Latam Daily: Colombia—Long-Awaited Fiscal Reform Signed into Law

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COLOMBIA: PRESIDENT DUQUE SIGNED INTO LAW LONG-AWAITED FISCAL REFORM FOLLOWING CONGRESSIONAL APPROVAL

Colombia's administration at last succeeded at delivering a much-awaited Fiscal Reform package, following last week's congressional approval on September 9. President Duque signed it into law yesterday (Tuesday, September 14), despite the turmoil that surrounded Colombia's fiscal reform at the beginning of the year and after losing the investment grade by two out of three international agencies. The reform, although far from the structural change that Colombia needs, sets out a path to stabilize public finances.

The initial proposal presented by the government had 34 articles, but following its congressional passage, the total number of articles increased to 65. Nonetheless, the main structure of the government's proposal was not changed and, potential additional fiscal income is still estimated at 1.2% of GDP in the long term (~COP 15.2 tn). Congress also approved the changes to the fiscal rule without significant changes, which means that now Colombia will operate under a debt anchor for the Central Government in a gradual reinstatement starting next year.

Five articles were withdrawn from the original proposal, including the one about the reduction from 5% to 0% in the withholding tax for debt investments by offshore agents. Among the 36 new articles are proposals to modify some fiscal programs to: formalize micro and small business; rules on declaration of hidden assets by natural persons; the management of some special assets under government administration (property seized for illegal activities); and the use of excess of liquidity by regional governments; among other measures such as the three VAT holidays.

All in all, the fiscal reform passed without substantial problems as main sources of additional revenues will come from the corporate sector (~1% of GDP) and from fiscal programs of austerity and reduction on tax evasion (0.2% of GDP). We consider the latter as ambitious, given that in previous administrations the nation already encouraged significant spending cuts and reinforcement of the tax administration entity DIAN.

What about the fiscal rule?

Proposed changes were approved by congress for the most part unchanged. As we discussed in a *Latam Daily* in July, the fiscal rule establishes a debt limit at 71% of GDP and, a long-term anchor of 55% of GDP for the Central Government. Each year the country should achieve a primary balance (excluding extraordinary transactions such as asset sales) under the following rule:

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Chart 1

$$Structural\ primary\ balance\ (\%\ of\ GDP) = \begin{cases} 0.2 + 0.1(Net\ debt\ _{t-1} - 55, if\ Net\ debt_{t-1}\ \leq 70 \\ \qquad\qquad\qquad\qquad 1.8\ if\ Net\ debt_{t-1},\ \ x > 70 \end{cases}$$

The fiscal rule will be fully implemented in 2026, in the meanwhile net primary fiscal balance for the Central Government shouldn't be less than -4.7% of GDP in 2022, -1.4% of GDP in 2023, -0.2% of GDP in 2024, and +0.5% of GDP in 2025, regardless of the current debt level. In 2021 the fiscal rule will remain suspended, which means a deficit of -8.6% of GDP for the Central Government, according to the latest MTFF.

Another change in the fiscal rule was creating an autonomous fiscal rule committee, which will have seven members, five experts designated by the Ministry of Finance, and two representatives from Congress (the president of each chamber for the economic affairs committee). A relevant change is that now the committee will have a budget to make a more robust analysis supported by technical staff.

Our take:

The fiscal reform approval is positive news. While it was not structural, it outlines a road towards more sustainable fiscal accounts. The potential additional revenue is almost guaranteed by the corporate sector; however, the fiscal austerity and tax evasion control metrics are things to keep an eye on.

On the fiscal rule side, we think it was a positive gain, however, it wouldn't be implemented until 2026. Nonetheless, talking about debt metrics instead of only fiscal balance is a more transparent approach.

Either way, as Minister Restrepo said, Colombia will need yet a new fiscal reform in a couple of years in view that the current Law represents only two-thirds of the total required adjustment. That said, Colombia will continue its tradition of being a "serial fiscal reformer" and the next government will have again to face this challenge.

—Sergio Olarte & Jackeline Piraján