Latam Daily: Colombia's New Tax Reform and Fiscal Rule; Chile Issues USD 2 bn in Debt

- **Chile: Government issued debt for more than USD 2 bn in foreign currency as previously announced; an additional USD 5.8 bn remains**
- **Colombia: Government presents new Fiscal Reform before Congress; additional details on changes to Fiscal Rule revealed**

CHILE: GOVERNMENT ISSUED DEBT FOR MORE THAN USD 2 BN IN FOREIGN CURRENCY AS PREVIOUSLY ANNOUNCED; AN ADDITIONAL USD 5.8 BN REMAINS

On Wednesday (July 21) the Ministry of Finance reported the issuance of Treasury bonds in international markets, for a total of 1.75 bn euros (approximately USD 2.15 bn). Including this issuance, Chile has now issued public debt for a total of USD 15.77 bn in 2021, of which USD 9.90 bn were bonds in foreign currency.

Earlier, on July 12, the Ministry of Finance had updated its estimation for the financing needs of 2021, anticipating additional issuances of up to USD 8 bn, authorized by the Transitory & Emergency COVID-19 Fund, mainly in foreign currency and for longer terms. Yesterday's debt issuance is part of that additional financing plan for this year. Therefore, of the USD 8 bn mentioned above, there are approximately USD 5.85 bn remaining in debt issuances for this year, which is expected to be mostly in foreign currency denominated bonds.

—Anibal Alarcón

COLOMBIA: GOVERNMENT PRESENTS NEW FISCAL REFORM BEFORE CONGRESS; ADDITIONAL DETAILS ON CHANGES TO FISCAL RULE REVEALED

Colombia's Legislature opened its new session on Tuesday (July 20), the same day the government presented its new tax reform. On the expenditures side, the government is planning to extend social programs in 2021 and in some instances through to 2022. Additionally, three VAT holiday days per year will become a permanent measure, as will certain stimulus for the tourism sector. The total fiscal deficit is expected to begin decreasing in 2022, with the primary fiscal surplus only arising until 2025.

Changes to the Fiscal Rule

As had been announced last week, the government is proposing changes to Colombia's Fiscal Rule, departing from a fiscal deficit anchor to a debt to GDP ratio anchor. Aiming to steer clear of unsustainable debt levels, a defined debt ceiling has been set at 71% of GDP, with a long-term target of 55% of GDP—an estimated optimal level to sustain growth under healthy public finances.

The mechanism to adjust the debt to GDP ratio to the set targets will be through the primary fiscal balance. According to the rule, if the debt is already at 55% of GDP, the target primary fiscal surplus will be 0.2% of GDP, while if the debt exceeds 55% of GDP, the surplus should be higher under the following function:

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Net primary balance in current period (% of GDP) = 0.2 +0.1(Net debt in previous period -55) if net debt in the previous year is below 70% of GDP.

Or 1.8 if Net debt in the previous year is above 70% of GDP.

The net primary balance will also include effects of economic growth, oil cycles and one-time transactions (i.e. asset selling). The rule will calculate the oil cycle based on observable variables, while the methodology for the economic cycle will be more transparently prescribed. This is a positive change versus the previous rule where cycles were based mainly on unobservable variables and unknown parameters.

Net primary balance = Primary fiscal balance – growth cycle – oil cycle – one-time transactions.

In regard to implementation, the government has defined a transition period between 2022 and 2025 to gradually start converging to the long-term goal, given that the country is still affected by the pandemic shock.

From our perspective, the proposed new Fiscal Rule is positive as it will have a more transparent anchor and methodology, allowing for a simpler way to monitor fiscal performance. However, the transition period is long, and we have to wait until 2026 to see the rule working fully.

Additional Highlights:

- **The Fiscal Reform bill aims to eliminate the withholding tax on fixed-income investments (public and private), looking to improve the competitivity and attract further investors.** This last change also should contribute to improving conditions to financing the budgetary needs. The current withholding tax is at 5% after being reduced in the National Developed Plan in May 2019 from 14%.

- **Budget Addition for 2021: In the financial plan 2021 (released in March), the Ministry of Finance (MoF) estimated a fiscal deficit of 8.6% of GDP for 2021.** However, since then some conditions have changed: 1) The initial Fiscal Reform was withdrawn amidst social unrest; 2) Colombia's downgrade in the credit rating, and 3) deteriorated financial market conditions. In the new Fiscal Plan, the MoF asked for a change in the budget while maintaining the fiscal deficit target.

Overall, main changes assume a lower fiscal income (COP 2.5 tn or ~ 0.2% of GDP), while also a need for greater resources to extend social programs. Therefore, net new sources will be COP 10.5 tn, which will be allocated to the Ministry of Finance from other areas of the national government budget. That said, the fiscal deficit of the central government is not expected to increase, maintaining the indebtedness plans from the Medium-term Fiscal Framework and avoiding higher debt issuances needs.

The Fiscal Reform bill, as presented, affirmed the main messages delivered at the Minister's press conference last week, including the proposed additional sources of revenue (table 1). We expect the government to urge Congress to expedite passage of the Fiscal Reform as some social programs are due to expire in August, although the final law would be released in around five weeks at the earliest. We don't expect substantial changes as the bill progresses in the legislature, given that the government has already discussed the text with the main social groups and congressional leaders.

—Sergio Olarte & Jackeline Piraján

Table 1

Additional Sources of Revenue: Colombia Fiscal Reform

Additional income (% of GDP)	Elimination of Corporate Tax Reductions (contemplated in Financing Law 2019)	Higher corporate income tax (35%)	Surcharge tax for financial institutions	Declaration of hidden wealth by individuals	VAT holiday and tourism law	Tax evasion controls	Total
Dec-21				0.03	-0.04		-0.02
Dec-22		0.3	0.03	0.03	-0.11		0.25
Dec-23	0.3	0.6	0.03		-0.05	0.3	1.2
Dec-24	0.3	0.6	0.03		-0.05	0.3	1.2
Dec-25	0.4	0.6	0.03		-0.05	0.3	1.2
Dec-26	0.4	0.6			-0.05	0.3	1.2

Sources: Scotiabank Economics, Ministry of Finance.