

# The Fiscal and Monetary History of Colombia: 1963-2012

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<sup>1</sup>The 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.

# Introduction

Hypothesis of project:

- Bad fiscal and monetary policies led to macroeconomic instability
- Macroeconomic instability was responsible for low growth and poor economic performance

# Introduction

In Colombia: Inverse of first holds, second doesn't

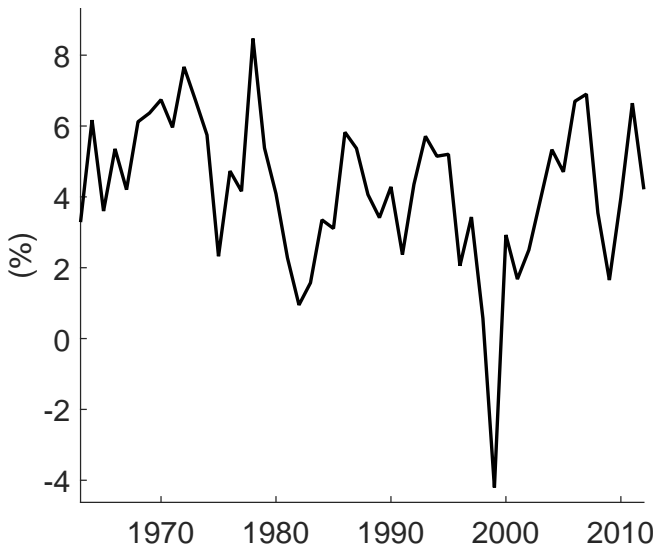
- Not so bad fiscal and monetary policies led to macroeconomic stability
- Macroeconomic stability did not lead to growth and good economic performance

# Colombia: Low(er) macro volatility

## Low volatility in growth

- Kodama (2013): lowest volatility in Latin America
- Few recessions

# Real GDP growth



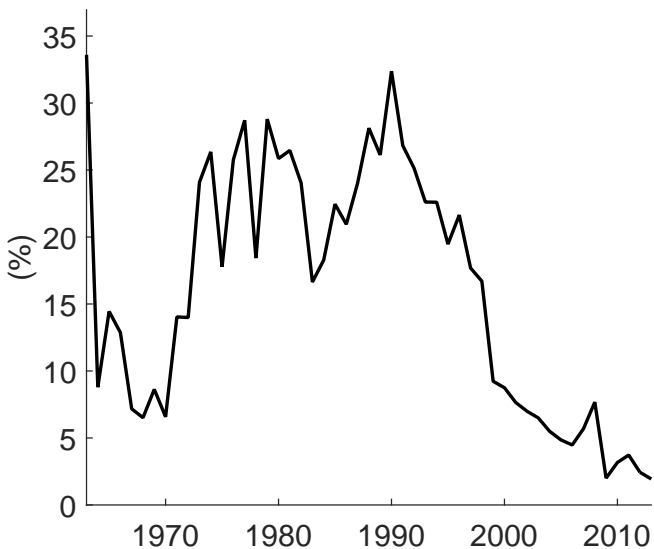
# Colombia: Low(er) macro volatility

## Low volatility in growth

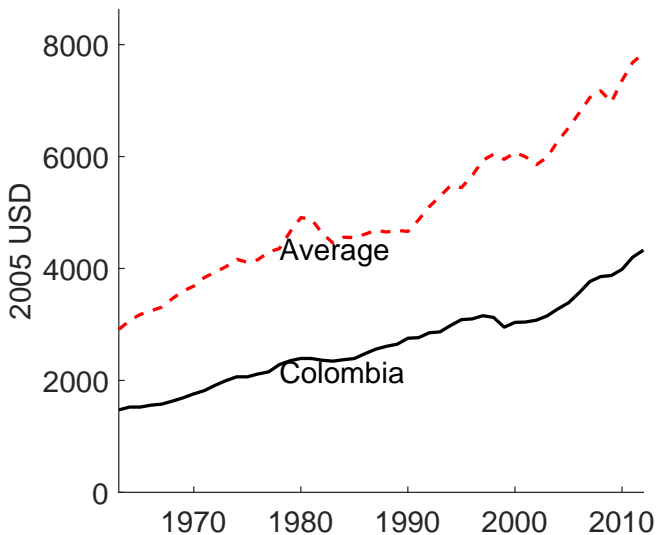
- Kodama (2013): lowest volatility in Latin America
- Few recessions

High and persistent inflation, but no hyperinflation

# Inflation

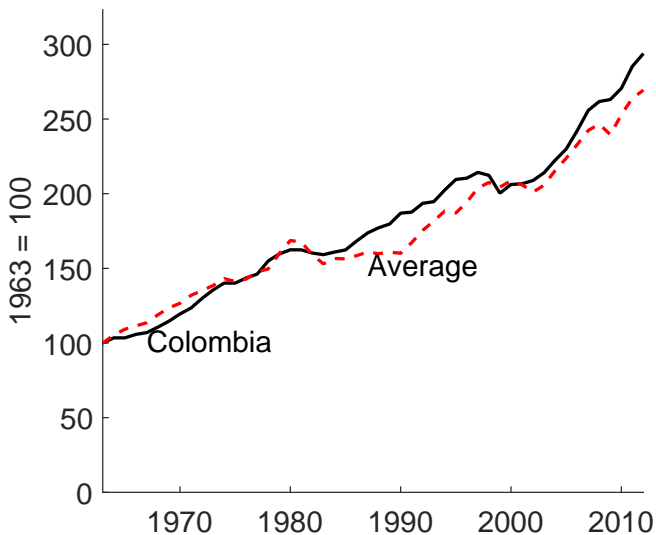


# Real GDP per capita





# Real GDP per capita growth



# Colombia: Exception?

Our hypothesis:

- Colombia was able to implement not so bad policies due to a small government
- Financial repression helped to control monetary aggregates and avoid instability: cause of low economic growth

# What we do

- Characterize the joint history of monetary and fiscal policies in Colombia since 1963
- Follow the general framework by Kehoe et al (2013)

# Cycles of government financing

- 1963-1975: Foreign debt
- 1976-1991: Monetary emission
- 1991-2012: Domestic debt

## Before 1991

- Monetary Board had no independence from government
- Central Bank was a development bank
- Increasing tolerance towards inflation
- Various forms of armed conflict (also after 1991)
- Reserve requirements were used to counteract increases in monetary base

## 1991

- New Political Constitution
- Central Bank independent from government
  - Explicit objective: low inflation
  - Difficult to lend to government
  - Cannot lend to private sector

# Framework: Kehoe et al (2013)

$$\begin{aligned} B_t - B_{t-1} + b_t^* - b_{t-1}^* + M_t - M_{t-1} + T_t \\ = D_t + B_{t-1}R_{t-1} + b_{t-1}^*r_{t-1}^* \end{aligned}$$

# Framework: Kehoe et al (2013)

$$\begin{aligned} B_t - B_{t-1} + b_t^* - b_{t-1}^* + M_t - M_{t-1} + T_t \\ = D_t + B_{t-1}R_{t-1} + b_{t-1}^*r_{t-1}^* \end{aligned}$$

$B_t$ : Government debt issued domestically



# Framework: Kehoe et al (2013)

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$b_t^*$ : Government debt issued abroad

# Framework: Kehoe et al (2013)

$$\begin{aligned} B_t - B_{t-1} + b_t^* - b_{t-1}^* + M_t - M_{t-1} + T_t \\ = D_t + B_{t-1}R_{t-1} + b_{t-1}^*r_{t-1}^* \end{aligned}$$

$M_t$ : Monetary emission

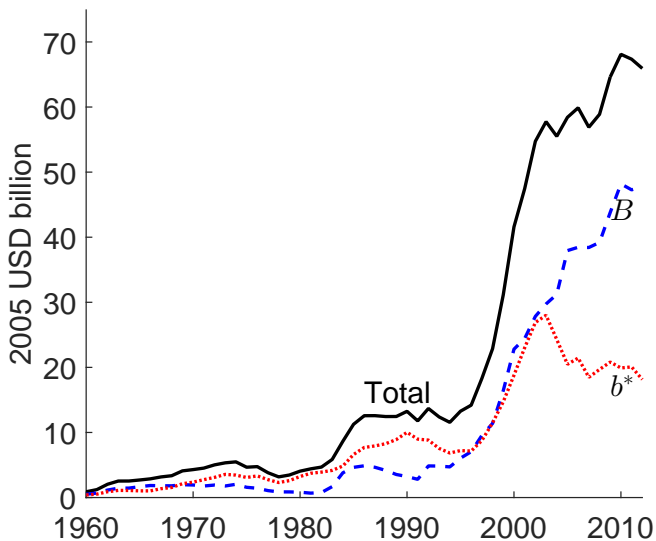
# Accounting unit

- National central government (NCG)
- We don't include local governments
  - Main source of revenue of local governments is transfers from NCG
  - Debt of local governments is around 3% of debt of NCG and is bounded by law

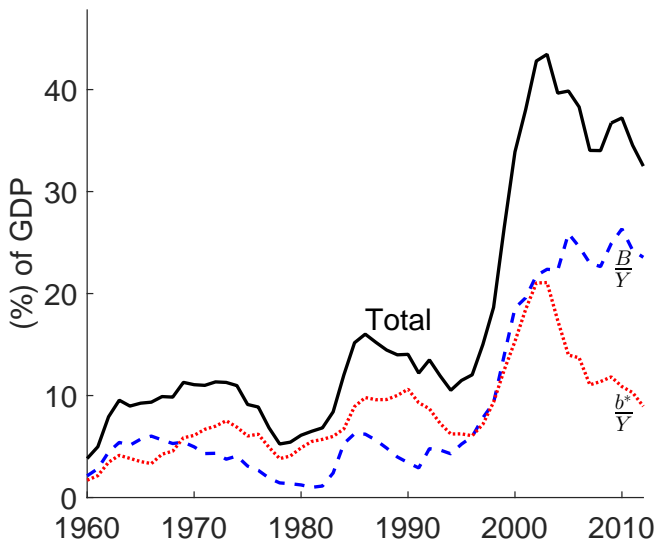
# Government debt

- We identify place of issuance, not currency
  - Domestic: Issued in Colombia, mostly in Colombian pesos
  - Foreign: Issued abroad, mostly in US dollars
- Indexed government debt is very recent and small
- Implied interest rates

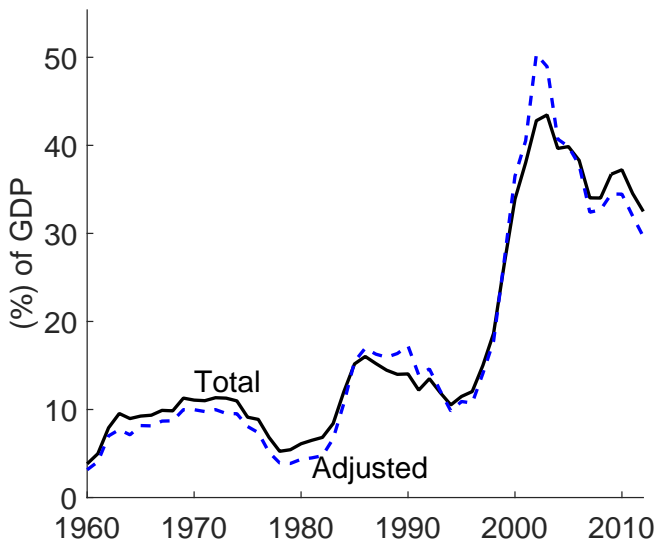
# Debt in constant USD



# Debt to GDP



# Debt and adjusted debt by RER to GDP



# Monetary emission

Prior to 1991

- Net credit from the central bank to the government
- Special Exchange Accounts (CEC)

After 1991

- Profits from the central bank



# CEC

- 1938-1993
- Resources derived from movements in exchange rate
  - Profits from management of foreign exchange
- Taxes on coffee exports and remittances
- 1993: Became a fund of foreign exchange reserves

# Data sources

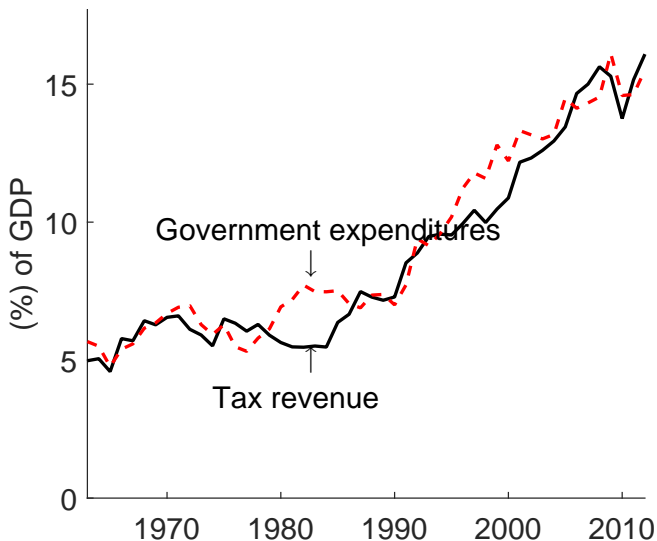
## Financing of fiscal deficit

- 1963 - 1985: Garcia Garcia and Guterman (1988)
- 1986 - 1989: Banco de la República Colombia (1989) and (1991)
- 1990 - 2002: DTIE at Banco de la República Colombia
- 2003 - 2012: Ministry of Finance and Public Credit

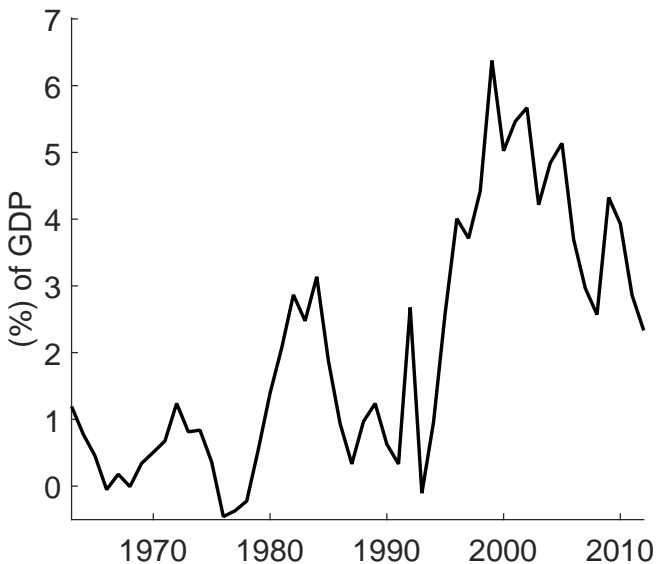
## Expenditures on interest on debt

- Junguito and Rincón (2007)

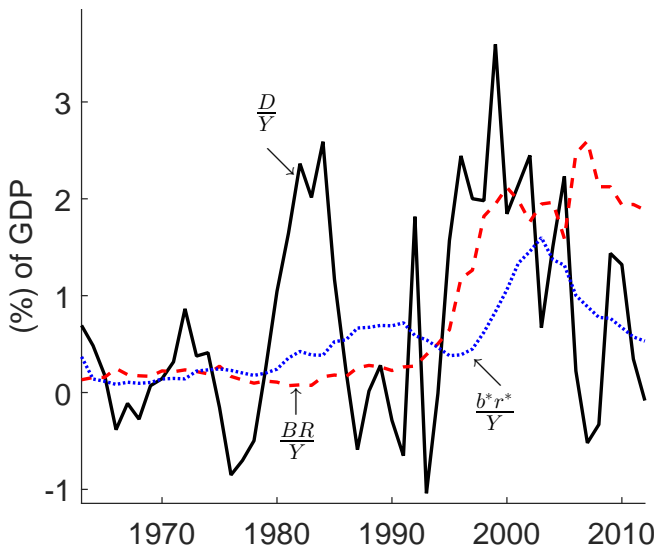
# Government expenditures and tax revenue



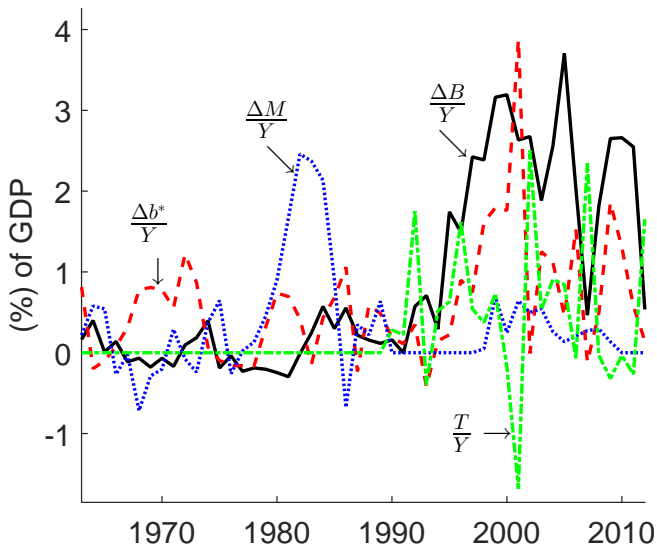
# Fiscal deficit



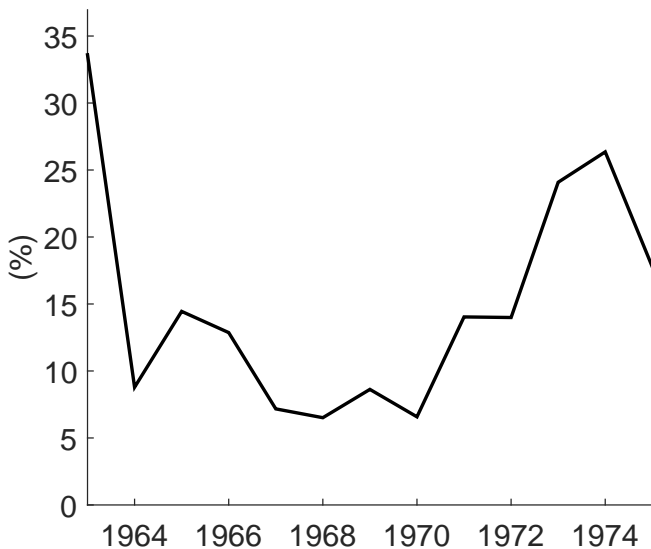
# Primary deficit and interest payments



# Financing



# Inflation



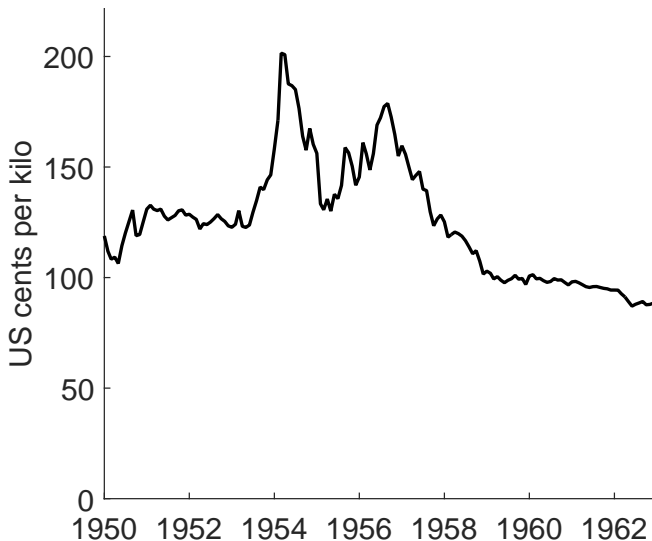
# Burst in inflation in 1963

1950's: Monetary and fiscal expansion

- 1953-1957: Military dictatorship
- Rise in price of coffee: 70% of exports



# Price of coffee



# Burst in inflation in 1963

## Early 1960's

- Lower price of coffee
- Law in 1961: higher expenditures, lower tax revenues
- Sources of financing:
  - Money emission:
  - Foreign debt: Launch of Alliance for Progress and US Agency for International Development
- Major rise in wages: around 25% on average across sectors.

# 1963-1975

- Smallest of the cycles we analyze: deficit peaked at 1.2% of GDP
- Financing mainly through foreign debt
- Begins: Establishment of Monetary Board
- Ends: Before boom of the price of coffee

# Monetary Board

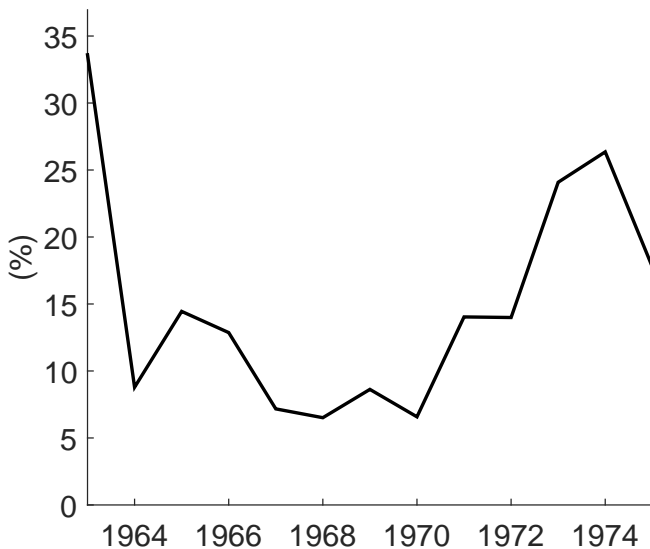
- Foreign exchange, monetary and credit authority
- Established in 1963. Lasted until 1990
- Objective
  - Theory: Get back monetary sovereignty for the government
  - Practice: Central Bank became a development bank
- Members: Ministers, head of the Central Bank, two advisors

# Inflation

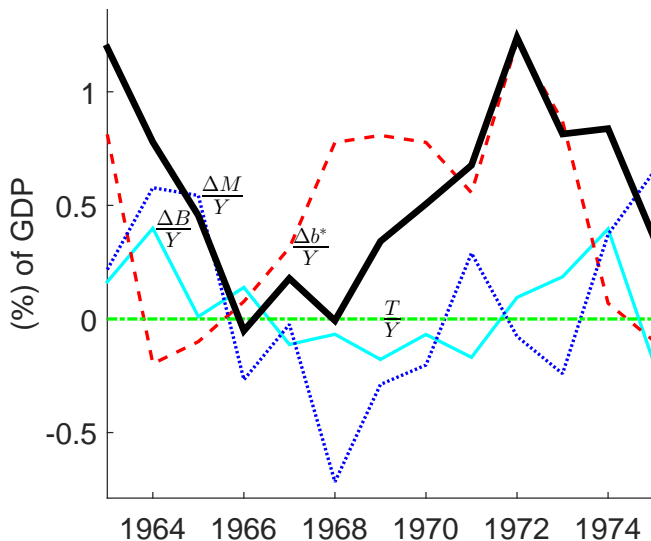
Although high, it was “socially acceptable”

- Indexed wages
- Decreasing mortgage real rates

# Inflation



# Financing

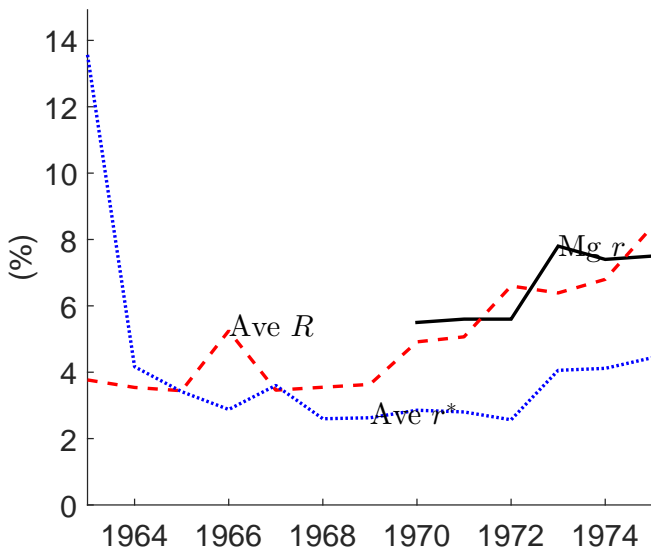


# Financing

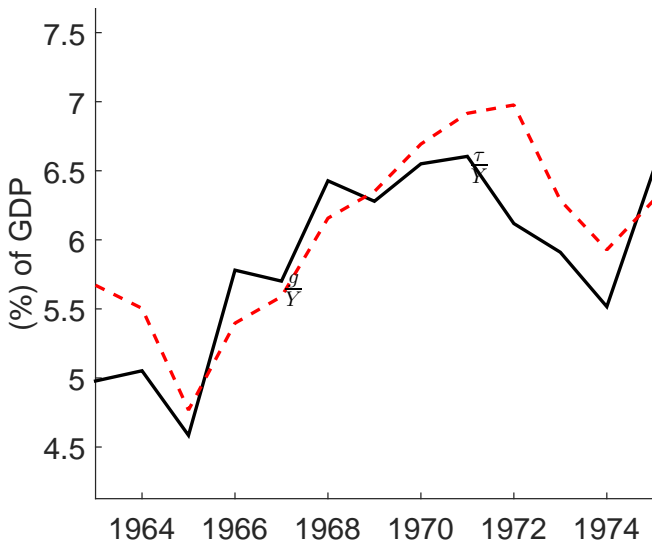
- Colombia was not the exception in taking advantage of foreign credit
- Most loans from multilateral entities (CAF, IDB, etc): low interest rates



# Interest rates on government debt



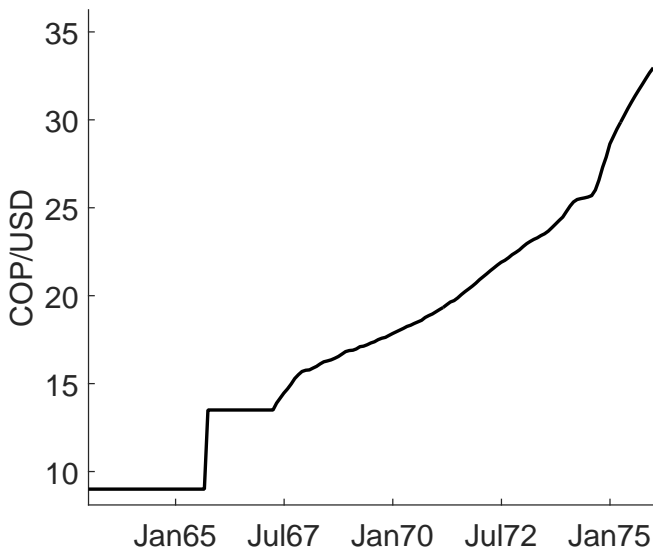
# Small government



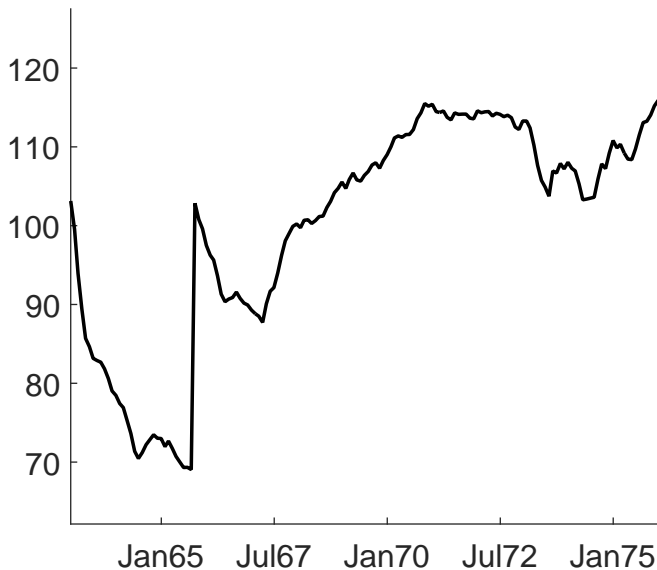
# Foreign exchange policy

- Multiple exchange rates prior to 1967
- Crawling peg and capital controls since 1967

# Nominal exchange rate



# Real exchange rate



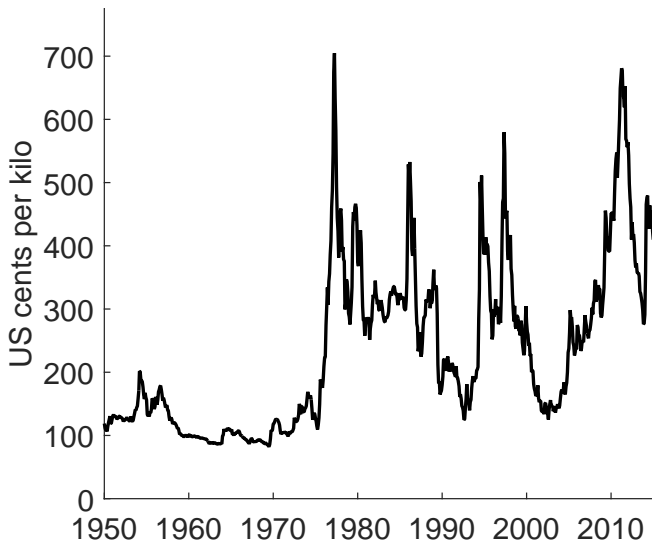
# UPAC system

- Established in 1974
- Two objectives:
  - Develop mortgage sector: construction and home ownership
  - Develop mortgage loan market: long maturity loans
- Special financial entities (CAV's) that lent and took deposits in UPAC, not pesos

# 1976-1991

- Financing mainly through monetary emission
- Begins: Rise in price of coffee
- Ends: Before promulgation of new political constitution in 1991
- 80's were not a lost decade for Colombia: average growth 3,3%

# Price of coffee





# Foreign exchange policy

Up to early 1980's

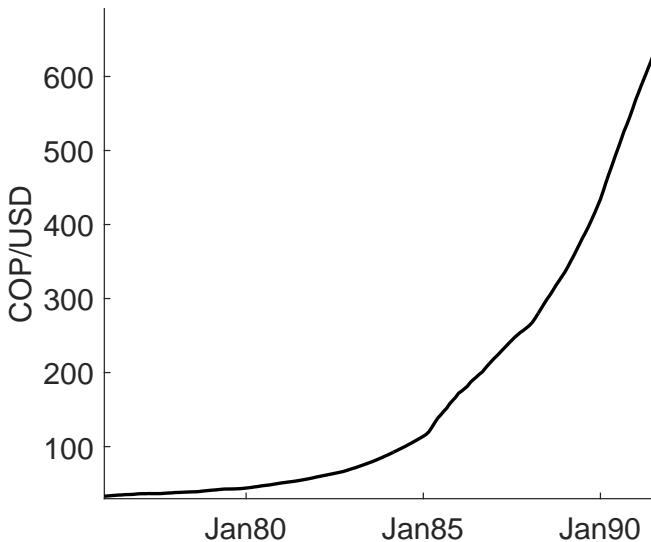
- Fixed exchange rate (crawling peg)
- “The boom is for coffee growers”: President López Michelsen
- Real appreciation
- High and persistent inflation

# Foreign exchange policy

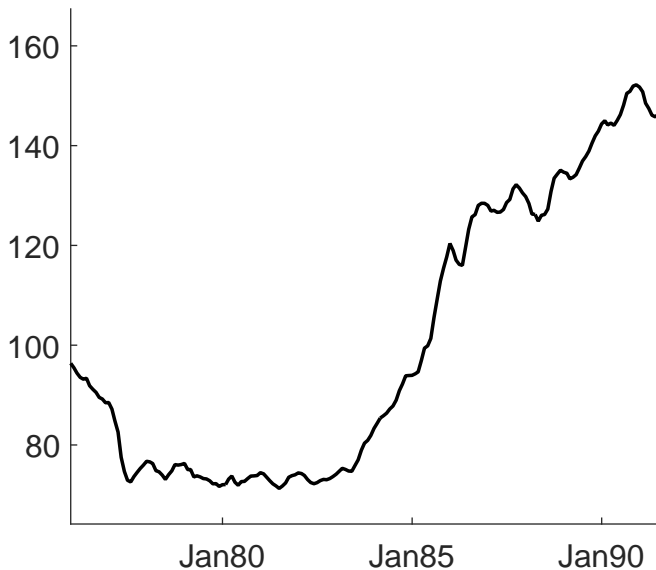
## 1980's

- Fixed exchange rate (crawling peg)
- Steeper nominal devaluation
- Real depreciation
- High and persistent inflation

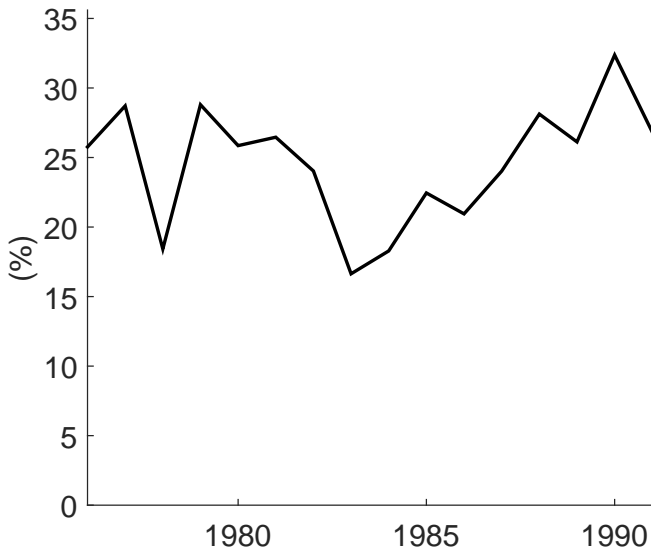
# Nominal exchange rate



# Real exchange rate



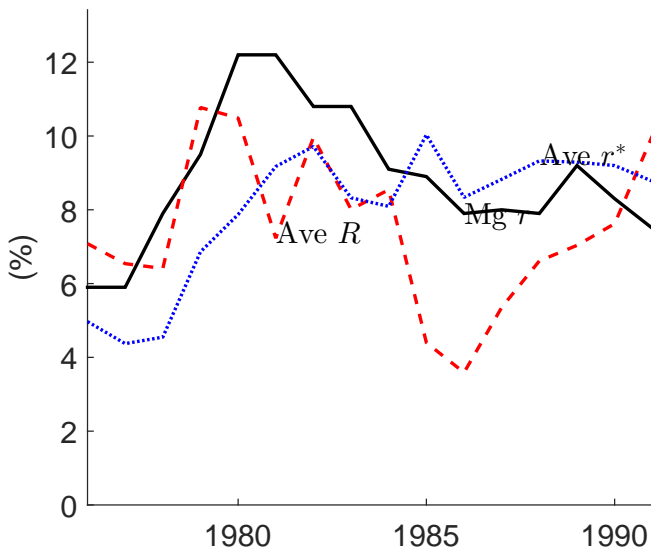
# Inflation



# “Crisis” of 1982

- GDP growth: 0,9%
- Due to coffee boom, Colombia only borrowed abroad for a short time
- Foreign debt remained low
- Banking crisis

# Interest rates on government debt



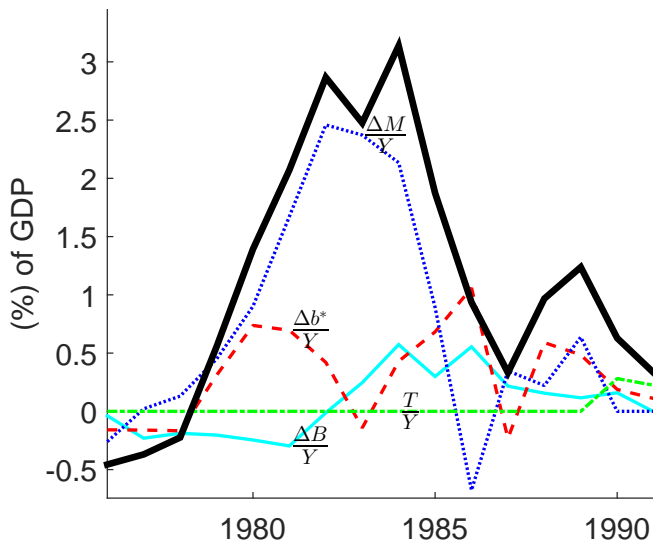
# Financing

Mainly through monetary emission

- Profits from exchange rate policy
- Central Bank rescued state-owned banks during early 1980's banking crisis



# Financing



# 1991-2012

- Financing mainly through domestic debt
- Begins: Promulgation of new political constitution in 1991
- Economic crisis of 1999: -4,2%

# Changes to Central Bank

- Monetary board ceased to exist
- Independent board of directors, even though the Minister of Finance is the head
- Difficult to lend to government
- Prohibited to lend to private sector
- Seignorage limited to profits of Central Bank

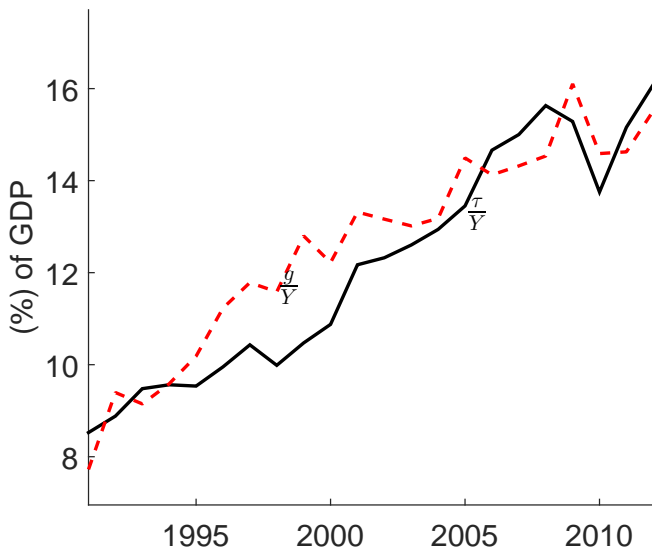
# “La Apertura”

- Liberalized capital account
- More liberal financial sector: Foreigners can own banks
- Pressure on CAV's

# Government

- Central government had to transfer increasing resources to regional governments
- Size of government increased

# Government expenditures and tax revenue



# 1990's

## Monetary and foreign exchange policy

- Crawling peg was replaced by a moving band
- Monetary policy: target growth of monetary base
- Monetary policy depended on foreign exchange policy

# 1990's

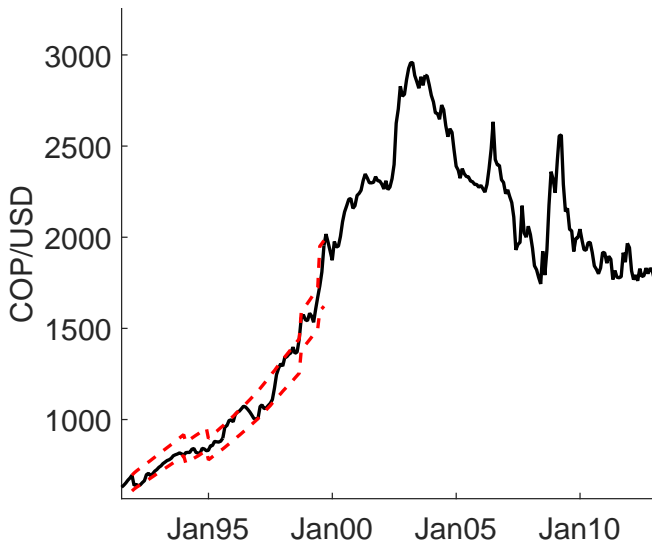
- Increasing fiscal deficit
- Increasing current account deficit
- Increasing foreign debt



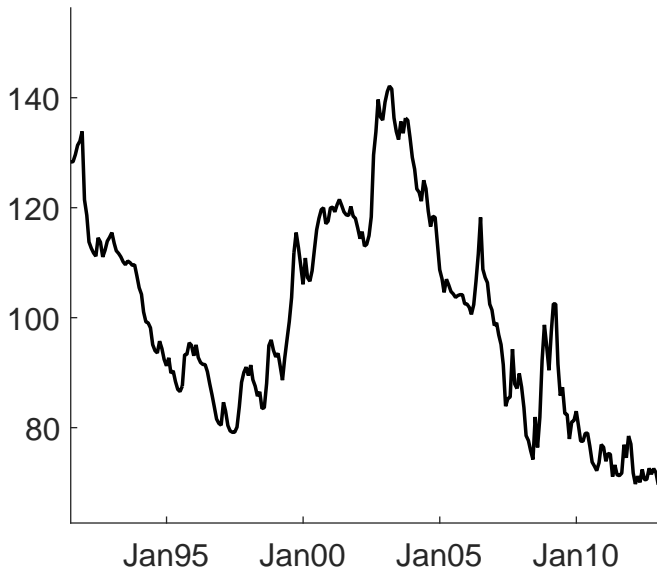
# Crisis of 1999

- GDP real growth: -4,2%
- Financial crisis: bank runs
- Mortgage crisis

# Nominal exchange rate



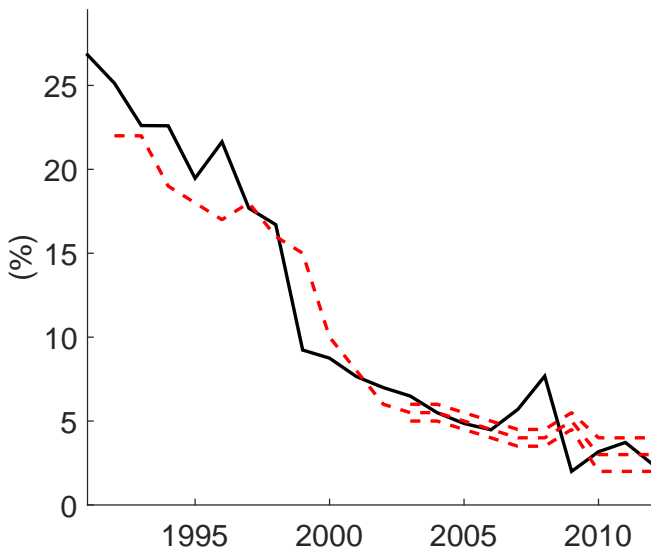
# Real exchange rate



# After 1999

- Free floating of exchange rate
- Inflation targeting: policy instrument is interest rate

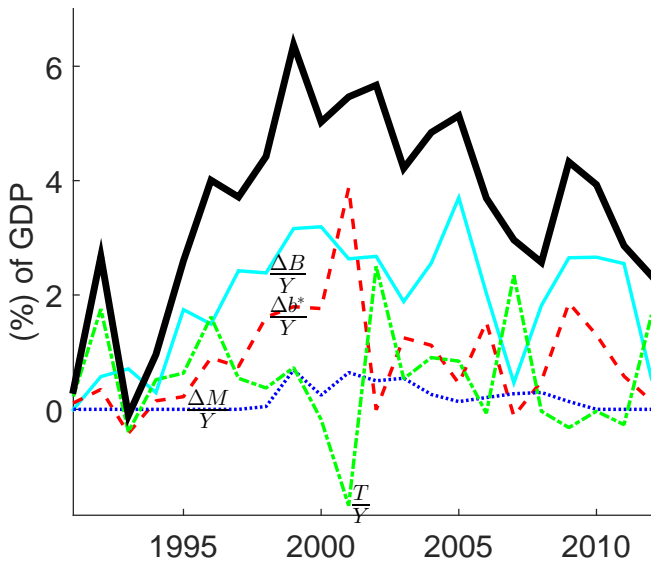
# Inflation



# Financing

- Development of domestic government debt market: TES
- Deepening of interbank market, specially after 1999

# Financing



## 1963-1991

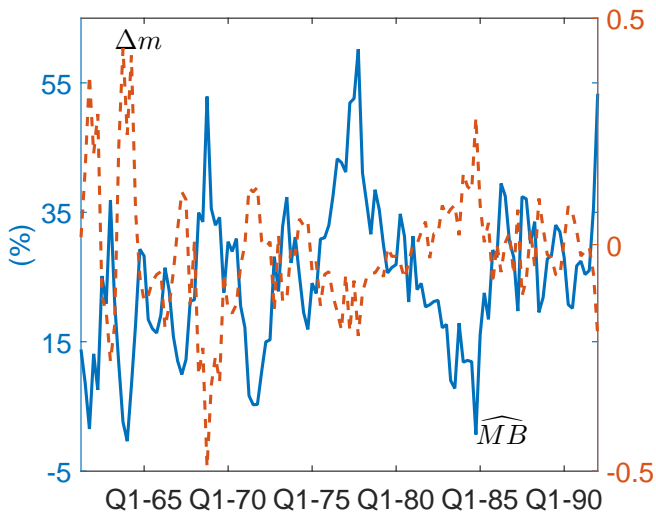
- No institutions to control inflation
  - Monetary board: credit and monetary authority, members belonged to government
- Inflation did not go over 30%



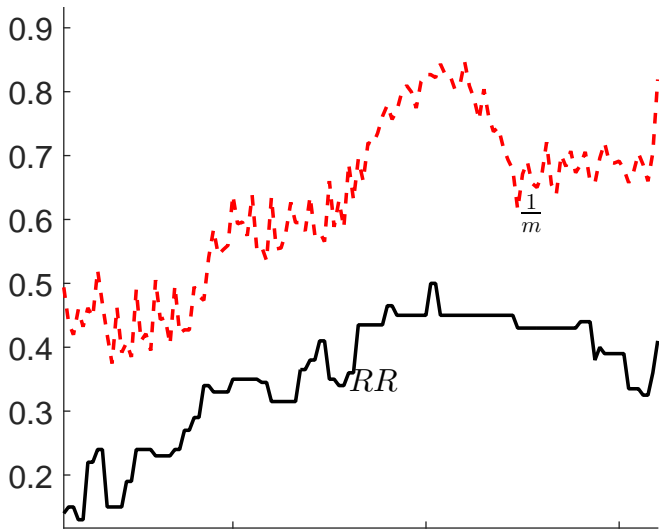
# Financial repression in avoiding hyperinflation

- When monetary base grew, the money multiplier decreased
- Money multiplier followed reserve requirements

# Growth of monetary base and change of money multiplier



# Reserve requirements and inverse of money multiplier



# Conclusion

- Colombia had macro stability
  - Small government for most of its history
  - Used reserve requirements to counteract monetary expansions: one reason for not so great economic performance
- Growth of Colombia was not better than other Latin American countries
- We identify three cycles of government financing, each characterized by a different source

# Conclusion

## Reasons for “exceptionalism” of Colombia

- Luck: i. e. Coffee boom
- Role of advisors of the Monetary Board
- Political clientelism: Robinson and Urrutia (2007)

# Real exchange rate

