Box 3

MAIN ASPECTS OF THE MEDIUM TERM FISCAL FRAMEWORK FOR 2015

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1. Introduction

The consolidated public sector (SPC by its acronym in Spanish) closed out 2014 with a deficit equal to 1.8% of GDP. However, the target was 1.6% of GDP, according to the Medium Term Fiscal Framework (MFMP by its acronym in Spanish) for that year. While the central government (GNC by its acronym in Spanish) had a deficit equivalent to 2.4% of GDP, the decentralized sector (SD by its acronym in Spanish) registered a surplus equal to 0.7% of GDP (Table B3.1).

The drop in international oil prices, the loss of economic momentum, both domestically and internationally, and regulatory changes in temporary taxes are the events that marked the end of the previous fiscal year and influenced the national government's fiscal projections. Although Colombia is not a major player in the international oil market, its fiscal situation is sensitive to changes in the oil price and the amount of oil produced, mainly because of tax collections, royalties and the dividends paid by Ecopetrol.

This being the case, the Government and Congress adopted a series of measures in late 2014 to offset the effect of the plunge in oil prices on public finances, to stimulate growth and to generate earnings in the future. First of all, a tax reform bill (Law 1739/ 2014) was passed to finance the 2015 budget by collecting COP12.5 trillion (t) in revenue. This reform extended the tax on financial transactions (GMF by its acronym in Spanish), raised the so-called "income tax for equity" (CREE by its acronym in Spanish) by one point,

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Table B3.1
Consolidated Public Sector Fiscal Balance

Item	Billions of COP			Percentage of GDP		
	2014	2015[a/]	2016[a/]	2014	2015[a/]	2016[a/]
1. Non-financial public sector	(13,264)	(18,914)	(21,119)	(1.8)	(2.3)	(2.4)
Central government (GNC)	(18,356)	(23,881)	(30,995)	(2.4)	(3.0)	(3.6)
Decentralized sector	5,092	4,968	9,877	0.7	0.6	1.1
Social security	4,002	3,694	5,796	0.5	0.5	0.7
National-level companies	(2,680)	(187)	(277)	(0.4)	(0.0)	(0.0)
Local-level companies	606	266	414	0.1	0.0	0.0
Regional and local	3,164	1,195	3,943	0.4	0.1	0.5
2. Banco de la República's quasi-fiscal balance	(1,129)	(1,057)	(74)	(0.1)	(0.1)	(0.0)
3. Fogafin's balance	625	898	723	0.1	0.1	0.1
4. Financial restructuring costs	39	24	24	0.0	0.0	0.0
5. Statistical discrepancy	83	-	-	0.0	0.0	0.0
Consolidated public sector	(13,724)	(19,096)	(20,493)	(1.8)	(2.4)	(2.4)

a/ Projected
Source: Ministerio de Hacienda y Crédito Público (MHCP)

created a surcharge on that tax, and replaced the tax on net worth with a wealth tax, which was extended up to 2018. Secondly, the government announced the postponement of COP5.9 t in budget spending, with an adjustment of COP1.7 t in operating costs, COP 0.2 t in debt service and COP 4 t in investment.[1] Finally, in an effort to stimulate economic growth and job creation, the government launched the second version of its Plan to Promote Prosperity and Employment (PIPE 2.0 by its acronym in Spanish). Among other objectives, PIPE 2.0 is designed to strengthen investment in transport infrastructure and education, broaden subsidized interest rates on mortgages, boost tourism and stimulate the export sector with zero-tariff policies for raw materials and capital goods.

2. The Fiscal Scenario in 2015 and 2016

According to the government's estimates, public finances would suffer in 2015-2016, mainly due to the loss of revenue from the oil industry. The bulk of the impact will come in 2016, since a portion of income tax collections and Ecopetrol dividends will be based on operations this year, which have been severely affected by low international prices for crude oil.[2] These estimates were based on an expected GDP growth rate of 3.6% in 2015 and 3.8% in 2016. The government also assumed the long-term price of Colombian crude would be USD74 dollars a barrel in the first year and $ USD70 in the second, with production at one million barrels.

a. 2015

According to the MFMP, the SPC deficit will amount to 2.4% of GDP in 2015, with a 3% of GDP imbalance in GNC operations compared to a surplus in SD finances equal to 0.6% of GDP. The fiscal projections in this last sector are characterized by a deficit reduction for domestic companies and less of a surplus in the territories, due to the increase in spending that usually comes during the final year in office for mayors and governors (Table B3.1).

GNC finances posted a larger deficit because of the drop in oil revenue. However, it is important to mention that taxes will increase slightly as a share of proceeds, thanks to the tax reform bill passed late last year. As noted earlier, that legislation maintained the tax on financial transactions and created a wealth tax to replace the net worth tax. In terms of expenditure, 2015 will see an increase in interest payments on the debt that would be offset by a reduction in operational and investment payments (Table B3.2).

Financing for the GNC deficit will come from COP43.1 t in loans, including COP30.6 t from the sale of TES (government bonds) and COP12.6 t in external disbursements. The GNC also will use an estimated COP 2.6 t in Treasury resources from the operation of the National Single Account System.

b. 2016

The MFMP estimates a deficit equivalent to 2.4% of GDP for the consolidated public sector in 2016, with an imbalance in GNC finances equal to 3.6% of GDP, plus a 1.1% of GDP surplus in the SD (Table B3.1). Within the SD, regional finances are expected to improve and a better fiscal situation is forecast for social security, mainly due to reduced payments from the National Pension Fund for Local Authorities (Fonpet).

There will be more of a gap in GNC finances, mainly because of fewer dividends from Ecopetrol, which will be severely affected by low international prices for crude oil. According to official estimates, there should be no major changes in tax revenue during the year, thanks to an anti-evasion program currently being implemented by the National Tax and Customs Bureau (DIAN). GNC revenue overall, as a percentage ofGDP, is expected to go from 16.3% in 2015 to 15.6% in 2016. Expenditure will account for 19.1% of GDP, which is similar to the percentage observed in recent years (Table B3.2).

The central government deficit in 2016 will be funded largely with loans, including COP 15 t in external disbursements and COP 31.1 t in domestic debt issues. The Treasury operations will amount to COP 4.2 t.

3. The Medium Term Fiscal Situation

According to the estimates in the MFMP, the SPC will see its finances improve gradually in the years ahead, reaching a surplus by 2020. This trend is based on how central government's operational performance evolves. Its deficit will increase in 2015 and 2016, then fall to around 1% of GDP as of 2021 (Graph B3.1). The of-

1 A similar measure was announced with respect to the draft budget for 2016. In this case, investment was cut by COP5 t, and a freeze was put on overhead and personnel expenses in the executive branch. The defense and justice sectors were an exception.

2 According to the current estimates, the dividends Ecopetrol transfers to the government would decline from COP10.8 t in 2014 to COP 4.1 t in 2015 and COP2.4 t in 2016.

Table B3.2
Central Government (GNC) Fiscal Balance

Item	Billions of COP			Percentage of GDP		
	2014	2015a/	2016a/	2014	2015a/	2016a/
Total revenue	125,904	131,316	134,171	16.7	16.3	15.6
Tax revenue	108,343	116,846	126,229	14.3	14.5	14.6
Non-tax revenue	616	481	514	0.1	0.1	0.1
Special funds	1,569	2,223	2,377	0.2	0.3	0.3
Capital resources	15,377	11,765	5,050	2.0	1.5	0.6
Total Expenditure	144,260	155,197	165,166	19.1	19.2	19.1
Interest	16,979	20,885	24,455	2.2	2.6	2.8
Operation and investment b/	127,292	134,297	140,695	16.9	16.6	16.3
Net lending	(11)	16	16	0.0	0.0	0.0
Total balance	(18,356)	(23,881)	(30,995)	(2.4)	(3.0)	(3.6)
Structural balance	(17,406)	(18,106)	(18,504)	(2.3)	(2.2)	(2.1)

a/ Projected
b/ Operational and investment spending includes payments and floating debt
Source: Ministry of Finance and Public Credit (MTFF; 2015)

ficial estimates were calculated taking into account strict enforcement of the so-called Fiscal Rule Act, which sets quantitative targets for the central government's structural deficit: 2.3% of GDP in 2014, 1.9% of GDP in 2018 and 1% of GDP as of 2022 (Table B3.3).

The projection for the central government considers the cycle of economic activity and mining, calculated with data on potential GDP and the long-term price of oil. This information was supplied by independent technical committees established under the law. Specifically, the assumption is that GDP growth will increase gradually from 4.2% in 2017 to 5% in 2020, then decline to 4.3% in 2024, when it will converge to potential GDP growth. As for the oil industry, it is assumed the long-term price of crude will decline from USD65 per barrel in 2017 to USD58 in 2019, then increase to USD64 between 2023 and 2026. Oil production is expected to stay at one million barrels per day until 2022, and then decline to 940,000 barrels/day in 2026. According to these assumptions, the cyclical component of the deficit will close in 2020 and the projected deficit over the next five years will be higher than the structural deficit. This will enable the government to increase its borrowing. [3]

3 That establishes a declining structural balance for the central government that is less than or equal to -2.3% of GDP in 2014, -1.9% in 2018 and -1.0 in 2022.

In the medium term, GNC finances are expected to see a change in total revenue, down from 16.7% of GDP in 2014 to 15.7% by 2026, given lower revenue from the oil industry. However, it is important to point out that the projections in the MFMP assumes a tax reform bill will be passed to replace the temporary income derived from the financial transaction tax and the levy on wealth, which are set to expire in 2022 and 2018, respectively. As for expenditure, the MFMP foresees a gradual reduction in total payments from 19% of GDP in 2014 to 16.7% of GDP in 2029, with a change of more than 2 pp throughout the period analyzed. The biggest cuts are in operating expenses. These include personnel costs, which the MFMP says should not increase more than inflation. However, the estimates on spending do not consider new regulatory changes in the General System of Participation (SGP by its acronym in Spanish), and that investment expenses remain stable throughout the period at 1.8% of GDP.

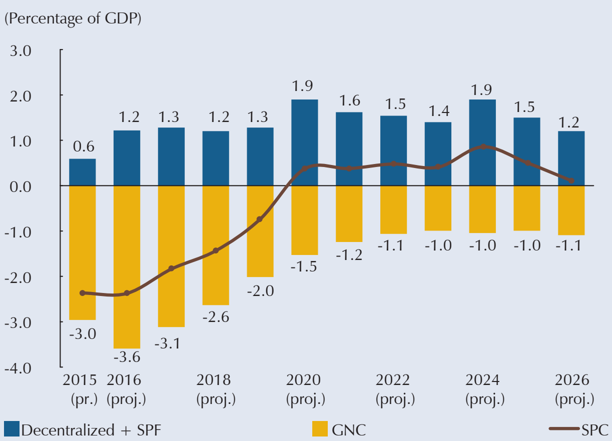
Given the projections in the MFMP for 2015, the balance of the GNC's gross debt would amount initially to 39.9% of GDP in 2016, then decline gradually to 29.8% of GDP in 2026. This trend reflects the downward trend in the fiscal deficit, which - with strict adherence to the rule – should be close to 1% of GDP as of 2022 (Graph B3.2).

Table B3.3
Central Government (GNC) Fiscal Balance

Item	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Total revenue	15.7	15.8	15.8	16.2	16.4	16.3	16.1	16.0	15.8	15.7
Tax revenue	14.8	14.9	14.8	15.4	15.5	15.4	15.2	15.1	14.9	14.8
Non-tax revenue	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Special funds	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Capital resources	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5
Total Expenditure	18.8	18.4	17.8	17.8	17.6	17.3	17.2	17.0	16.9	16.7
Interest	2.7	2.8	2.7	2.7	2.5	2.5	2.4	2.4	2.2	2.1
Operation	14.3	13.8	13.3	13.3	13.3	13.0	13.0	12.8	12.9	12.8
Investment	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Total balance	(3.1)	(2.7)	(2.0)	(1.5)	(1.2)	(1.1)	(1)	(1)	(1)	(1)
Primary balance	(0.4)	0.1	0.7	1.2	1.3	1.4	1.4	1.3	1.2	1.1
Structural balance	(2.0)	(1.9)	(1.6)	(1.4)	(1.2)	(1)	(1)	(1)	(1)	(1)

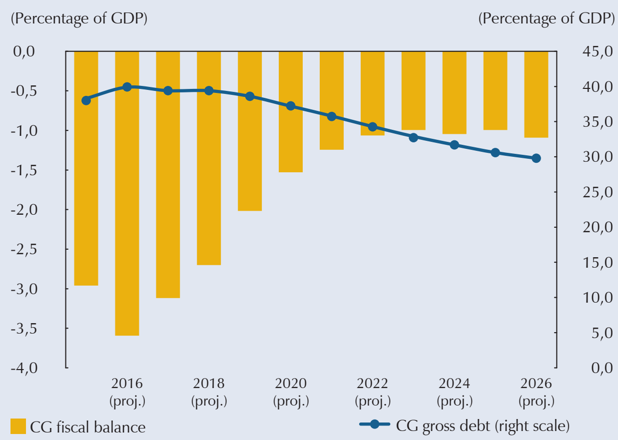
Source: Ministerio de Hacienda & Crédito Público(MFMP; 2015)

Graph B3.1
Consolidated Public Sector (SPC) Fiscal Balance



(pr.) Preliminary
(proj.) Projected
Source: Ministerio de Hacienda y Crédito Público (MHCP)

Graph B3.2
Consolidated Public Sector Fiscal Balance



(proj.) Projected
Source: Ministerio de Hacienda y Crédito Público (MHCP)