Chapter 16

Latin America and the Caribbean
Colombia

Despite fiscal difficulties, the country has succeeded in using the private market mechanism to raise funds while limiting local borrowing.

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Lessons

Colombia has made a significant shift—though with restrictions—toward decentralization, but the consequent shift to substantial transfers has caused fiscal imbalances for the central government. Strong central control curbed an earlier acceleration in subnational borrowing. Continuing deficiencies in the regulatory framework surprisingly have not led to widespread fiscal difficulties, though decentralization and mandated spending have continued to strain fiscal balances.

Use of credit by subnational governments grew sharply in the 1990s because of inflexibility in local expenditures. Borrowing restrictions were lax because of legislated mandates to increase central transfers to finance required expenditures, and private banks, provided with an intercept mechanism, were content to lend. As a result, subnational borrowing doubled relative to GDP. The substantial increase in debt led to enactment of a law requiring approval from the Ministry of Finance for additional debt and tying borrowing controls to the fiscal health of local governments. In addition, new rules required banks to increase capital reserves for riskier subnational loans, increasing the cost of borrowing from commercial banks.

The new law slowed the growth of subnational debt substantially, and the central government has been able to avoid large bailouts of subnational governments. In contrast to Argentina and Brazil, Colombia essentially used a market-based mechanism to impose limits on local borrowing, allowing borrowing to continue in a controlled environment.

Findeter, an innovative government financial intermediary, has played an important role in facilitating local borrowing by providing loans to subnational governments that cannot access the private market and by discounting loans made by private banks. However, it has experienced some difficulties in recent years. For the central government, chronic fiscal imbalances have been a continued concern. In 2001 it implemented new laws to streamline the intergovernmental transfer regime and free up extra revenues to address its imbalances.

Bogotá is the star of Colombian subnational borrowing. It has successfully issued domestic debt and in 2001 became the first and only Colombian city to issue an international bond. The city is in the rare position of having its credit rating constrained by the sovereign rating (which is dampened by political instability). More recently, macroeconomic instability has put a strain on Bogotá's financial position, but this does not detract from its history of fiscal prudence and several years of operating surpluses. Its record of competent management has secured its position as one of the strongest municipal borrowers in Latin America. Indeed, even in the face of refinancing pressures stemming from the short-term maturity of its obligations, the city has successfully managed the currency and interest rate risks on its outstanding debt.

Colombia is a unitary country with 43 million inhabitants, 75 percent of whom live in urban areas. Although beset by domestic turmoil, and despite the flagging world economy, the country has generally turned in a good economic performance in the past few years. Inflation has been declining, dropping from nearly 17 percent in 1999 to 8 percent in 2001, but economic growth also has been slowing, from 3.4 percent in 1999 to 1.6 percent in 2001.

In 2002, thanks to the tight monetary policy of the Central Bank, inflation remained relatively low (7 percent). However, the country had another year of slow economic growth (an estimated 1.6 percent), with adverse effects on public revenues and expenditures. Recent forecasts put the fiscal deficit for 2002 at 4 percent of GDP, well above the target of 2.6 percent. Two of the main sources of pressure on the national budget are growing military spending and a rise in pensions. President Alvaro Uribe Velez, elected in May 2002, focused his presidential campaign on fighting drugs, guerrillas, and paramilitaries, which explains the increase in military spending. The government plans to solve the pension problem with a national referendum to reform the pension system in 2003.

In Colombia all levels of government, including subnational units, rely heavily on domestic debt markets to fund their deficits. In addition, the federal government has been working toward a domestic government bond market since 1995—with much success compared with other governments in the region. However, Colombia's economic and political situation undermines investor confidence, a situation exacerbated by the crises in other Latin American countries, such as Argentina, Brazil, and República Bolivariana de Venezuela. As a result, the voluntary government bond market has remained closed since August 2002. The national government needs to restore public confidence, particularly investor confidence, because it is almost impossible for the government to forgo borrowing from the domestic debt market.

Intergovernmental Relations

Colombia's 1991 Constitution defines three types of subnational territories: departments (states), districts (municipalities with the status of departments), and municipalities.[1] The country has four districts: Bogotá (capital district), Barranquilla, Cartagena, and Santa Marta. The Constitution commits the central government to providing compensating resources when it imposes spending or service requirements on subnational governments. The central government has honored this commitment so far, but continued fiscal imbalances could lead to exceptions or limits. Colombia's recently launched and still incomplete process of decentralization has led to problems in maintaining fiscal balances at the national level because of resource transfers to subnational governments as well as problems in avoiding unsustainable deficits at the subnational level (Dillinger and Webb 1999).

The decentralization was begun in 1983 several years after the military lost control of the government. An early landmark in the process was Law 78 of 1986, which required that mayors be elected by the people rather than appointed by the governors of departments. Similarly, the 1991 Constitution mandated that governors of departments be elected rather than appointed by the president. In addition, the Constitution committed the central government to expanding the revenue sharing system (*situado fiscal,* or "situado") to ensure adequate provision of the services it is intended to support.

Revenues

Since 1983 departments have collected taxes on liquor, cigarettes, vehicles, and lottery sales; these taxes form the core of departments' own revenues. In addition, departments receive transfers from the central government through the revenue sharing system, established in 1971 by Law 46 to transfer 13 percent of the central government's ordinary revenues. The 1991 Constitution and Law 60 of 1993 expanded the revenue sharing system by adding the income, customs, and value-added taxes, increasing the system's share of the central government's revenues to 22.1 percent in 1993 and to 24.5 percent in 1996. Law 60 required that 15 percent of the shared revenues be distributed equally among the departments and the other 85 percent according to specific social indicators.[2] The Congress is required to review this sharing formula every five years.

In addition, under Colombian law all hydrocarbon royalties must be distributed to subnational governments according to a formula directing 47.5 percent of royalties to producer departments, 12.5 percent to producer municipalities, and 8 percent to municipalities that are ports, with the other 32 percent redistributed across the country. The discovery of oil has increased the importance of this revenue source.

For municipalities, locally raised taxes cover about a third of expenditures in the aggregate. Wealthier municipalities raise more, poorer ones less. The primary sources of local tax revenue are the property tax and the business tax (on gross turnover). The many other local taxes tend to be unproductive. An interesting exception is the *contribucion de valorization,* a local betterment fee based on the user-pays or benefit principle. Some observers believe this tax could be used more extensively (Ahmed and Baer 1997).

In the mid-1990s municipal spending was equal to about 6 percent of GDP, but municipal tax revenues were only about 2 percent of GDP. For most municipalities, then, transfers from the central government are critical. Under Law 60, 60 percent of the shared revenues *(participaciones municipales)* transferred by the central government to municipalities are to be distributed according to the number of inhabitants with unsatisfied basic needs, and the other 40 percent according to such indicators as population size, administrative efficiency, and improvements in the quality of life. Transfers to municipalities were expected to grow until 2002.

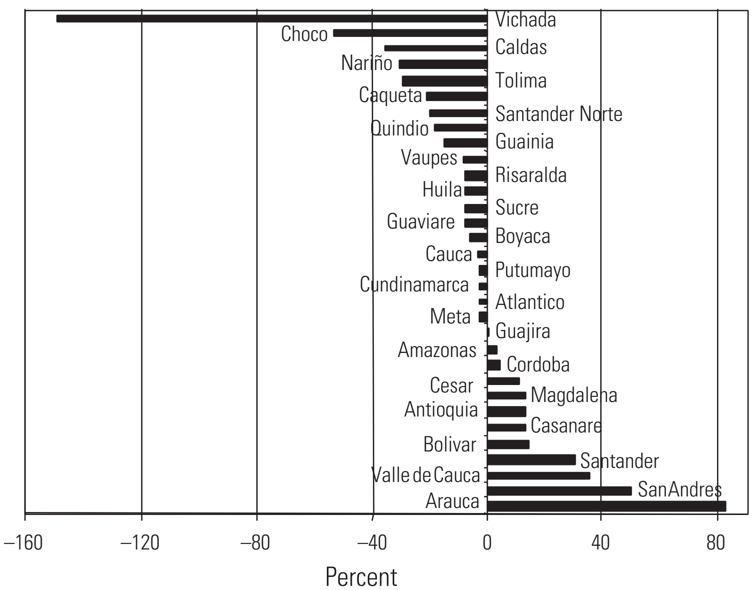
Thus as a result of the new arrangements introduced by the 1991 Constitution and Law 60, the central government has been transferring almost 47 percent of its total revenues to subnational governments. In addition, the rules mandate that any increase in its tax base must be shared with subnational units. These heavy demands have caused continuing fiscal problems for the central government.

Expenditures

Subnational governments have little autonomy in managing their expenditures. Consider this example in education: subnational governments are responsible for paying teachers' salaries, but the size of the salaries is determined through negotiations between the central government and the national teachers' union. As part of the ongoing decentralization process, the central government transferred responsibility for education, health care, and investments in water and sewerage to subnational governments in the 1990s. However, a lack of capacity to handle these services led to reconsideration of the transfers to some municipalities. After a review, the services were transferred only to departments and to some larger municipalities with proven management capacities.

The revenue-sharing system stipulates how resources transferred by the central government are to be spent. Departments are required to spend 60 percent of the revenues for education, 20 percent for health care, and the remaining 20 percent for other purposes. Municipalities must apply the transfers to basic education (30 percent); health (25 percent); water supply (20 percent); physical education (5 percent); and housing, welfare, debt service, and other uses (20 percent). The earmarking and tight rules have made it difficult for departments to balance their budgets. Part of the difficulty stems from the fact that the central government continues to set workers' wages and the terms of employment.

For subnational governments, the budgetary inflexibility resulting from the earmarking of most of their revenues and the mandated spending linked to transfers can lead to unsustainable fiscal deficits, reflected in rising levels of debt. Only 12 departments achieved a fiscal surplus in 2000. Among the 20 that had fiscal imbalances, 9 had deficits exceeding 15 percent of their total revenue, and for Vichada the fiscal deficit was almost 150 percent of revenue (figure 16.1). Subnational governments also suffered serious effects from the country's slow economic growth in 1999 and 2000.



Source: World Bank based on Colombian Ministry of Finance.

Figure 16.1. Fiscal Balance as a Share of Total Revenue by Department, Colombia, 2000

Regulatory Framework for Subnational Debt

The earmarking of revenues and the centrally determined use of transfers encouraged growing use of credit in the early 1990s. Banks expanded their lending on the strength of the constitutional mandates to increase transfers to local governments. The weak reporting by and control over local governments and the ability to use intergovernmental revenue transfers to secure debt also loosened constraints on borrowing (Ahmad and Baer 1997).

Subnational borrowing had been rare in the past, but during the 1990s subnational bank debt rose as a share of GDP—from 2.6 percent in 1991 to 4.6 percent in 1997, including indirect debt and the debt of subnational government-owned companies; direct debt in 1997 was 3 percent of GDP (Dillinger, Perry, and Webb 2001). Until 1997 the central government required prior approval from the Ministry of Finance for any subnational borrowing.

In 1997 a new law, Law 358, was enacted to curb the excessive use of credit by subnational governments. Under this law, called the "traffic light" law, the Ministry of Finance analyzes two indicators of indebtedness before approving subnational borrowing:

- Capacity to pay, measured by the ratio of interest payments to operating surplus (the operating surplus is defined as current revenues less fixed current expenses).
- Sustainability of debt, measured by the ratio of debt outstanding to current revenues.

Based on these indicators, a subnational government might be free to borrow or might face restrictions (table 16.1).

On the supply side the Central Bank implemented various policies relating to subnational borrowing in the past decade. Since 1999, however, it has tightened regulations, requiring that banks maintain capital reserves for the full amount of any loans to subnational governments with a "red light." This regulation has made the loans costly to lenders and thus to borrowers, supporting the effectiveness of the traffic-light system. In Colombia, unlike in Argentina and Brazil, the Central Bank has always been prohibited from lending to subnational governments.

Table 16.1. The "Traffic Light" System for Regulating Subnational Borrowing, Colombia

Rating	Indicator	Result
Green	Interest as % of operational savings less than 40% and debt stock/current revenues equal or less than 80%	No restrictions on lending
Yellow	Interest as % of operational savings equal or greater than 40% but less than 60% and debt stock/current revenues equal or less than 80%	Lending only with Ministry of Finance's authorization
Red	Interest as % of operational savings greater than 60% or debt stock as % of current revenues greater than 80%	No lending, unless the subnational agrees to adjustment plan

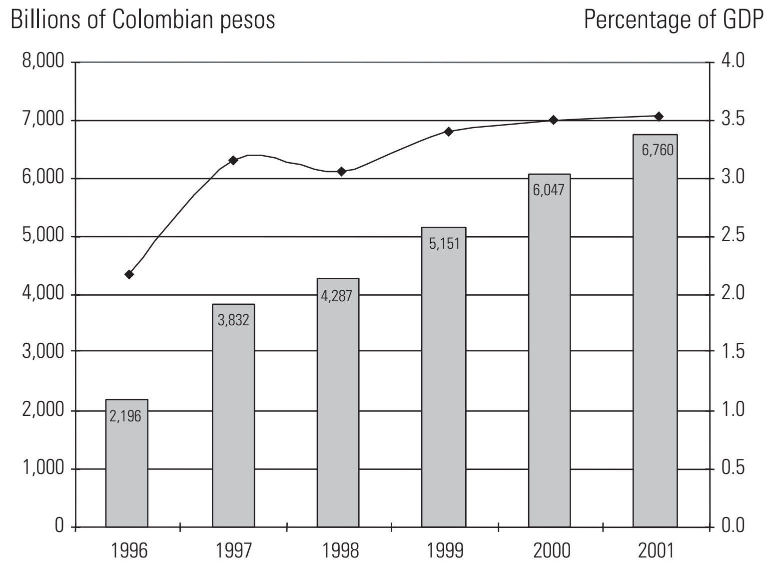
Source: Law 358 of 1997.

Subnational Debt

The growth in subnational debt was a direct consequence of the decentralization. The inflexibility in local expenditures made it difficult to adjust spending, resulting in fiscal imbalances. Also contributing to the growth in debt was the regulatory framework. The framework had been poorly defined until 1997 and the passage of Law 358, which introduced a stricter approach to regulating subnational borrowing. On the positive side, in Colombia, unlike in Argentina and Brazil, subnational governments did not own banks, so nontransparent lending practices were avoided.

According to the Ministry of Finance, commercial banks account for more than 50 percent of total lending to subnational governments, and financial corporations account for more than 15 percent. Public and private banks lend to subnational governments at variable interest rates and require that they pledge specific revenue sources to repay loans. Some governments have pledged shared revenues even though they had only limited ability to use these earmarked resources for debt service.

Subnational indebtedness grew during the second half of the 1990s, but the "traffic-light" controls under Law 358 appear to have put on the brakes (figure 16.2). The increase in indebtedness between 1996 and 1997 was the largest of the period in both relative terms (74 percent) and absolute terms (1.6 billion Colombian pesos [Co$]).[3] Subnational borrowing then tightened, and despite the recession of 1999, subnational indebtedness as a share of Colombia's GDP remained stable from 1999 to 2001. Because of



Source: World Bank based on Colombian Ministry of Finance.

Figure 16.2. Direct Subnational Debt, Colombia, 1996–2001

the limits established by the traffic light law, debt service requirements for most departments are less than 10 percent of their total revenue. In 2000 only two departments devoted more than 10 percent of their total spending to interest payments (for Valle de Cauca the share was 42.10 percent, and for Arauca, 54.87 percent).

Despite the pressures facing subnational governments, the central government has not had to conduct comprehensive bailouts. During 1998 the departments of Valle de Cauca and Santander Norte were not servicing their debt. Valle de Cauca renegotiated the terms of its debt with the banks and at the end of that year reached a restructuring agreement with them. This market solution to a subnational debt problem differed from the approaches adopted in such Latin American countries as Argentina and Brazil.

Findeter: A Financial Intermediary for Subnational Credit

In 1989, under Law 57, the Colombian government created Findeter (Financiera de Desarrollo Territorial) as a second-tier financial institution to finance or rediscount commercial bank loans made for municipal capital projects. The central government owns 92.53 percent of the company, and the departments own the remaining shares.

Findeter has evolved from a municipal development fund that disbursed credit at subsidized rates to a bank that provides credit at market rates as well as technical advisory services. It also has improved its efficiency. In the past gaining access to funds took an average of 18 months, but in recent years Findeter has reduced the wait to approximately 6 to 8 months. While the institution's original purpose was to lend to local governments, today it can serve a broader range of borrowers, including the private sector (table 16.2).

Since its inception Findeter has provided credit, directly or indirectly, amounting to almost Co$3.7 trillion, allocated across a variety of uses (figure 16.3). Subnational governments that cannot access the private credit market finance most of their projects through Findeter. The terms and conditions of the loans it provides differ substantially from those provided by commercial banks, because most bank loans are short to medium term while Findeter's are medium to long term (table 16.3).

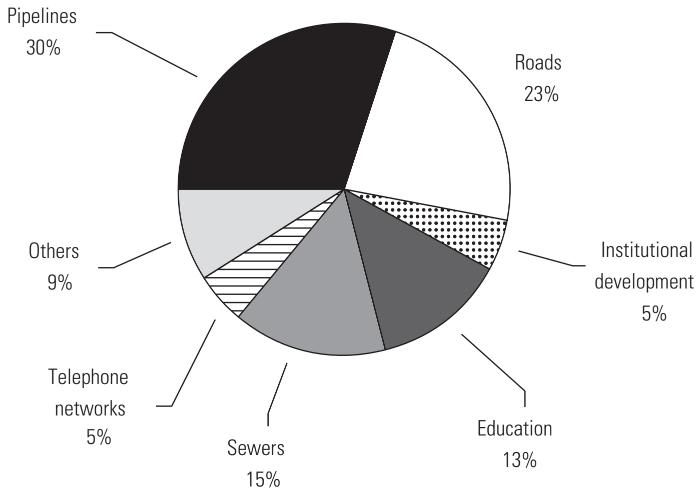
As a second-tier lender, Findeter rediscounts commercial bank loans for subnational governments for up to 100 percent of the loan. However, the commercial banks perform the financial and risk analysis and bear the full credit risk (a key factor in reducing moral hazard). Findeter thereby provides a ready market for the loan but does not assume the credit risk of the counterpart commercial bank.

Subnational governments have seen the relative interest rates on their loans decline. Two factors have contributed to this. Because most subna-

Table 16.2. Potential Borrowers from Findeter

Private sector	Public sector	Others
Companies and individuals involved in education	Departments Districts	NGOs dedicated to such activities as local cultural activities
Private companies that provide public services	Municipalities Municipal associations	
Nongovernmental organizations (NGOs) involved in public services	Metropolitan areas Decentralized organisms (not included in the federal budget, such as housing agencies)	

Source: World Bank based on Findeter.



Note: Underlying values are in 1999 Colombian pesos.
Source: World Bank, based on Findeter data.

Figure 16.3 Allocation of Credit from Findeter 1989–99

Table 16.3. Terms and Conditions of Findeter Loans

Credit amount	Up to 100 percent of the project cost
Amortization	Up to 12 years, including 3 years' grace for principal payments Up to 6 years, including 1 year's grace for principal payments for preinvestment projects
Amortization system	Quarterly
Interest payments	Quarterly
Rediscounts	Up to 100 percent of the credit
Annual interest rate (rediscounts)	Average fixed interest rate for bank certificates of deposit plus 2.5 percent
Fees	Surveillance: flat fee of 1 percent of the credit amount Commitment: annual fee of 0.75 percent of the undisbursed amount

Source: Findeter.

tional governments have pledged shared revenues for loan repayment and banks can intercept these revenues, subnational governments are seen as strong credits. Findeter has an outstanding track record in refinancing municipal loans, with only 2 percent of its loans nonperforming in 1996. Because of its low rate of nonperforming loans during the past decade and its medium- and long-term investment perspective, Findeter was able to encourage commercial banks to extend maturities and lend directly to local governments.

Although the scheme in which commercial banks performed the financial and risk analysis and retained the credit risk worked initially, recently Findeter has found it difficult to have commercial banks as intermediaries. Because of excess liquidity, the commercial banks' portfolio in Colombia declined by 8 percent between November 2000 and December 2001. Findeter's credit line now has to compete with commercial banks in the market. In the current economic cycle, with local governments already carrying excessive debt and having no additional revenue streams to pledge, commercial banks are not finding adequate guarantees to act as intermediaries.[4]

Recent Developments

In 2000 the Colombian Congress passed Law 617 to establish a regulatory framework for making fiscal adjustments at the subnational level. The main goal is to provide a long-term solution for subnational fiscal imbalances. The law was designed to free current revenues to fund operating expenditures fully and capital investments partially. The law sets specific limits, such as restricting personnel expenditures to no more than 50 percent of nonearmarked current revenues by 2004. In addition, it establishes a prohibition on funding current expenditures with debt and restricts short-term treasury borrowings. To encourage fiscal discipline, the central government restructured more than Co$849 billion of subnational debt through the fiscal adjustment program. According to the law, the central government can provide guarantees for subnational governments if they agree to the following requirements:

- Implement a fiscal adjustment program.
- Reduce operating expenditures.
- Adjust legislative expenditures to enable a reduction in the expenditures of legislators.
- Reschedule debt to improve payment capacity.
- Obtain new credits from banks to finance the fiscal adjustment program.

In June 2001 a legislative act was approved requiring that the three types of intergovernmental transfers be combined in a new general participation system. The system became effective in January 2002. The funds will grow annually by the average annual percentage change in national current revenues in the previous four years. During a transition period (2002–08) transfers will grow by the rate of inflation plus 2 percent in 2002–05 and by the rate of inflation plus 2.5 percent in 2006–08.

Since the new general participation system is still being tested, its results are uncertain. Nonetheless, the new scheme clearly allows the central government to reduce its fiscal imbalances, since the system does not include the additional revenues that have resulted from the national tax reform introduced by Law 633. Thus subnational governments will benefit less than the central government.

Capital District of Santa Fe de Bogotá: First Subnational Issuer in the International Bond Market

Unlike many other municipalities, Bogotá sought to take full advantage of the greater opportunities offered by the decentralization process that began in Colombia in 1983.[5] Decentralization gave residents the chance to choose local representatives through elections every three years, and it granted municipalities more independence to address the needs of their residents along with full responsibility for financial management. (A new law aimed at extending the term of elected municipal representatives and allowing greater flexibility in seeking reelection is to be implemented in 2004.) The Law of Urban Reform of 1989 was designed to help municipalities improve their operations through such mechanisms as expropriation, land banks, land readjustment, land improvement taxes, designation of priority areas for urban expansion, and transfer of construction and development rights.

For both political and technical reasons, however, many Colombian municipalities never made full use of their ability to improve financial self-sufficiency through their own tax base, cost recovery policies, and other initiatives. Instead, they preferred to continue their dependence on mandatory revenue sharing by the central government. For many of them the consequence was a precarious financial situation—a result of fluctuating transfers and large municipal debts, most of which are guaranteed by future national transfers.

Bogotá is one of the few municipalities that undertook tax reform, sought out new revenue sources, reorganized and streamlined sectoral institutions, and found ways to improve its operations to the point where it was able to successfully float local and international bond issues to cover some of its funding needs. Despite these positive actions, Bogotá's financial health deteriorated recently as a result of macroeconomic problems in the country that affected direct transfers as well as property values and business activity, two key factors in determining own revenue for Bogotá. Moreover, the city's revenue structure is incompatible with its growing financial needs. Recent reluctance by the city council to approve several new tax and cost-cutting initiatives has added to the problem. In addition, the capital investments completed in the past few years will demand greater current spending for operation and maintenance.

Despite these dampening factors, the city's experience with bond issues illustrates its relative strength in municipal financing. In 2001 Bogotá sold US$100 million in bonds in the international market, becoming the first and so far only Colombian city to access that market. Despite the 2001 devaluation of the Colombian peso, the city saw a good opportunity in the international market. It undertook the bond issue not only because of the sound financial condition it had achieved, but also as a marketing strategy to show itself to the world. While this was Bogotá's first time borrowing abroad, the city has a strong record in bond issues, having earlier launched 11 bond issues in the local bond market.

Features of the Bond Issue

The launch was very successful and obtained a low interest rate of 9.5 percent (table 16.4). The issue did not carry a sovereign guarantee. Given the uncertain situation in Colombia and the difficult straits of the emerging economies of Latin America, the market reception was gratifying. The city was able to issue the bond at a fixed interest rate, a very important feature because almost all of its debt has variable interest rates. Nonetheless, this bond clearly implies more currency risk exposure for the city. Bogotá's authorities are working to reduce the risk exposure.

The Issuer

Bogotá, the capital district of Colombia, had an estimated population of 6.6 million in 2001, 16 percent of the country's total, and occupies an area of 1,732 square kilometers. Administratively, the city is not part of the department of Cundinamarca but has direct fiscal and political relationships with the central government. The city was granted its autonomous status, similar to that of a department or municipality, following constitutional reforms in 1991. The city is a net contributor to Colombia's subnational sys-

Table 16.4. Features of the Bond Issue by the Capital District of Santa Fe de Bogotá

Feature	Details
Date of issue	2001
Issuer	Capital District of Santa Fe de Bogotá
Currency	U.S. dollar
Amount	US$100 million
Maturity	2006
Amortization	Bullet
Interest rate	9.5 percent annually
Interest periods	Semiannual
Market	International bond market. The notes were issued under the U.S. Securities and Exchange Commission Rule 144A and Regulation S.
Purpose	Funding infrastructure projects.
Status	Direct, unconditional, unsecured, unsubordinated ranking pari passu with all obligations of the issuer. No sovereign guarantee.
Covenants	The district will not allow liens on its assets or revenues to secure any of its external indebtedness in the form of securities unless the notes are secured equally. Other covenants exist.
Cross-default	Failure to pay any public external indebtedness or external debt constituting guarantees of the district for amounts greater than US$20 million.
Governing law	State of New York
Rating	Fitch Ratings: BB+ (global) Standard & Poor's: BB (global)

Source: World Bank based on Moody's and Standard & Poor's.

tem: it accounts for more than 20 percent of GDP but for only a small percentage of central government transfers.

Bogotá owns eight independent companies that provide a wide range of services, including water, housing, energy, telephone, television, and mass transit. All are controlled by an independent board of directors but subject to budgetary oversight by the district.

The mayor is elected for a three-year term and cannot be reelected to consecutive terms. Council members are also elected for a three-year period.

Economic Performance. As the country's capital and main financial center, the city is a major economic engine, contributing more than 20 percent of the country's GDP with less than 17 percent of its population. During the first half of the 1990s Bogotá's economy grew faster than that of the nation. During the second half of the decade, however, the gap between the national and city growth rates narrowed, and Bogotá could not avoid the economic recession that began in 1997. The city's per capita income is 50 percent higher than the national average.

Manufacturing accounts for 16 percent of the city's economic activity, and finance and real estate account for almost 30 percent. Other services represent 27 percent (transport and communications 10 percent, construction 7 percent, and trade 10 percent). Although exports do not play a key role in Bogotá's economic base, the city administration is committed to increasing exports by promoting agreements with the Cundinamarca department to improve transport, communications, and infrastructure.

Bogotá is by far the largest urban center in the country. Since 1990 its population has grown by almost a third. Immigration into the city is a concern for authorities because of the demands it imposes on infrastructure. Immigration also has an impact on labor indicators. In June 2001 the unemployment rate in Bogotá reached 18 percent, compared with a national rate of 15 percent.

Financial Performance. The city has a positive track record of sound financial and fiscal management, reflected in the string of operating surpluses it has achieved since the early 1990s. In addition, Bogotá has an aggressive investment plan to meet the needs of its growing population. However, the fall in revenues since 1997 has hampered implementation of the investment plan and caused rescheduling and deferral of some projects.

Current revenues reached their peak in 1998 at US$1.3 billion, while total revenues reached their highest level in 1999 at US$1.9 billion (table 16.5). The economic recession that began in 1997 affected revenues, but the administration was able to cut some expenditures to offset the decline. National transfers to the city reached their peak in 2000, accounting for 35 percent of current revenues that year. In 2001, in response to the economic

Table 16.5. Revenues and Expenditures, Capital District of Santa Fe de Bogotá, 1995–2001 (millions of U.S. dollars)

Item	1995	1996	1997	1998	1999	2000	2001
Current revenues	770				1,058		1,271
1,274	1,108				995	1,033	
Current expenditures					586	773	859
882	925				782	715	
Operating balance	94				186	330	297
112	155				231		
Capital revenues	85				254	223	234
820	554				613		
Capital expenditures					336	584	702
743	961				769	570	
Total revenues	854				1,312		1,493
1,509	1,928				1,548		1,646
Total expenditures	922				1,357		1,562
1,625	1,885				1,550		1,285
Fiscal balance	–158				–144		–150

downturn, the central government took initiatives to reduce its transfers. Bogotá's capital revenues stem from dividends from its enterprises, income from financial assets, asset sales, and reductions in the capital maintained in certain companies.

Bogotá has cut not only current spending but also capital spending to maintain a sound fiscal and financial position. In 1999 the city was planning to sell its telecommunications company (Empresa de Teléfonos de Bogotá, or ETB), but the financial crisis triggered by the Brazilian devaluation and the ripple effects on Latin American economies adversely affected the deal. During the past decade the city financed most of its investments through a pay-as-you-go scheme, making it possible to maintain stable debt service levels.

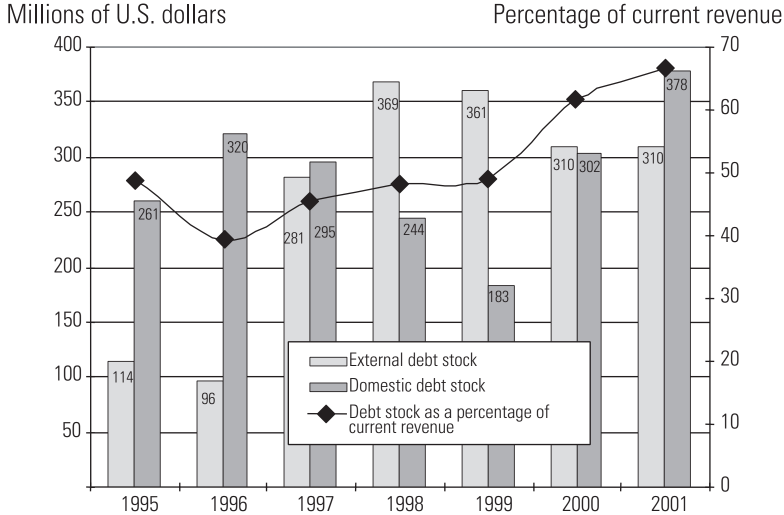
Projections for 2001 showed that the city would achieve an operating surplus for the eighth consecutive year and also enjoy a fiscal surplus that would allow it to make its debt payments (US$80 million) while saving money for further investments.

Debt Profile. Because the city has not financed its capital investments through borrowing, its debt has remained sustainable. The composition of its debt stock changed during 1995–2001. The share of external debt increased, reaching a peak in 1999 (figure 16.4), but external debt declined in both relative and absolute terms in 2000 and remained stable in 2001. The external debt consists of a syndicated loan arranged in 1997, the bond issue, and multilateral loans.

Bogotá's debt service payments have remained smooth in recent years as a result of its conservative debt policy (figure 16.5). The city estimates that its ratio of interest payments to operating surplus will peak in 2002, at 30 percent, and then decline to 24 percent by 2004, well below the 40 percent ceiling established by Law 358 of 1997 (the "traffic-light" law). City authorities generally are more concerned about hedging interest rate risks than hedging currency risks because only 3.6 percent of the debt stock bears interest at fixed rates while almost 55 percent of the debt is denominated in Colombian pesos. The authorities are also taking refinancing risk into account. More than 35 percent of the debt outstanding is due during 2002–04, and almost 90 percent is due during 2002–06. Accordingly, city officials are planning to refinance the debt by contracting loans with multilateral agencies and issuing bonds in the domestic market.

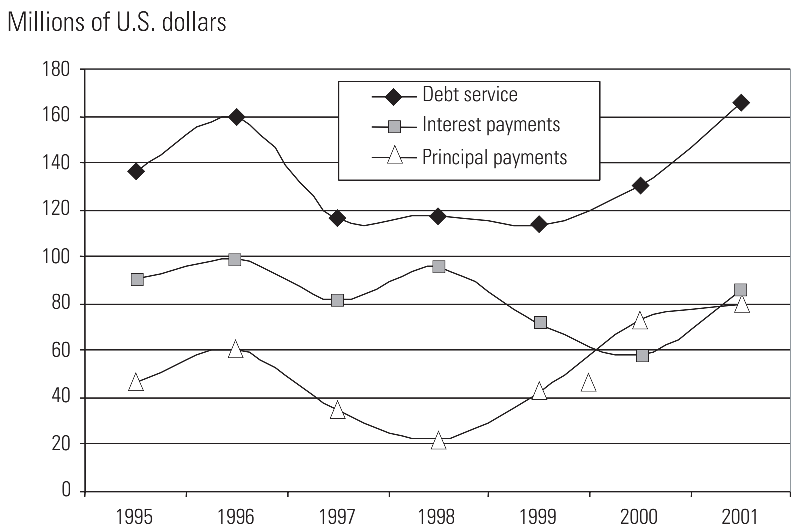
Recent Developments

As noted, the central government took several initiatives in 2001 and 2002 to limit its transfers to subnational governments. How great an impact the



Source: World Bank based on Fitch Ratings.

Figure 16.4. Debt Stock, Capital District of Santa Fe de Bogotá, 1995–2001



Source: World Bank based on Fitch Ratings.

Figure 16.5. Debt Service, Capital District of Santa Fe de Bogotá, 1995–2001

cut in transfers will have on Bogotá's finances remains unclear. Conservative estimates forecast losses of Co$644 billion for Bogotá during the transition period (2002–08) for the new regime established by the national government. This figure represents a 14 percent decline in transfers during the full transition period.

Beyond the changes under the new transfer scheme, Bogotá has seen a downward trend since 1997 in the national transfers it has received, in both relative and absolute terms (for example, shared revenues covered half of the city's education expenditures in 1990 but only 38 percent in 2001). Because the city must rely increasingly on its own revenues, authorities are committed to improving tax collections, cutting certain costs (in 2001, for example, the city eliminated 4,058 permanent positions), and expanding the tax base.

Credit Ratings

The U.S. dollar bond issue was globally rated by Standard & Poor's (BB) and Fitch Ratings (BB+). Their analyses reflected concerns about the economic recession and violence affecting the country at the time of the issue, but both agencies concurred that the city has shown a great commitment to maintaining prudent financial management.

According to the rating analyses, the ratings took into account the following positive factors:[6]

- Satisfactory fiscal operations.
- Proven ability to manage severe economic downturns.
- Manageable and affordable debt position.
- Valuable assets.
- The city's status as Colombia's main economic center.

The ratings also reflected some negative factors:

- A weak local economy that suffered the effects of the national economic recession.
- Significant pension liabilities.
- The potential adverse effects of the reform of the government transfer system.
- Country risk.
- The increasing service needs of a growing population.

According to one of the rating agencies, Bogotá deserves an investment-grade rating. However, because the sovereign's rating imposes the ceiling, the country's weak financial situation and its macroeconomic conditions undermined the credit status of the city. The devaluation of the Colombian peso, the economic recession, and the violence in the country all had adverse effects on the issue.

In recent years the international bond market for emerging market economies has been very volatile, and several Latin American economies have experienced financial crises and problems that have affected the entire region. Nonetheless, Bogotá was able to launch a successful bond issue. The transaction suggests that even in the face of trying national and regional conditions, strong subnational borrowers can gain access to the market.

The city administration's reputation was a major factor in the success of the issue. Even after several years of economic recession the city's management was able to cut spending and boost revenues to offset the decline not only in its own revenues but also in those received from the central government. The city's experience in the domestic bond market helped it prepare the bond offering. In addition, its financing policy for capital expenditure helped maintain relatively low levels of debt, considered a positive factor at the time of the issue. Its comprehensive investment plan and maintenance of valuable assets also were viewed positively by investors.

Notes

This chapter relies on information provided by the World Bank, Fitch Ratings Colombia, Standard & Poor's, the Colombian Securities and Exchange Commission, and the Colombian Ministry of Economy and Public Credit.

1. Departments are the main territorial divisions of Colombia. They were created in 1831, when the country was divided into five departments: Cundinamarca, Boyacá, Magdalena, Cauca, and Itsmo.

2. The number of students enrolled, the number of school-age children not attending school, the number of patients seen by health units, and the number of potential patients based on population.

3. In 1997 inflation (based on the consumer price index) was 18.5 percent.

4. World Bank consultant reports as reported in www.findeter.gov.co.

5. Much of this introductory section draws from World Bank sources.

6. Based on credit reports by Fitch Ratings and Standard & Poor's.