1.19
-2	6.70	8.48	0.32
-3	6.70	8.48	0.32
-4	7.30	9.13	2.24
1963-1	9.00	10.00	4.62
-2	9.00	8.91	7.03
-3	9.00	8.74	7.50
-4	9.00	8.41	6.53
1964-1	9.00	8.04	5.25
-2	9.00	7.56	4.02
-3	9.00	7.56	3.54
-4	9.00	7.56	2.59

Table IV-8 (continued)

1965-1	9.00	7.58	1.56
-2	9.00	7.34	0.86
-3	9.37	7.54	1.54
-4	12.21	9.25	7.21
1966-1	12.42	9.12	7.50
-2	12.68	8.88	7.36
-3	13.13	9.22	7.64
-4	13.53	9.31	2.21
1967-1	13.32	9.03	2.61
-2	13.68	9.12	2.21
-3	14.34	9.45	2.15
-4	15.05	9.80	2.83
1968-1	15.64	10.17	3.03
-2	15.96	10.14	2.85
-3	16.26	10.35	2.46
-4	16.50	10.53	1.97
1969-1	16.78	10.68	1.38
-2	17.02	10.64	1.40
-3	17.30	10.75	1.14
-4	17.65	10.78	0.78
1970-1	17.79	10.92	0.75
-2	18.08	10.82	0.88
-3	18.37	11.02	1.09
-4	19.10	11.28	1.61
1971-1			
-2	19.38	11.03	

Sources and Method: Average basic rate obtained dividing import peso values by import dollar values. The real rate was obtained dividing the basic rate by the ratio of Colombian to U.S. wholesale prices. Basic data was taken from IMF-IFS. The index of instability of the real rate was computed as in Chapter III, i.e., it is defined as the average of the absolute value of quarter-to-quarter percentage changes for four consecutive quarters. When the index is given for a year, it covers the four quarterly changes during that year; when it is given for a quarter, it refers to the percentage changes during that quarter plus those the preceeding three quarters.

March 1958, and until early 1959 that tax had to be paid with U.S. dollars purchased in the fluctuating free market. In January 1959, importers were given the option of making payments through the free market, in which case they were exempted from the 10 percent remittance tax. In May 1959, that tax was absorbed, in principle, into customs duties, with the first ten percentage points of the duty, insofar as applicable, being payable in U.S. dollars. The wise de facto flexibility which had existed for the average effective import rate during 1958 and early 1959 was dead; the basic selling certificate rate of 6.4 Pesos, which ahd been reached by October 1958, after reaching a high of 6.8 in June 1958, became after May 1959 the pegged effective import rate. This rate was below the effective rates reached during 1958; even after it was raised to 6.7 Pesos in 1960 it remained substantially below the late 1958 de facto levels.

It is noteworthy that such a return to "stability" was partly promoted by those who after 1967 became champions of the crawling rate. The reasons given for the new pegging in 1959 were the usual ones: fear of inflation, need for "stability", the impact of a more devalued peso on public and private foreign debts denominated in dollars, etc. Naturally, as the real import exchange rate became eroded from the 1958 levels, increasing use was made of prior deposits, tariffs and import controls, until the pressures became too great late in 1962. The unfortunate 1962 episode will be reviewed in detail later; here it is enough to note that its origins can be traced back to the misguided re-pegging of 1959. From the end of 1962 until September 1965, the mirage of a stable import rate was again sought; the pegged 9 Peso rate was buttressed primarily by tight import controls.

Because of the existence of import controls applied with fluctuating severity in different periods, there is little systematic link between the real effective import exchange rate and actual imports. Correlations between percentage changes in imports and in the exchange rate and the stability index presented in Table IV-8, similar in structure to the regressions presented in Table III-13 for minor exports, yield only insignificant coefficients and tiny R^2's, whether the whole 1954-70 period is considered, or it is broken up in subperiods. The best result is obtained for 1958 through 1970-2 for which the t-statistic for the change in the exchange rate variable reaches 1.4, with a coefficient ("elasticity") of -0.37, while the corresponding values for the instability index are 1.6 (t-statistic) and 2.02 (coefficient). The R^2 is 0.05, with a very low Durbin Watson statistic.

The bureaucratic bodies officially in charge of establishing exchange rate policy have differed from time to time. During the Lleras Restrepo administration, the President himself kept a close watch over the exchange rate. According to Decree-Law 444 of March 1967 (article 21), the "Junta Monetaria", acting through the Central Bank, is charged with regulating the market for foreign exchange. The key personalities in the Junta are the Minister of the Treasury and the manager of the Central Bank. The certificate rate is typically modified (raised) twice a week, by small amounts.

Table IV-9 presents the monthly changes in the certificate rate since the reforms of March 1967. At the start of the new system, the monthly changes were fairly irregular, apparently in an attempt to establish the principle that this was indeed a fairly unregulated market, and that it could even witness an appreciation, as it did during January 1968. These

Table IV-9

Percentage Monthly Changes in the Certificate Rate

	1967	1968	1969	1970	1971	1972
January	0	-0.13	0	0.39	0.63	0.76
February	0	0.95	0.59	0.67	0.57	0.71
March	0.07	0.57	0.71	0.89	0.93	0.89
April	2.81	0.75	0.18	0.27	0.67	0.75
May	2.23	0.81	0.47	0.38	0.41	0.74
June	1.97	0.12	0.58	0.55	0.81	0.74
July	1.24	0.62	0.46	0.43	0.91	
August	2.39	0.43	0.92	0.54	0.85	
September	1.93	0.73	0.06	0.70	0.74	
October	0.92	0.85	0.40	0.75	0.79	
November	1.36	0.84	0.51	0.48	0.88	
December	0.70	0.36	0.73	0.74	0.97	
Average	1.73*	0.58	0.47	0.57	0.76	
December to December Change	16.74	7.11	5.75	7.00	9.53	

*Refers to April through December only.

Sources and Method: Certificate rate quotations taken at the end of each month. Basic data from IMF-IFS. December-to-December changes in Colombian and U.S. price indices (averages for the month) have been as follows:

	Colombia		U.S.	
	Wholesale Prices	Consumer Prices	Wholesale Prices	Consumer Prices
1966-67	5.7	6.5	1.0	2.6
1967-68	4.9	5.6	2.8	4.5
1968-69	9.9	12.4	5.5	6.0
1969-70	6.6	3.5	2.2	5.6
1970-71	11.5	14.1	3.9	3.3

Basic data from IMF-IFS.

early exchange rate movements were anxiously watched by Colombia's creditors and aid-donors, who doubted the firmness of the Colombian commitment to a crawling peg; it is said that the slowdown in the rate of depreciation during December 1967 and January 1968 caused telegrams to fly between Washington and Bogota, and fear was expressed that once the certificate rate reached and became unified with the capital market rate (which had been pegged at 16.3 Pesos since the capital market replaced the free market early in Decmeber 1966) there would be a return to a fixed 16.3 Peso peg. The unification point was reached in June 1968, but the upward crawling continued although not without an unusually low depreciation rate during that month, which must have caused a few jitters. But the low depreciation rates of June, July and August 1968 apparently had more to do with the visit of His Holiness Pope Paul VI to Colombia, during August 22-24, than with any attempt to return to a fixed peg. Similarly, the difficult political situation which developed between the election and inauguration of President Misael Pastrana Borrero (April-August 1970) seems to account with the slowdown in the depreciation rate observed for those months. Since the new President was inaugurated, the rate of depreciation has become steadier, seldom falling outside a 0.6 to 0.9 percent per month range.

It is not clear how much the demand for import licenses and for imports in the free list is influencing the decisions to move the exchange rate. It is said that foreign creditors, and in particular the IMF, annually agree with Colombian authorities on a minimum target for import registrations so as to decrease any temptation which may exist to slowdown the depreciation rate and tighten import controls. It is known that authorities also try

to keep some sort of link between depreciation and inflation in Colombia and abroad, but given the weaknesses of price indices (and of the rigid purchasing power theory), that link is deliberately kept loose. Note, however, how the depreciation rate accelerated during 1971 and 1972 as the Colombian inflation picked up. On the whole, it appears that broad depreciation targets are set on a yearly basis, depending on expected inflation, imports, exchange earnings, etc., and from then on the monthly rate is determined "by ear". So far, the results are good.

Footnotes to Chapter IV

*Besides those thanked in earlier chapters, I would like to acknowledge the help of Richard Cooper and Van Whiting in the preparation of this chapter.

1 Consider the following Colombian-like situation:

	Before	After a 20% drop in Coffee Earnings
Coffee exports	US$400	US$320
Other exports	150	180
Imports	550	500

To bring about the increase in other exports and the contraction of imports, assuming a supply price-elasticity of one for other exports and of about -0.45 in the price-elasticity of import demand, a 20% devaluation in the non-coffee exchange rate would be required, assuming no increase in home-good prices.

2 See Luis Ospina Vasquez, Industria y Protección en Colombia, 1810-1930 (Medellín: E.S.F., 1955)

3 This paragraph is based on David S.C. Chu, The Great Depression and Industrialization in Latin America: Response to Relative Price Incentives in Argentina and Colombia, 1930-45; A Dissertation presented to the Faculty of the Graduate School of Yale University in Candidacy for the Degree of Doctor of Philosophy, 1972, Chapter 2 and Appendix B-2; and on "The Economic Policy of Colombia in 1950-66", UNECLA, Economic Bulletin for Latin America, Vol. XII, No. 2, October 1967, especially pp. 90-95.

4 According to Departamento Administrativo de Planeación y Servicios Tecnicos, Plan Decenal de Desarrollo Económico Industrial, 1960-70 (Bogotá, n.d.), Chapter IV.

5 According to Benjamin I. Cohen, "An Analysis of Colombia's Exports" (mimeographed, September 22, 1965), p. 3. Toward the end of 1959, according to the data presented in ECLA, "Custom duties and other import charges and restrictions in Latin American countries: average levels of incidence" (E/CN.12/554 and Add. 1-11), the arithmetic means of customs duties and other charges (including the cost of financing prior deposits) in ad-valorem equivalents in Colombia were as follows:

Total	41%
Unprocessed foodstuffs	68
Raw materials	31
Intermediate products	36
Processed fuels	11
Capital goods	27
Processed foodstuffs and tobacco	138
Chemical and pharmaceutical products	31
Durable consumer goods	101
Other consumer goods	57

6 In his remarkable and influential article "Protectionism and Industrialization in Latin America", Economic Bulletin for Latin America, Vol. IX, No. 1, March 1964, pp. 61-101.

7 See David Morawetz's writings on this subject, particularly "Common External Tariff for the Andean Group", mimeographed, 1972. Colombia apparently succeeded in obtaining a minimum common tariff close to its own in exchange for going along with a common code for direct foreign investment which was tougher than it wished.

8 Other tariff summaries confirm, in general, these conclusions. See in particular, Instituto para la Integración de América Latina, Banco Interamericano de Desarrollo, "Instituciones e Instrumentos de Política Económica Colombiana en Materia de Comercio Exterior" (mimeographed, November 1968), Table 2; and David Morawetz, "Harmonization of Economic Policies in Customs Unions: The Andean Group" (mimeographed), December 1971, page 11a.

9 See Richard A. Musgrave, President, and Malcolm Gillis, Editor, Fiscal Reform for Colombia: Final Report and Staff Papers of the Colombian Commission on Tax Reform (Cambridge, Massachusetts: Harvard Law School, International Tax Program, 1971), especially Chapters 12 and 13.

10 See, for example, El Tiempo of September 10, 1971, where it was reported that the Executive had asked Congress to eliminate the heavy consumption tax on imported cigarettes decreed in Law 19 of December 1970, arguing that otherwise smuggling could not be stopped. The Minister of the Treasury sensibly argued that "...public and ostentatious smuggling weakens national morality, weakens the prestige of public institutions, and discredits the country in the eyes of foreigners". National tax revenues from cigarette imports were running in 1971 sixty percent below those of 1970, as a result of the higher tax!

11 In a remarkable move, the Director of Customs called a press conference during August 1971 to denounce widespread corruption and inefficiency in the nation's customs and harbors, particularly in those of Buenaventura. He announced measures to control such ills, but complained that import and sales taxes provided very strong stimuli to contraband, referring in particular to Law 19 of December 1970, whose approval he had opposed. He denounced that in the harbor of Buenaventura there were ten known organizations dedicated exclusively to stealing goods in transit, often in complicity with public employees in customs, the railroad and harbor. Even 80 tons of steel was stolen! Such raids are often sponsored by the owners of the merchandise, so they can obtain insurance payments as well as new import licenses. See El Tiempo, August 26, 1971.

12 It appears that Musalem computes the opportunity cost of the idle deposits as the rate of inflation plus average yields in the Bogotá Bourse. The latter, however, could already make allowances for inflationary expectations, in which case the figures overestimate opportunity cost. See Alberto Roque Musalem, Dinero, Inflación y Balanza de Pagos: La Experiencia de Colombia en la Post-Guerra (Bogotá, Colombia: Talleres Gráficos del Banco de la República, 1971), page 154. In his calculations he also includes the opportunity cost of the prior deposits required before the Central Bank hands over the necessary foreign exchange to pay for imports.