

The Colombian economy

Outlook and challenges

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Colombia INSIDE OUT
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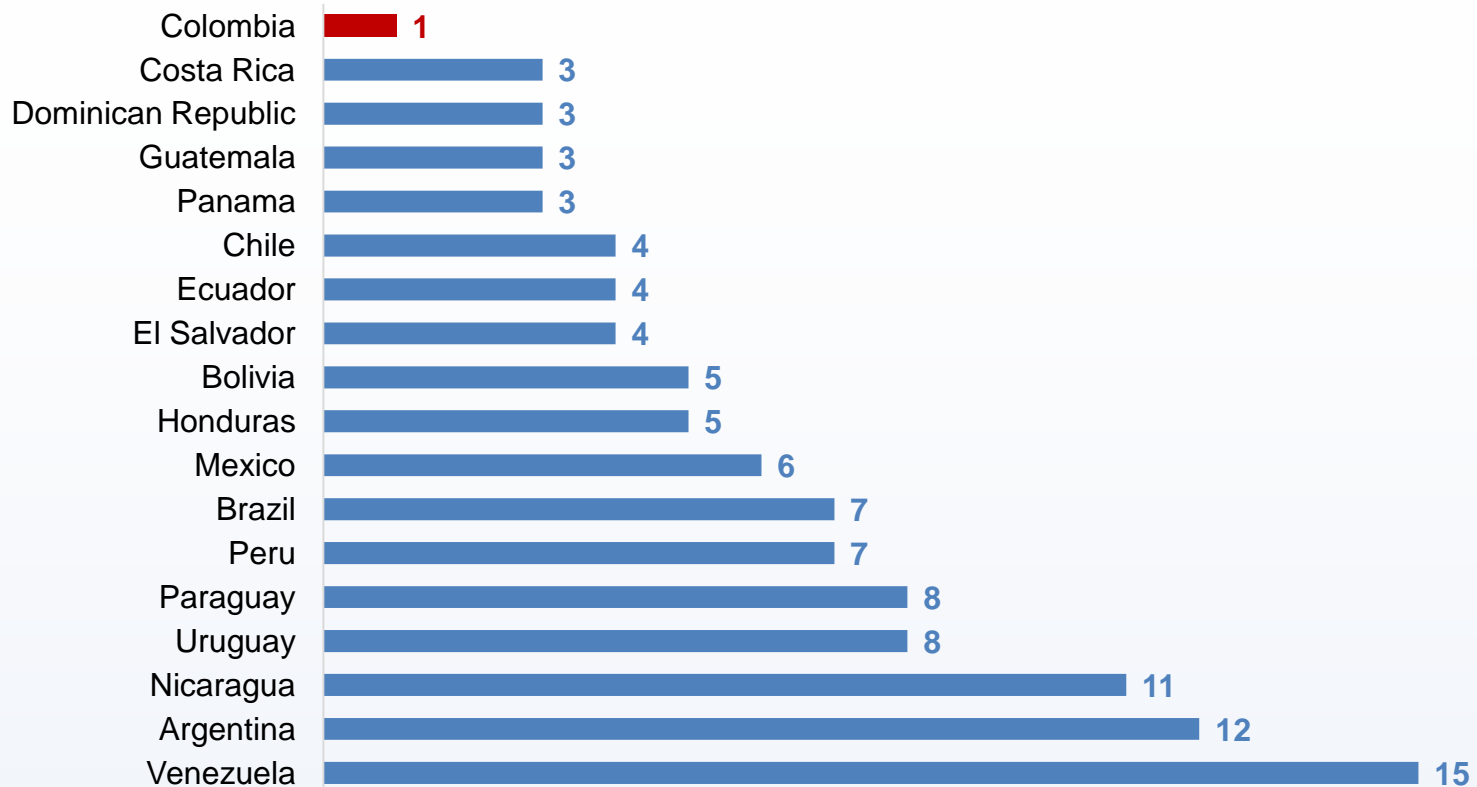
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Colombia's economic growth is remarkably stable compared to the rest of Latin America

Number of years with negative economic growth between 1980 and 2017



Source: IMF – WEO (July 2018 update), DGPM-MHCP calculations

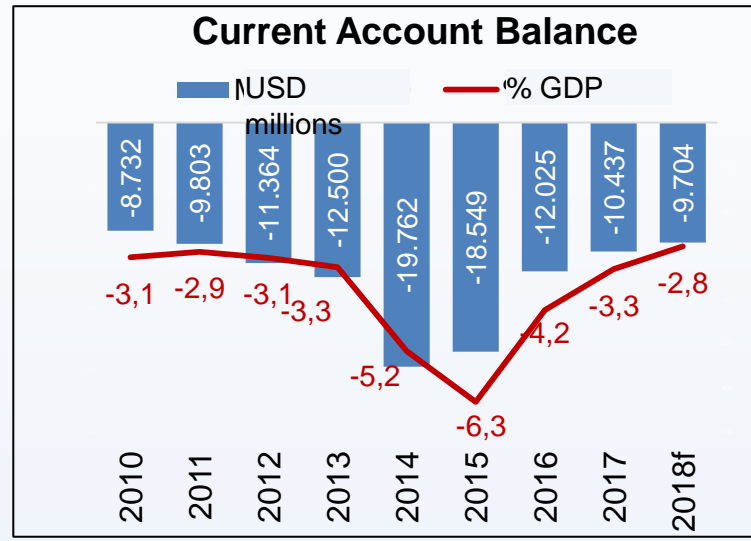
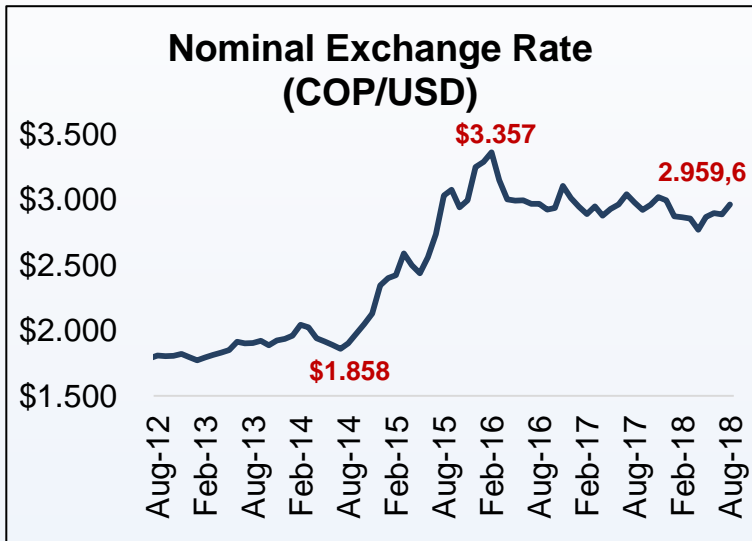
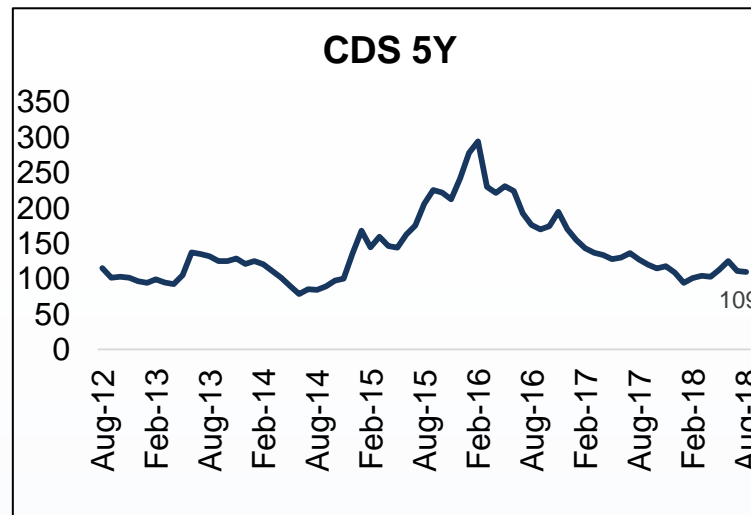
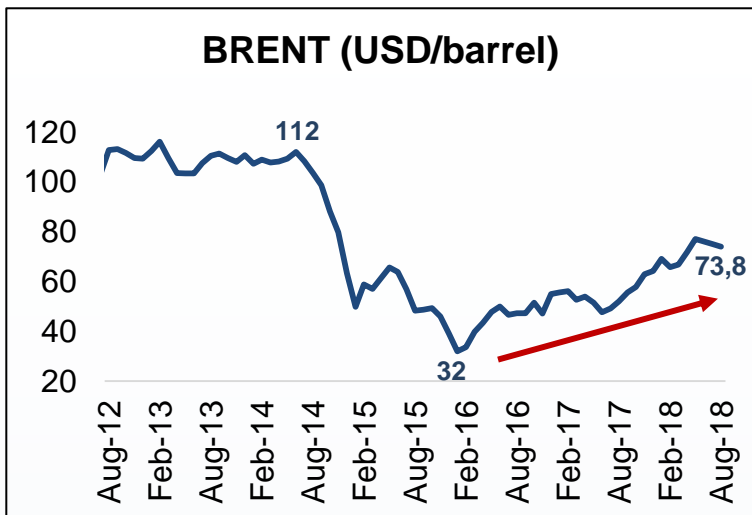


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We surpassed successfully the 2014 turmoil



Nevertheless, potential growth reduction brings costs

- Colombian potential growth rate dropped **from 4.8% in 2012 to 3.5% in 2018**, according to Medium Term Fiscal Framework (MTFF) estimates
- For a 10 year horizon : this drop means an accumulated loss of about 34% of 2018 GDP (discounting at 15%).
- Tax collection loss among 5% and 9% of 2018 GDP (assuming tax collection accounts for 14% of GDP).



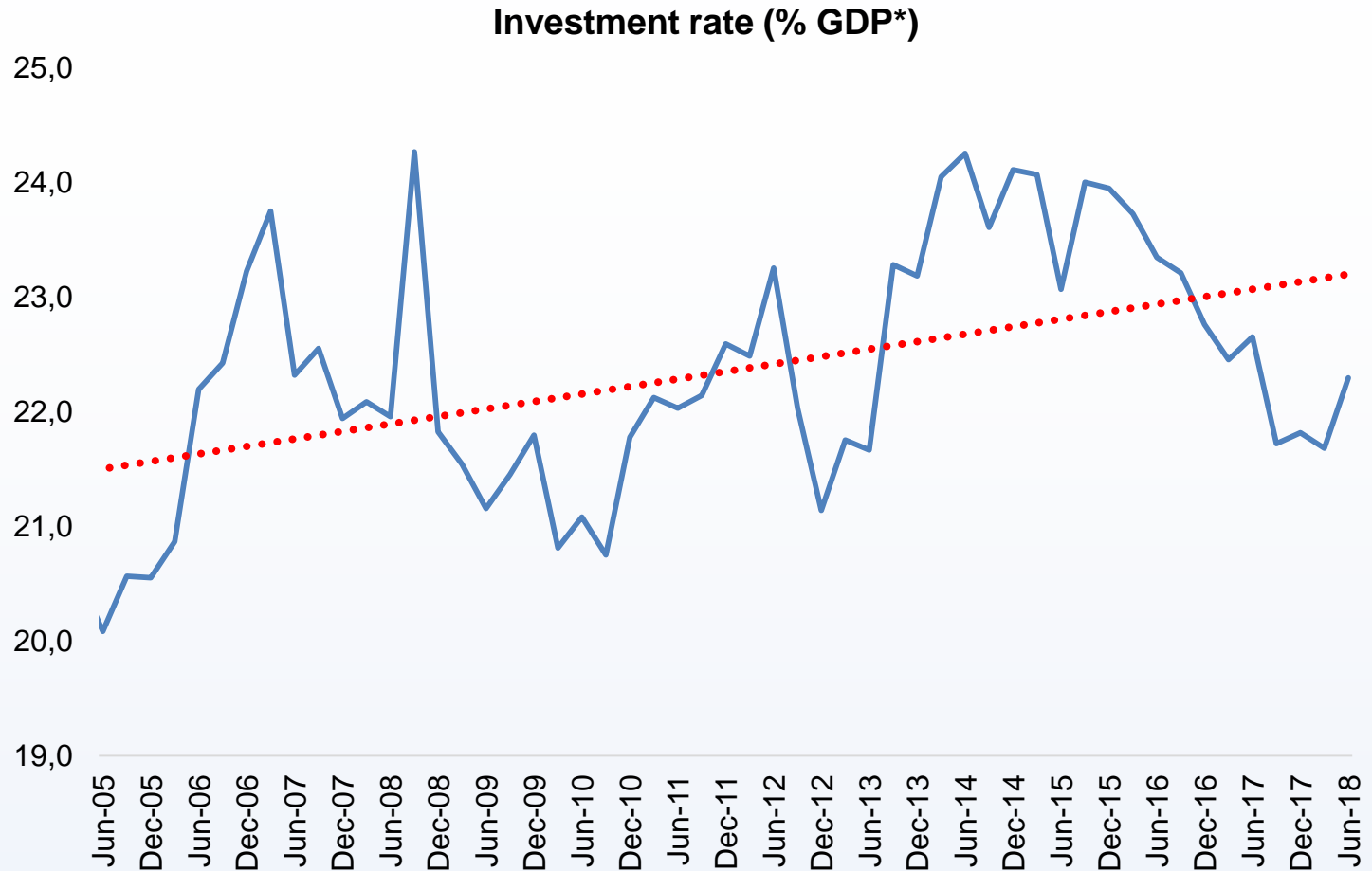
1. Why did this happened?
2. How could we solve these issues?
3. Economic Reactivation Plan
4. Investors Confidence and Capital Markets
5. Conclusions



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Not a Physical Capital Issue



*GDP: current prices, base year 2015. Seasonally adjusted series

Source: DANE, calculations DGPM-MHCP



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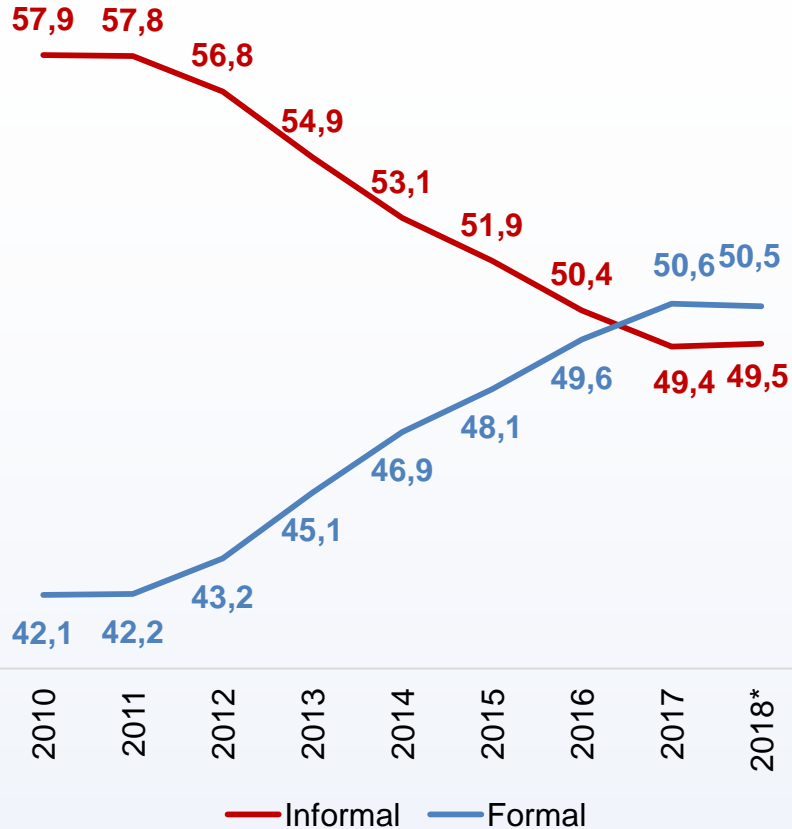


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Not a Human Capital Issue

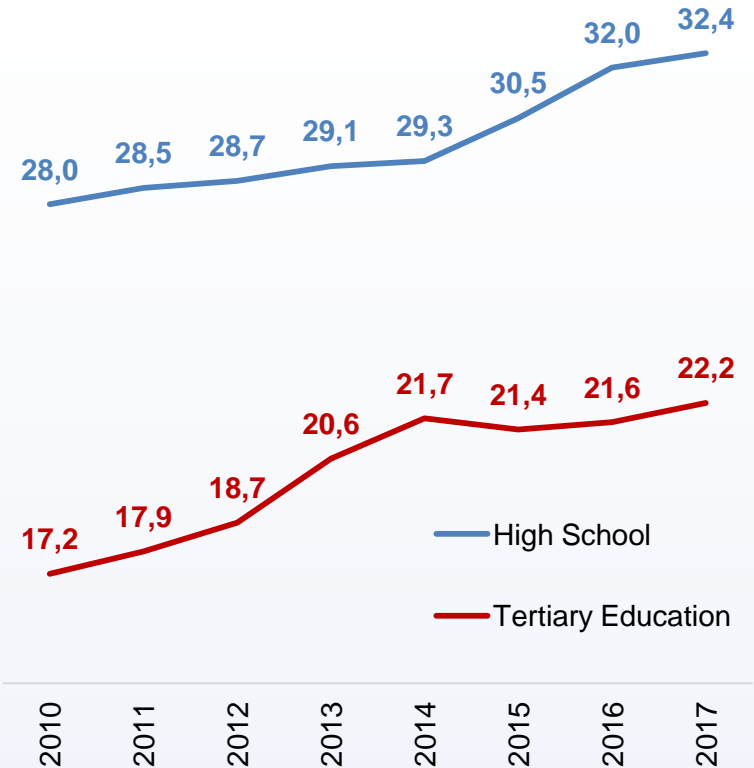
Informality rate (%)

Social Security Criteria – 13 main cities



Employment by Education Level

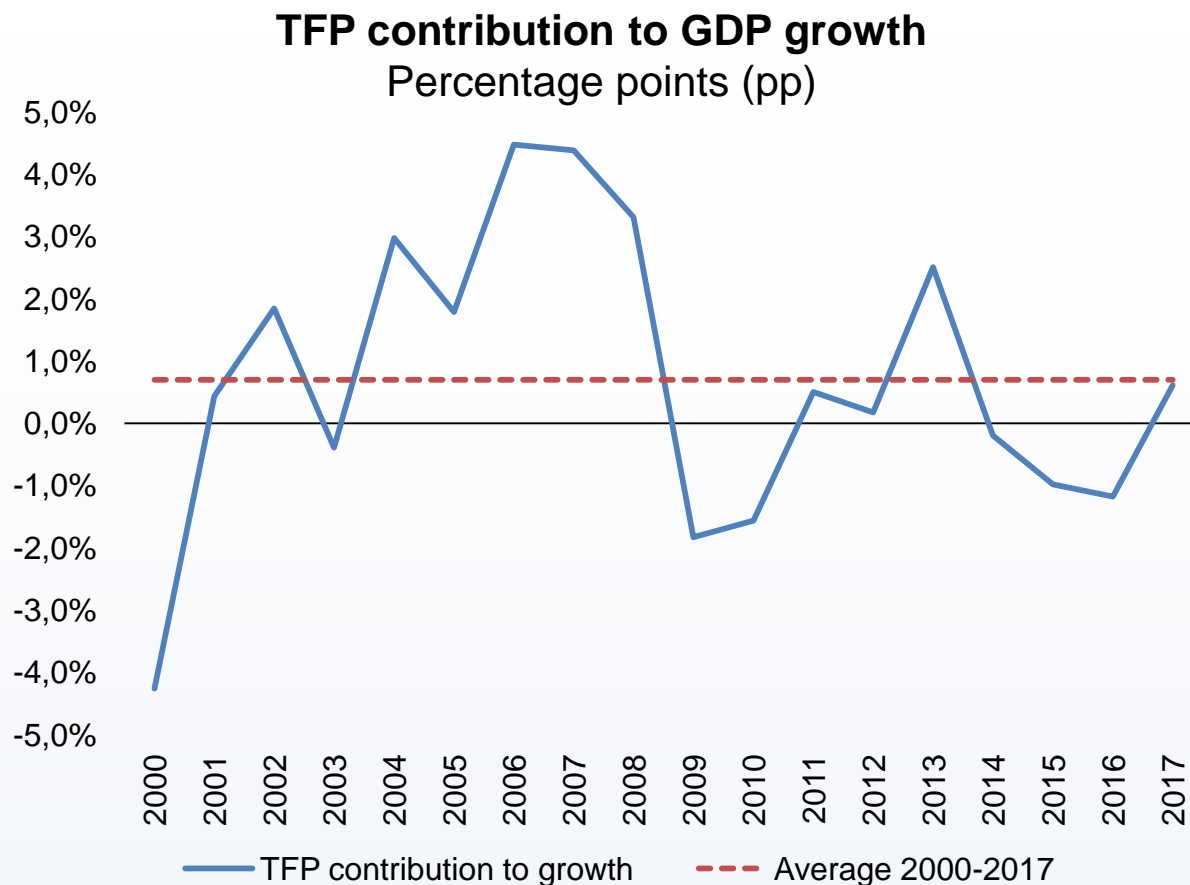
(% of total, annual average)



*Average of the twelve months ending in June 2018

Source: DANE. Calculations by: DGPM – MHCP.

A Productivity Associated Issue



Contribution of the TFP estimated using a Cobb-Douglas production function with two factors of production, capital and labor. When including the contribution of capital and labor to growth, the unemployment rate and the rate of capacity utilization are taken into account.

Source: DANE, calculations DGPM - MHCP

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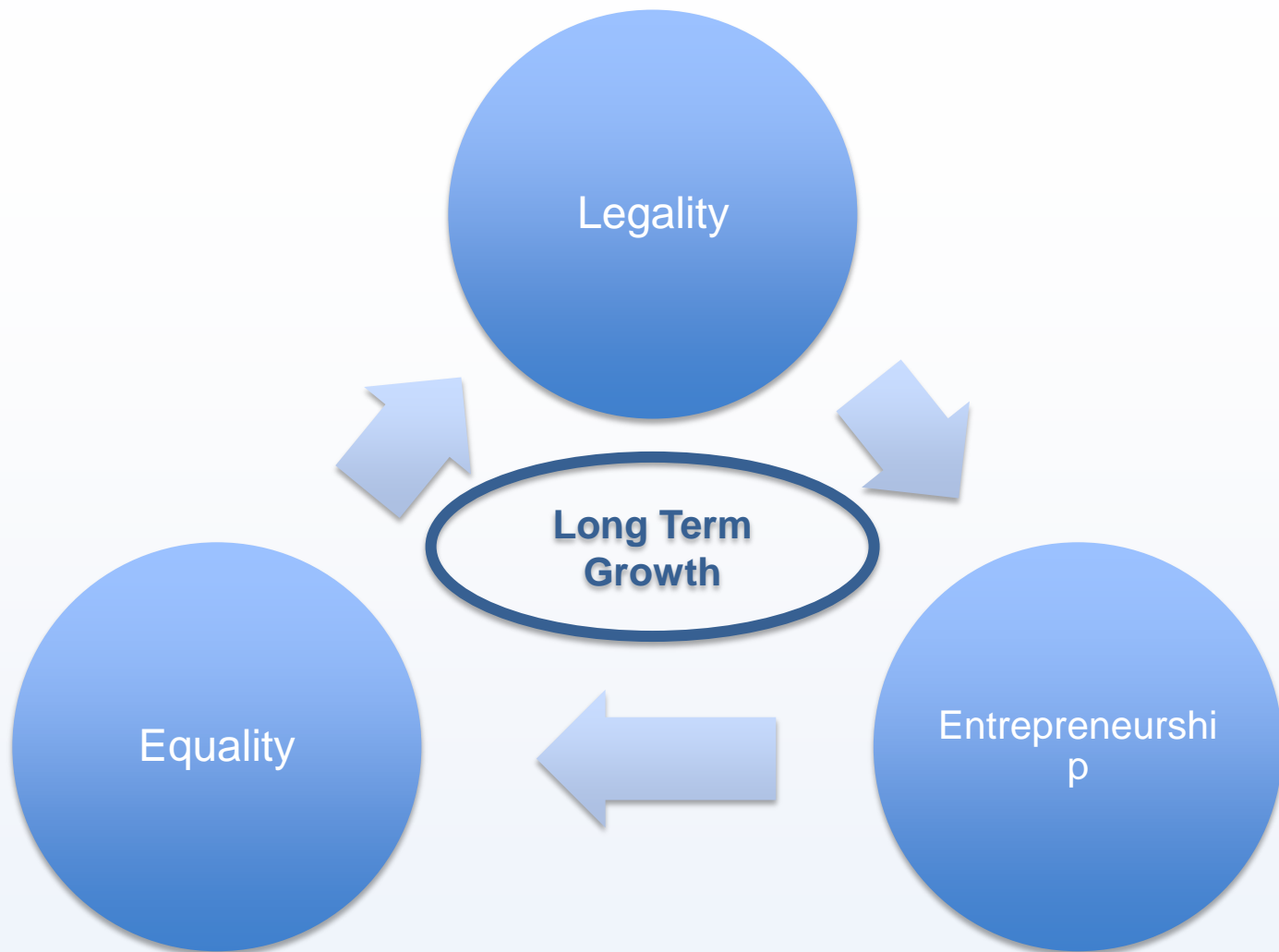
There's a Long List of Key Culprits to Blame

- **Possibility # 1** Institutional flaws
 - Justice
 - Governance
 - Security
- **Possibility #2:** Our infrastructure fails and lack of public goods
- **Possibility #3:** Because our supply of human capital fails, despite recent progress

In order to formulate a **Government strategy**, it is necessary to make an explicit vision that orders and prioritizes the multiple and complex causes of our main problems



Strategic Vision Around 3 Key Axes:



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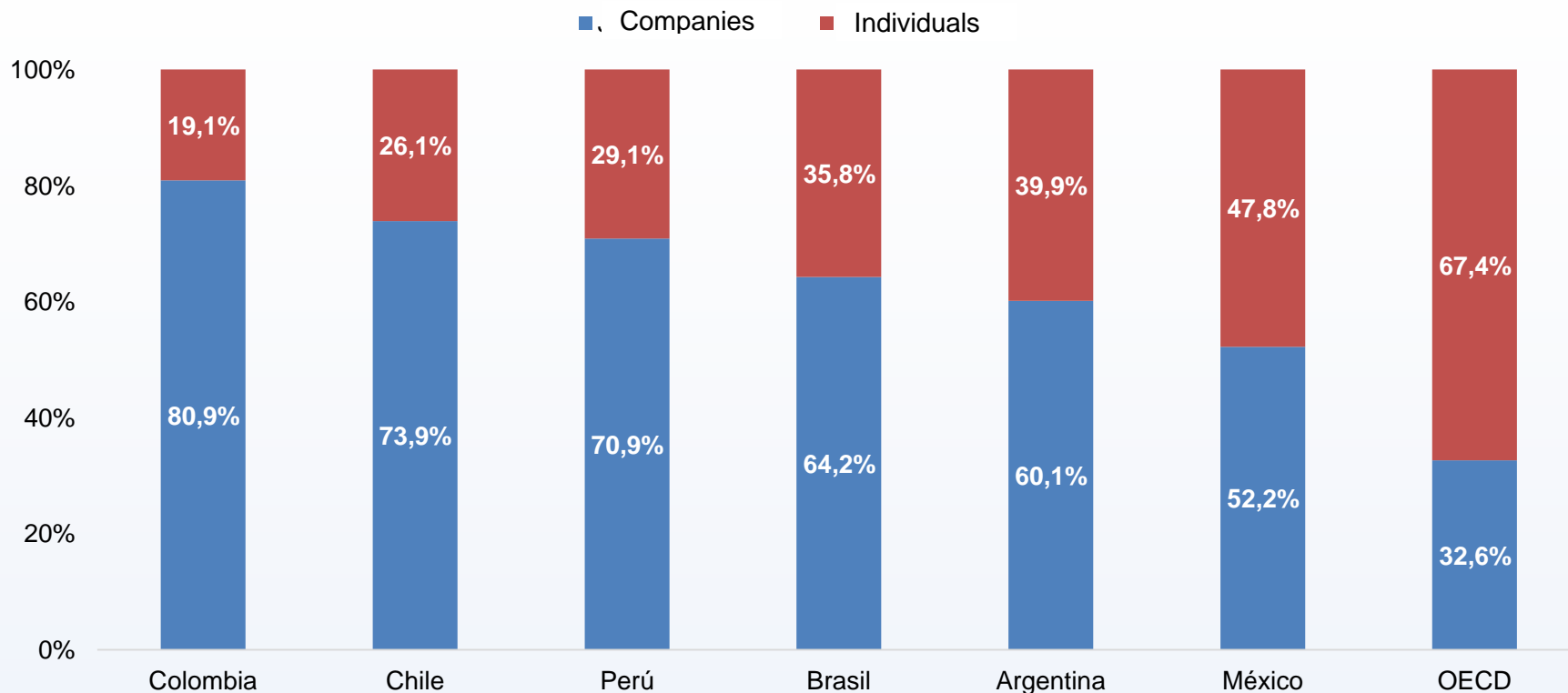
Reactivation plan: Income issues

1. **Colombian's firms tax rate is high**
2. Explanation goes beyond the nominal tax rate
3. VAT structure has regressive exemptions that reduces tax collections



Colombian Companies Share of Tax Burden is Considerable Higher than that of Individuals

Personal and Corporate Income Tax – Share (2016) International comparison



Source: OECD, *Revenue Statistics in Latin America and the Caribbean (2018)*.

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Corporate Income Tax Rate

Effective Tax Rate (ETR) by firm size in Colombia

| | # Firms | ETR Corporate income tax | ETR other taxes | ETR contributors | ETR complement | ETR lower limit | ETR upper limit |
|--------------|---------------|--------------------------|-----------------|------------------|----------------|-----------------|-----------------|
| Large | 3.143 | 29,0% | 9,4% | 7,1% | 6,4% | 45,5% | 51,9% |
| Medium | 7.252 | 32,8% | 17,7% | 24,2% | 13,3% | 74,7% | 88,0% |
| Small | 6.868 | 34,6% | 22,5% | 41,7% | 19,2% | 98,7% | 117,9% |
| Total | 17.263 | 29,5% | 11,7% | 10,9% | 7,4% | 52,2% | 59,6% |

Source: Gómez & Steiner (2015)

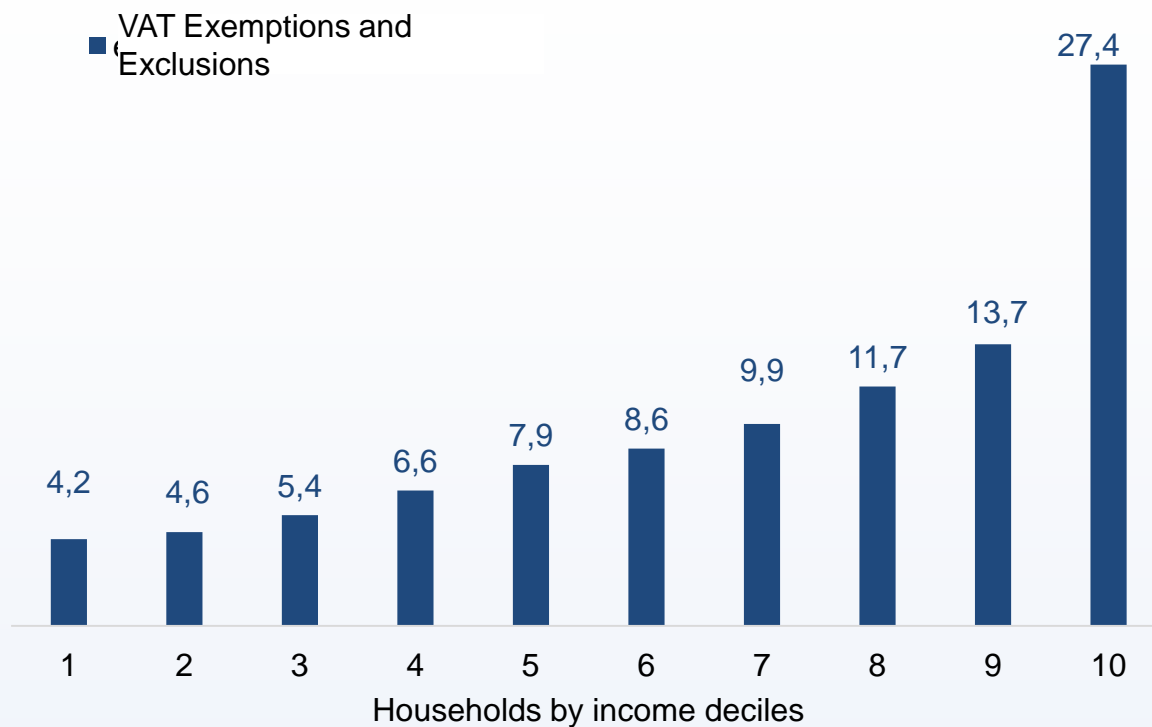
Reactivation plan: Income issues

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High income households have more benefits from non-taxed products

Household Expenditures on VAT discharged goods (% of total expenditure)



Source: ENPH-DANE.



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Economic Reactivation Plan: Expenditure issues

1. **Subsidies:** better targeting to improve equality. In pension issues, there is unanimity.
2. There is not detailed information about correspondence between current beneficiaries and vulnerable population (health, public services, etc.).
3. **Judicial judgement:** An expensive debt with excessive financial costs vis à vis market interest rates.
4. Interaction between multiple public revenue sources can be improved (**more than optimal unused royalties resources co-exist with highly demanding funding needs in different latitudes of the country**)



Fiscal Rule is a Key Element

1. Fiscal rule (FR) is not susceptible to changes.
2. Colombian fiscal situation is very weak for 2018 and 2019.
3. National government is designing an economic reactivation plan that will guarantee the convergence of the fiscal situation to the strict fulfillment of the FR and the stabilization of the public debt.



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Capital markets and economic growth partnership



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First Idea: Building on What's Been Built

Colombia has solid pillars in the capital market

1

ROBUST REGULATORY FRAMEWORK

Adjusted to the best international practices and focused on investor protection.

2

RISK BASED SUPERVISION

Comprehensive approach enhanced by self-regulation scheme that raises industry standards.

3

INTEGRATED INFRASTRUCTURE

Transparency, efficiency and security for agents.

4

INSTITUTIONAL MECHANISMS FOR INTEGRATION

The Pacific Alliance is a favorable platform for the regional integration of the market.



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However, we have to face important problems

We need to:

1. Increase the scope of assets that Pension Funds (AFPs) are allowed to invest in.
2. Standardize compliance and costs according to international standards.
3. Foster financial integration to consolidate a deep and relevant financial system.
4. Promote IPOs.
5. Generate conditions to make the market viable.



Second Idea: Proposals to Strengthen Capital Market

An Experts Committee will be convened to formulate proposals to enhance the Capital Market's structure

Objectives:

1. Diagnose the current state of the capital market in Colombia
2. Identify current market failures that hinder its deepening
3. Advise on the implementation of current international regulatory standards
4. Boost the supply of financial products to finance infrastructure investment projects
5. Identify market vulnerabilities to implement macroprudential supervision policies



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Concluding Remarks

1. Main policy issue: increase medium and long term economic growth
2. Current administration organizes its governing strategy in three main axes: Legality, entrepreneurship and equality
3. Our agenda is focused on economic reactivation
4. We are going to convene an Experts Committee to promote capital market deepening

