

The Fiscal and Monetary History of Colombia: 1963-2012

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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.

Introduction

Macro history of Latin America:

- 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

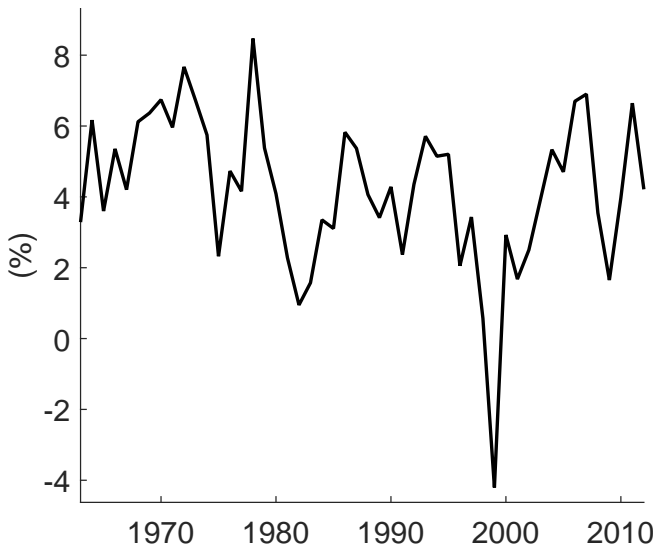
- Not so bad fiscal and monetary policies led to macroeconomic stability
- Macroeconomic stability did not lead to growth and good economic performance

Colombia: Low(er) macro volatility

Low volatility in growth

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

Real GDP growth



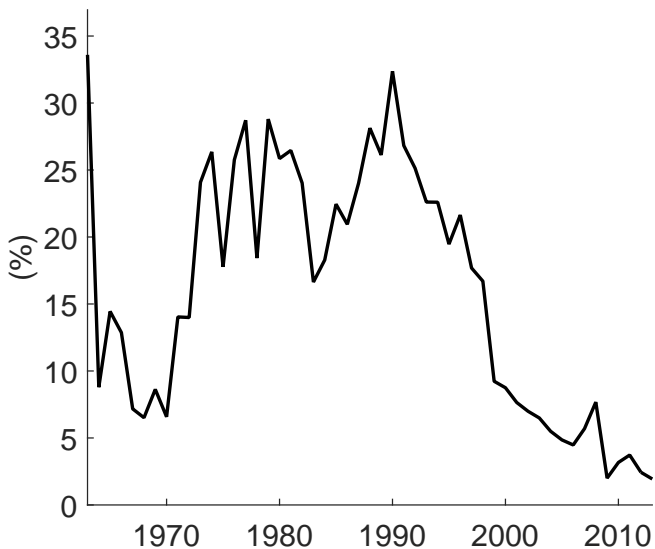
Colombia: Low(er) macro volatility

Low volatility in growth

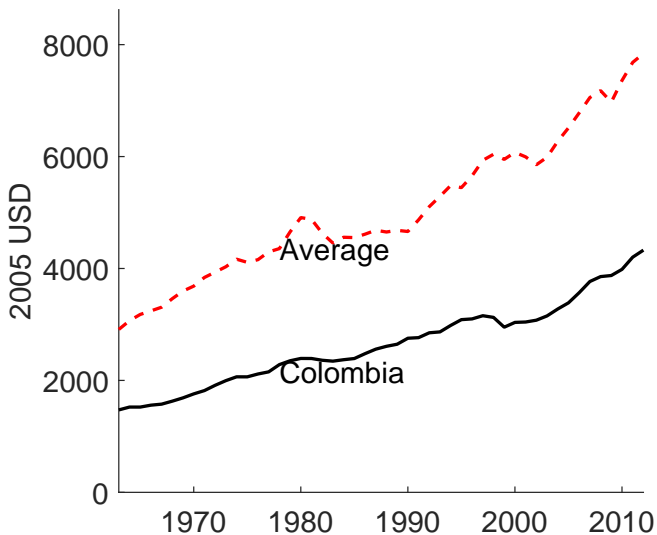
- Kodama (2013): lowest volatility in Latin America
- Few recessions

High and persistent inflation, but no hyperinflation

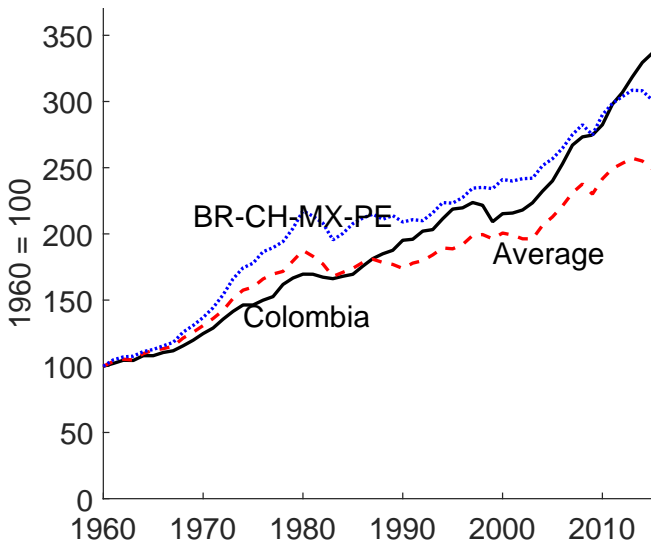
Inflation



Real GDP per capita



Real GDP per capita growth



Colombia: Exception?

Combination of

- Luck: i. e. Coffee boom
- Remembering history: hyperinflation early XXth century
- Financial repression to avoid hyperinflation

Colombia: Exception?

- Before 1991
 - Colombia had a small government: consequence of policies was not too bad
 - Financial repression helped to control monetary aggregates and avoid instability: cause of low economic growth

Colombia: Exception?

- 90's
 - Government of increasing size and macro imbalances led to crisis in 1999
- Since 2000
 - Independence of Central bank helped to avoid instability

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

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)

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B_t : Government debt issued domestically

Framework: Kehoe et al (2013)

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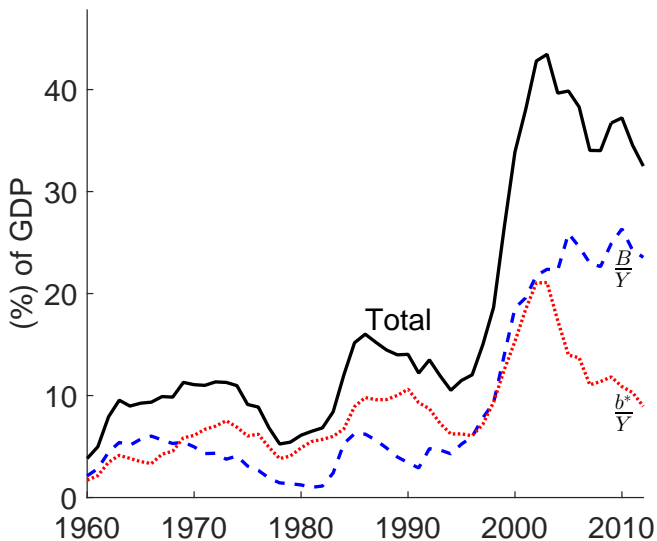
b_t^* : Government debt issued abroad

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

Debt 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

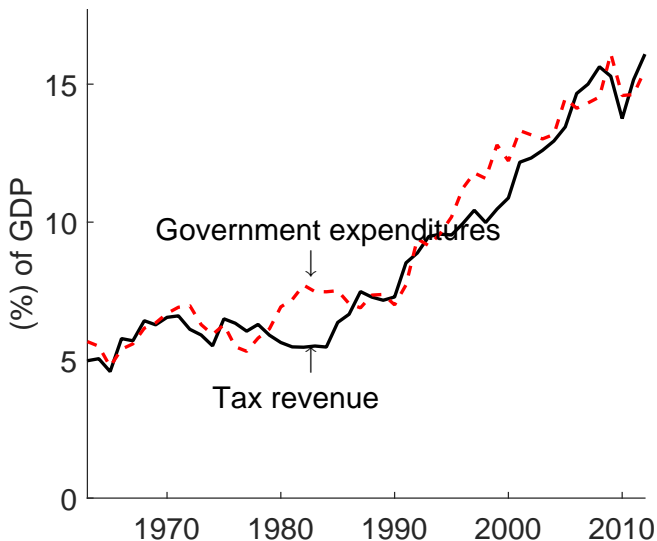
Financing of fiscal deficit

- 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

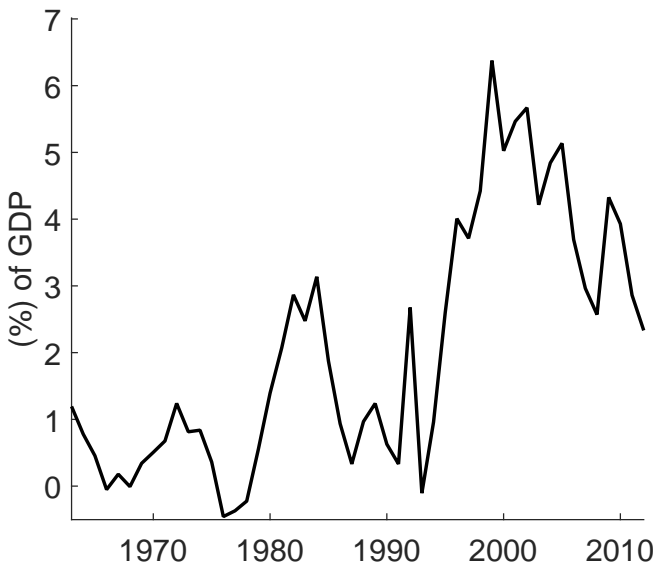
Expenditures on interest on debt

- Junguito and Rincón (2007)

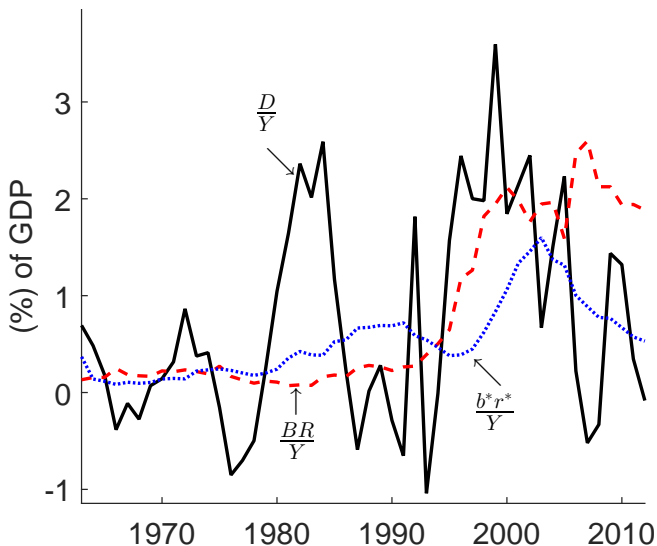
Government expenditures and tax revenue



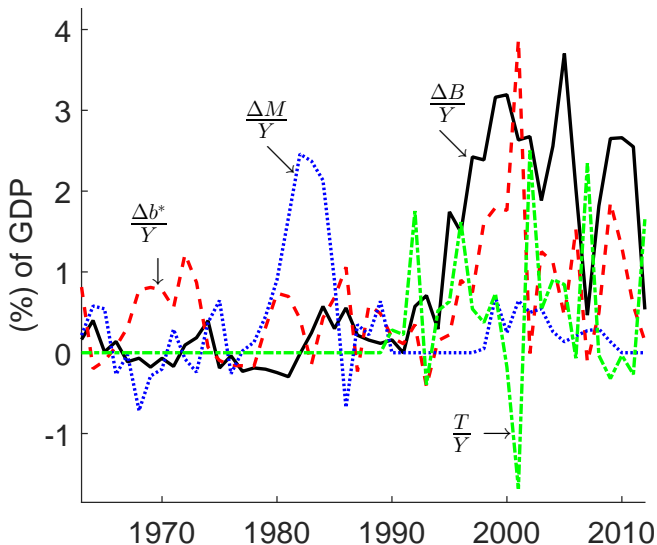
Fiscal deficit



Primary deficit and interest payments



Financing



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

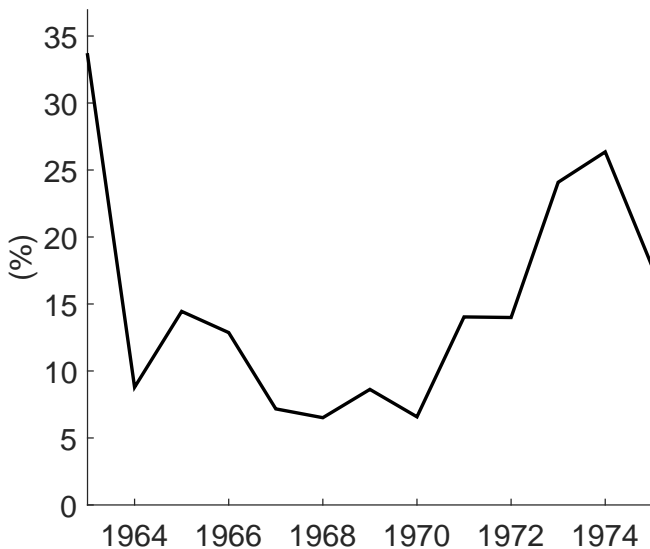
- Foreign exchange, monetary and credit authority
- Established in 1963. Lasted until 1990
- Members: Ministers, head of the Central Bank, two advisors

Inflation

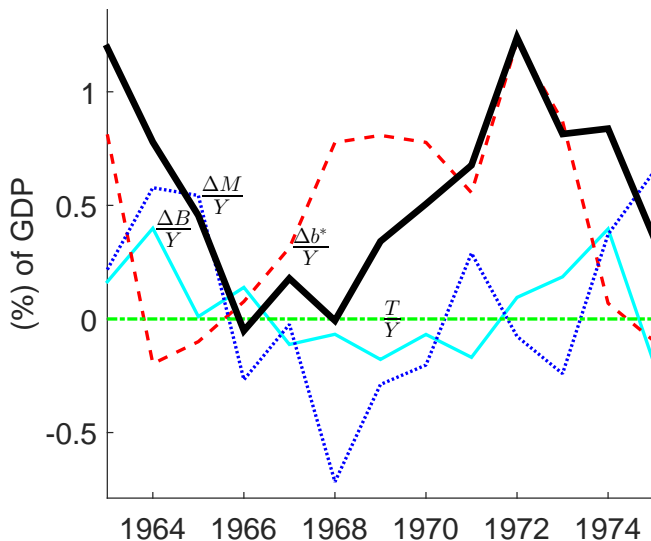
Although high, it was “socially acceptable”

- Indexed wages
- Decreasing mortgage real rates

Inflation



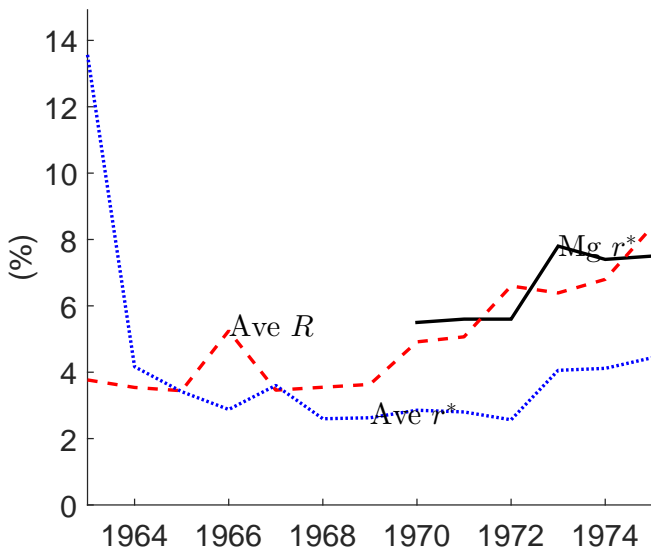
Financing



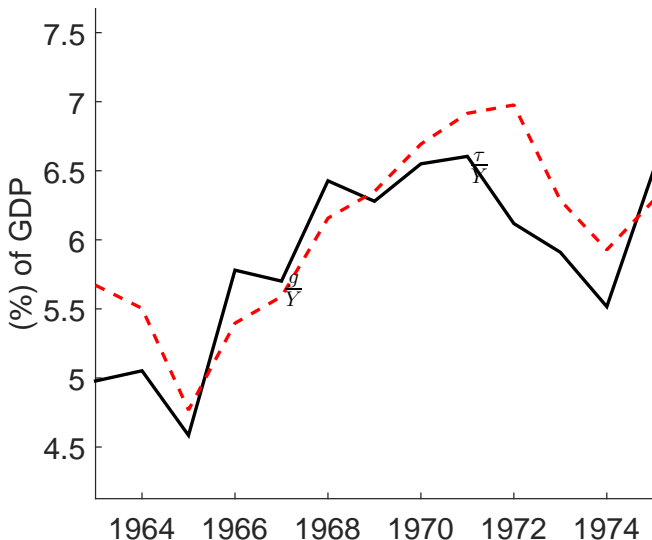
Financing

- 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



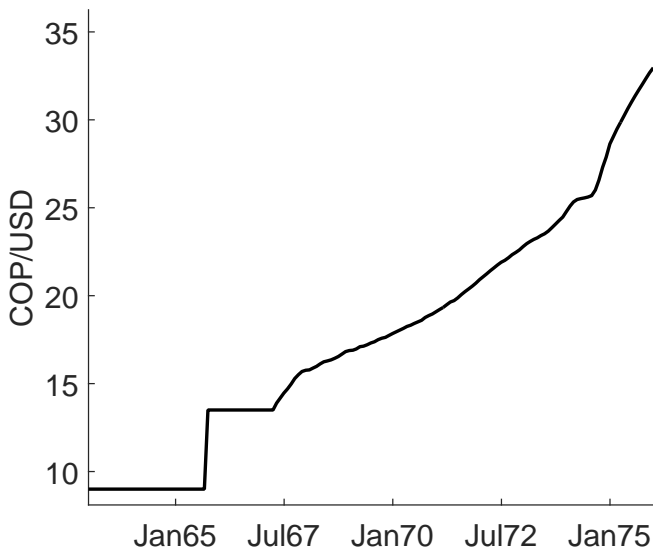
Small government



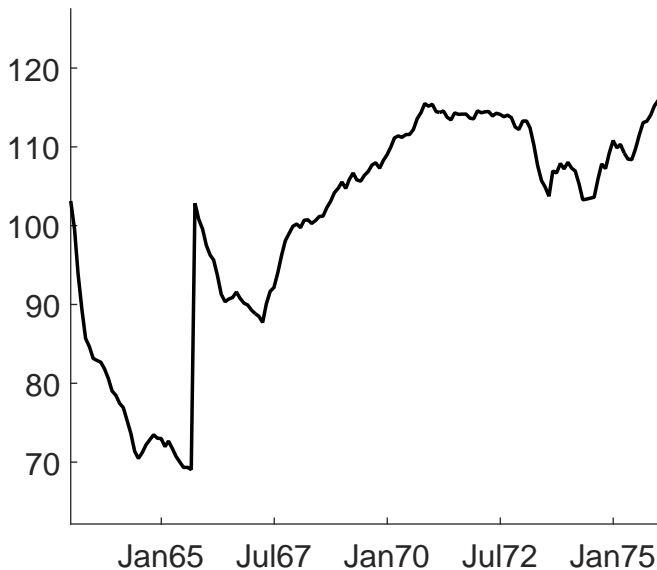
Foreign exchange policy

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

Nominal exchange rate



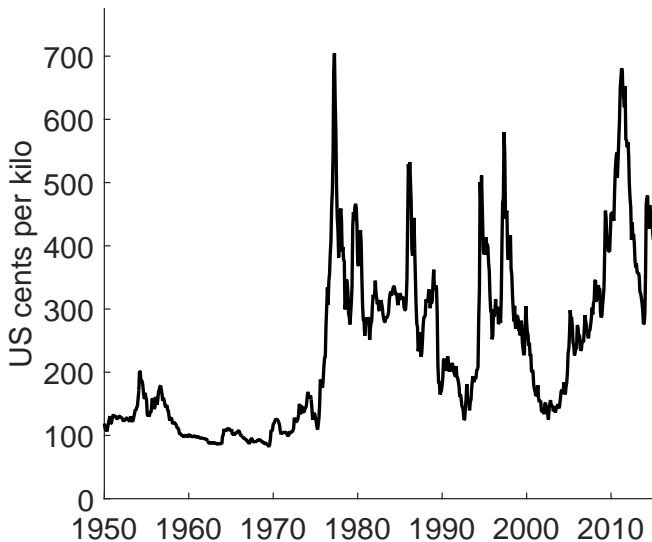
Real exchange rate



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: no recessions and average growth 3,3%

Price of coffee



Foreign exchange policy

Up to early 1980's

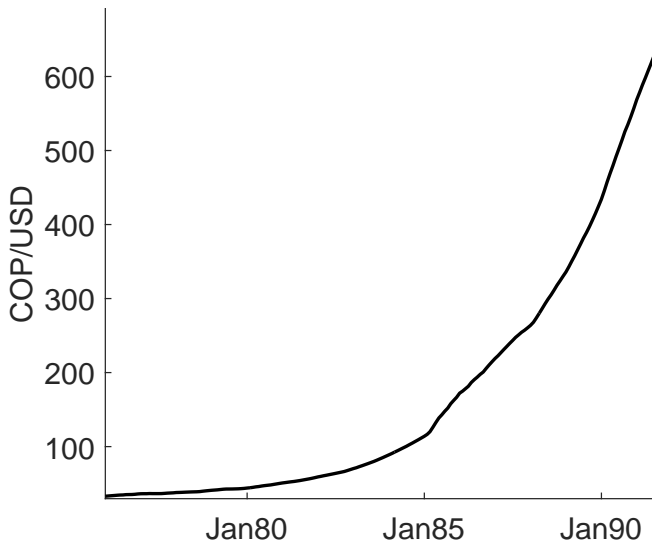
- Fixed exchange rate (crawling peg)
- “The boom is for coffee growers”: President López Michelsen
- Real appreciation
- High and persistent inflation

Foreign exchange policy

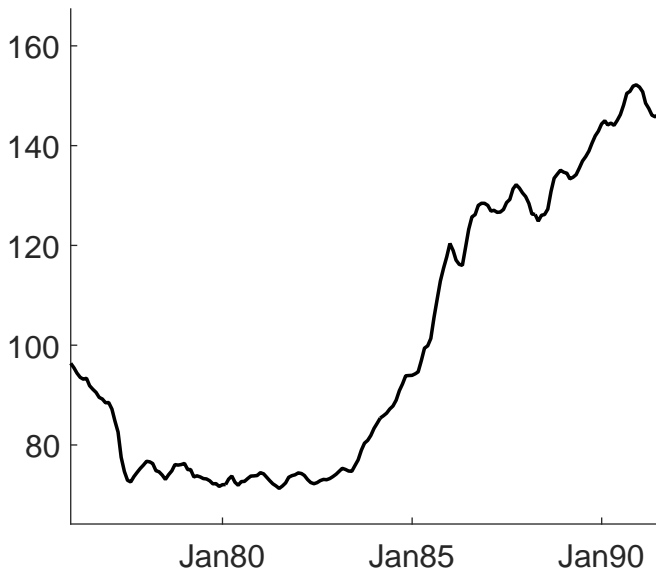
1980's

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

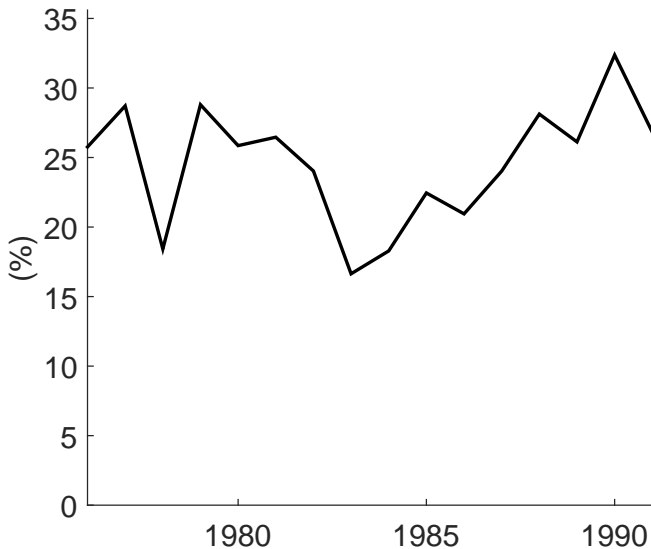
Nominal exchange rate



Real exchange rate



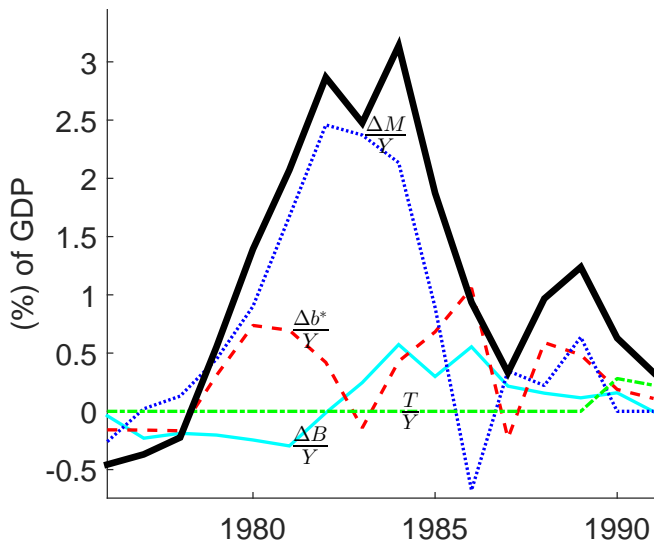
Inflation



“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

Financing



1991-1999

- 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

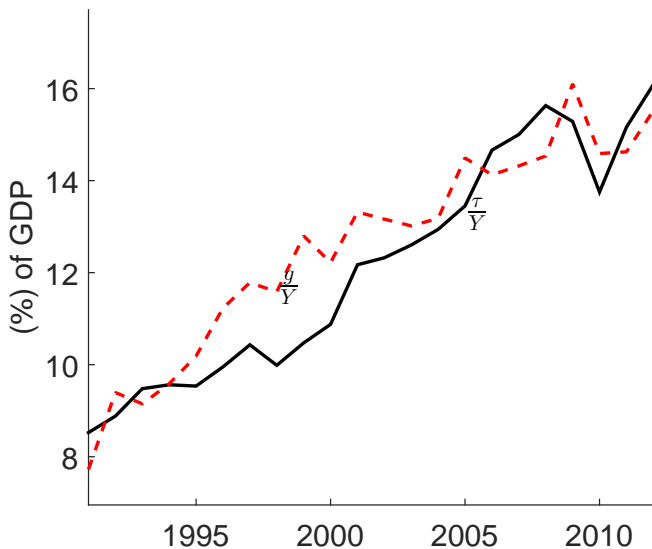
“La Apertura”

- Liberalized capital account
- More liberal financial sector: Foreigners can own banks

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

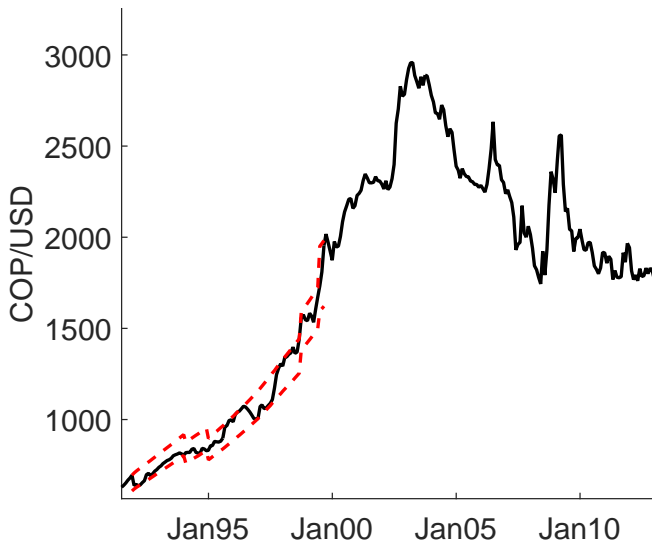
Crisis of 1999

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

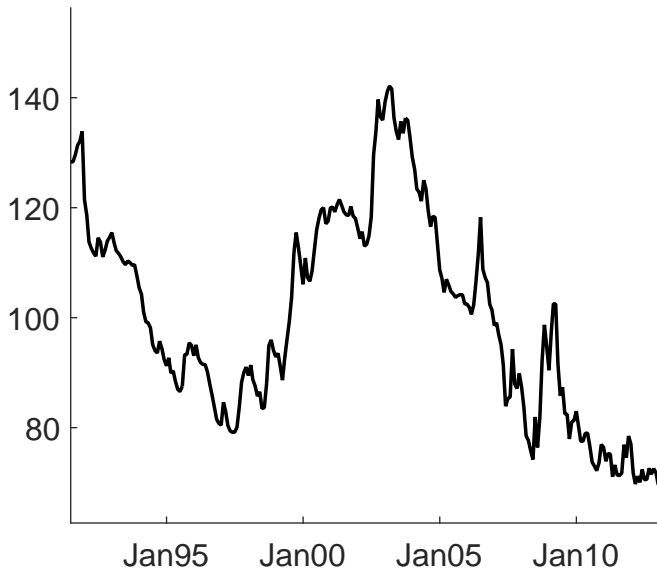
After 1999

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

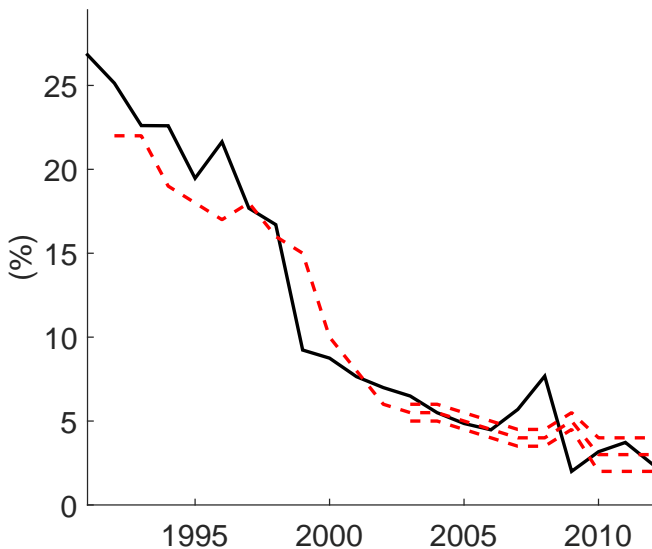
Nominal exchange rate



Real exchange rate



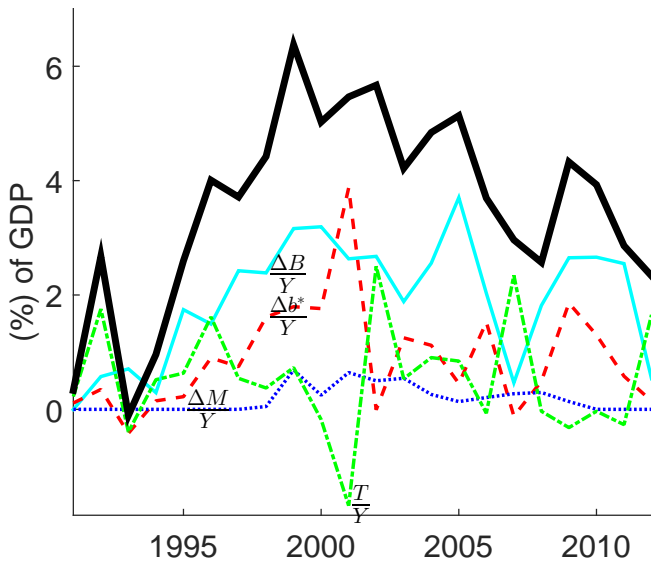
Inflation



Financing

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

Financing



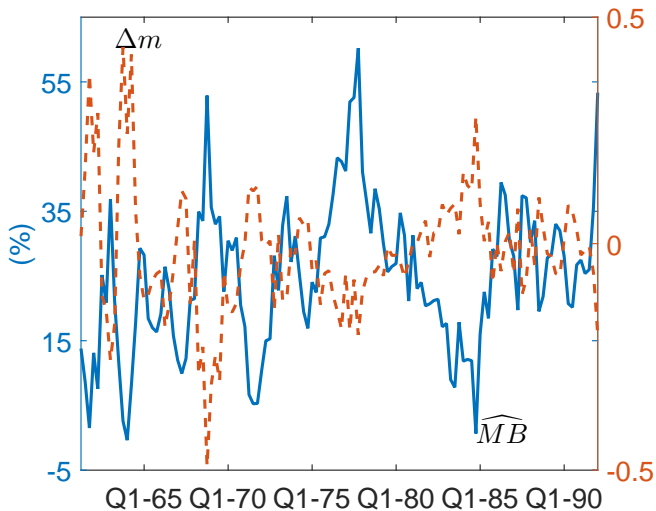
1963-1991

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

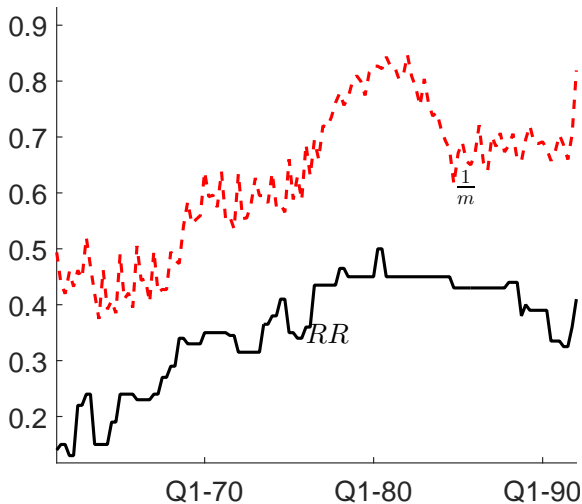
Financial repression in avoiding hyperinflation

- 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

Real exchange rate

