

5 Fiscal accounts: tax reform in 2016

2015 will be a quiet year for the finances of the Colombian National Government

Although the government's Medium-Term Fiscal Plan (MFMP) provided for a considerable fall in mining and oil revenues (due to factors other than lower crude prices), contemplating a fall, according to the government's own accounts, from 20% of its income in 2013 to 15% in 2014, these calculations did not include a fall in the oil price. Based on this scenario, and without considering a lower oil price, the government foresaw a reduction in dividends from Ecopetrol, amounting to a decrease from 1.9% of GDP in 2013 to 1% in 2015.

As a result, the Tax Reforms went beyond covering the hole left by the dismantling of the tax on wealth and financial transactions and sought to counteract the lower revenues from oil. However, the reforms did not take account of a scenario involving lower oil prices, so the government was forced to update the deficit forecast for 2015. This deficit rose from 2.4% of GDP (forecast in the MFMP in June 2014) to 2.8% in the new environment of less favourable oil prices. This difference is equivalent to requiring additional resources amounting to COP3.6trn in 2015.

Of this amount, COP1.7trn will be funded by internal borrowing, by greater net resources generated by the higher exchange rate, and by dollar resources obtained in 2014 with the aim of pre-financing 2015. However, if the 2014 issue was financing for 2015, the issues that the government planned for 2015 will have to be reduced. Nevertheless, according to its most recent Financial Plan, the government is not going to reduce issues in dollars in 2015, and these resources will therefore finance part of the higher deficit. It should be noted that there is enough room domestically to finance this higher deficit in 2015, since domestic debt swaps and debt management transactions were carried out with the National Treasury in 2014, and these considerably reduced repayments for 2015.

Based on the above accounts, financing the greater deficit would seem highly feasible, and would presumably not affect the markets. As mentioned in section 3, January saw an issue on the international markets of USD1.5bn, from a total amount of USD2.5bn planned for 2015, at a highly favourable rate and with demand that considerably outstripped the government's expectations (the total amount of external financing for 2015 is USD5.1bn, USD2.5bn in bonds and USD2.6bn with multilateral institutions).

In short, it seems 2015 will be a quiet year for the finances of the Colombian National Government, thanks to the higher levels of revenue obtained as a result of the tax reforms implemented at the end of 2014, the flexibility introduced by the fiscal rule allowing the observed deficit to be higher than the structural deficit (due to the mining energy and economic cycle), and the space available for financing a higher deficit (Figure 5.1). The fiscal situation will be tighter in 2016. The deficit that must be met under the fiscal rule will require greater income and/or an adjustment in spending that will amount to the equivalent of 0.7% of GDP. We believe that the majority of this adjustment could come from income generated by tax reforms that could raise VAT by 2 percentage points.

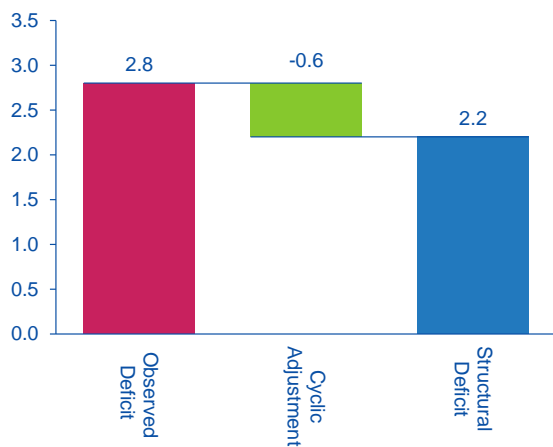
Tax reforms will be required in 2016.

According to our estimates, the deficit in 2016 will reach 2.5% of GDP; of this, 0.3% of GDP will be due to the lower cyclical revenues resulting from the fiscal rule and 2.2% will correspond to the structural deficit (Figure 5.2). Without the restriction on the deficit imposed by the fiscal rule, the deficit would reach 3.2% of GDP, 1% higher than the structural deficit for this year. This higher deficit is basically accounted for by lower than expected oil prices in 2015 (compared with the prices expected by the government in June 2014), and to a greater extent by higher interest payments and less efficient revenue collection than was expected by the government. To cover the difference between the deficit of 3.2% of GDP that would be recorded if the

fiscal rule did not exist, and the deficit allowed under the fiscal rule, the government could, on the one hand, raise the VAT rate (a two point internal and external rate rise would bring 0.5% of GDP) and, on the other, reduce spending by 0.2% of GDP. BBVA Research does not under any circumstances consider that the fiscal rule will not be honoured, given the benefits it has clearly brought.

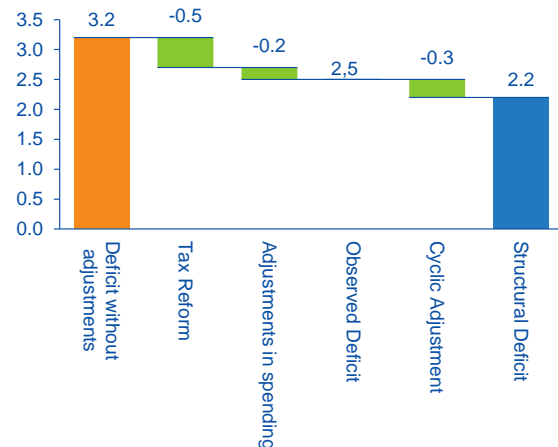
We must stress the importance of the fiscal rule for softening and moderating the impact of commodity prices and economic cycles on both the government’s accounts and the macroeconomy. At times of economic expansion or a boom in the oil sector, the rule encourages contractionary fiscal policies and thus stops the economy from overheating, while in periods of economic contraction or a decline in the oil industry, the rule promotes an expansionist fiscal policy and thus lessens any potential economic slowdown. In this regard, the fiscal rule and monetary policy are fairly well aligned. Another important aspect of the fiscal rule is the way it treats resources generated by commodities, by requiring the reserving of any resources that exceed long-term forecast thresholds and their use during periods of lower revenues (below the threshold). The fiscal rule therefore allows for the smoothing out of the economic cycle, and this reduced macro volatility, combined with the lower capital costs and greater general stability that it brings, strengthens economic growth in the long term. Finally, but no less important, there is the credibility in the markets afforded by the fiscal rule, which as we have already mentioned resulted in the placement of the most recent external bond issue at an excellent rate, despite acknowledgement of a higher fiscal deficit for 2015.

Figure 5.1
Breakdown of the deficit in 2015



Source: BBVA Research and the Tax Ministry

Figure 5.2
Breakdown of the deficit in 2016



Source: BBVA Research and the Tax Ministry

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