The Fiscal and Monetary History of Colombia: 1960-2017

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¹The views expressed in this paper are those of the authors and do not represent those of the Banco de la República Colombia or its Board of Directors.
Colombia is characterized by macro stability
Fiscal deficit

Low average deficit
Inflation

No episode of hyperinflation, although inflation was high and persistent for a while.
Real GDP per capita

Growth hasn’t been that remarkable
Crucial events

1991: new political Constitution

- Monetary policy
  - pre 1991: Central bank also had role of development bank
  - post 1991: independent Central bank. Inflation objective since 2001
Government expenditures vs tax revenue

pre 1991: small government. Average expenditures 6.8%
Government expenditures vs tax revenue

post 1991: increasing government size. 2017: 19.2%
mid 1990’s: increase in debt, particularly domestic debt
Primary deficit and interest payments

![Graph showing primary deficit and interest payments as a percentage of GDP from 1960 to 2010. The graph includes lines for primary deficit, interest on domestic debt, and interest on foreign debt.](image)
Exchange rate

pre 1967: fixed exchange rate
Exchange rate

devaluations: 33% in 1963, 29% in 1966
Exchange rate

1967: BoP crisis
Exchange rate

1967 - 1991: crawling peg
1991 - 1999: foreign exchange bands with positive slope
Exchange rate

1999: BoP crisis and worst economic crisis on records
1999 - today: flexible exchange rate
Crucial events

1982:
- BoP crisis
- Banking crisis: banks bailed out by government, who borrowed from Central Bank
- GDP grew by 0.9%

1999
- Worst economic crisis in records: -4.2%
- BoP crisis
- Banking crisis: banks bailed out by deposit insurance fund
Periods of analysis

- 1971 - 1990: fiscal dominance with higher fiscal deficit: high and persistent inflation
- 1991 - 2017: monetary dominance with increasing size of government: decreasing inflation, but worst economic crisis on records:
  - GDP growth in 1999: -4.2%
## Financing

<table>
<thead>
<tr>
<th>Periods</th>
<th>$\Delta \theta^N$</th>
<th>$\xi \Delta \theta^*$</th>
<th>Seigniorage</th>
<th>$D$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960-1970</td>
<td>0.25%</td>
<td>0.28%</td>
<td>0.91%</td>
<td>0.15%</td>
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<td>1971-1990</td>
<td>-0.17%</td>
<td>0.00%</td>
<td>1.39%</td>
<td>0.50%</td>
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<tr>
<td>1991-2017</td>
<td>0.97%</td>
<td>0.30%</td>
<td>0.96%</td>
<td>0.78%</td>
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<td>1960-2017</td>
<td>0.44%</td>
<td>0.19%</td>
<td>1.10%</td>
<td>0.56%</td>
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</table>
Financing
1960-1970

- Fiscal dominance
- Small government: 5%-7% of GDP
- Small deficit: peak fiscal deficit 1.19%, average: 0.43%
- 1967: BoP crisis
Small government

<table>
<thead>
<tr>
<th>Period</th>
<th>Tax revenue</th>
<th>Govt expenditures</th>
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<tbody>
<tr>
<td>1960</td>
<td>4.0%</td>
<td>5.5%</td>
</tr>
<tr>
<td>1962</td>
<td>4.5%</td>
<td>5.0%</td>
</tr>
<tr>
<td>1964</td>
<td>5.0%</td>
<td>5.5%</td>
</tr>
<tr>
<td>1966</td>
<td>5.5%</td>
<td>6.0%</td>
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<tr>
<td>1968</td>
<td>6.0%</td>
<td>6.5%</td>
</tr>
<tr>
<td>1970</td>
<td>6.5%</td>
<td>7.0%</td>
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</tbody>
</table>
Monetary emission was main source of financing.
1963: highest inflation on record
Monetary Board

- Foreign exchange, monetary and credit authority
- Established in 1963. Lasted until 1990
- Members: Ministers, head of the Central Bank, two advisors
Foreign exchange reserves

1967: BoP crisis
Exchange rate

devaluations: 33% in 1963, 29% in 1966
1971-1990

- Fiscal dominance
- Higher deficit: average: 1.05%
- High inflation: average: 23.1%
- 1982: BoP crisis
- Positive GDP growth every period
Coffee boom increased tax revenue and reduced external financing needs.
1982

- BoP crisis
- Speculative investments by banks led to nationalization of five banks between 1982 and 1986
- Government borrowed from Central Bank to fund nationalization
- 1985: creation of Fogafín (deposit insurance fund)
- GDP growth in 1982: 0.9%
Government expenditures increased to over 8%.
Increase in deficit was financed by domestic debt
Alternative measure of financing

Monetary emission

Foreign debt

Domestic debt

Domestic loans came from Central Bank
1991-2017

- 1991: new political Constitution
  - Affected monetary, fiscal and foreign exchange policy

- Monetary dominance, with an increasing size of government
  - Average fiscal deficit: 3.3%

- Decreasing inflation:
  - Average: 10.12% and single digits since 1999

- Worst economic crisis on records: GDP growth in 1999: -4.2%
Monetary policy

- Central bank became independent
  - Difficult to lend to the government
  - Prohibited to lend to the private sector
- Constitutional mandate that implies control of inflation
Central government increasing transfers to regions
Government expenditures

Lower increases in tax revenues implied growing fiscal deficit
Government expenditures

Highest fiscal deficit in sample: 6.4% in 1999
Increasing role of debt in financing
Development of domestic public debt market in mid 1990s
Foreign exchange policy

Nominal exchange rate band

Establishment of foreign exchange bands
At first helped to anchor inflation
Inflation

Inflation objective

Inflation

Crisis of 1999

- Increasing macro imbalances
  - Increasing fiscal deficit
  - Increasing current account deficit
- Increasing domestic indebtedness: mortgage loans
Current account

Sudden stop in 1998-1999
Foreign exchange policy

Central bank shifted exchange rate bands
Foreign exchange policy

Sept 1999: floated exchange rate
Crisis of 1999

- Banking crisis
  - 35 financial institutions were intervened
  - Bailout carried by Fogafín (deposit insurance fund)
- Increasing interest rates caused mortgage defaults to increase
- Worst economic crisis on records: GDP growth -4.2%
Inflation objective since 2001
Since then

- Commitment to fiscal rule has kept deficit relatively low
  - Average during XXth century: 3.5%
  - “Structural” deficit should reach 1% by 2022.

- Financing mainly through debt
  - Deepening of domestic government debt market
  - Deepening of interbank market
Conclusion

- We identify three periods where the finance structure of the budget deficit varies according to the economic institutional setup
  - 1971-1990: fiscal dominance with higher fiscal deficit: high and persistent inflation
  - 1991-2017: monetary dominance with increasing size of government: decreasing inflation but worst economic crisis on records
Real exchange rate

<table>
<thead>
<tr>
<th>Periods</th>
<th>Apr71</th>
<th>Dec84</th>
<th>Sep98</th>
<th>May12</th>
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Real GDP per capita growth

Catchup?