The Draft Government Budget (PGN in Spanish) for 2023 amounts to COP$391.4 trillion, representing a nominal growth of 11.1% with respect to 2022. Of the total amount, 64% (COP$250.6 trillion) is allocated to operations, 19.9% (COP$77.9 trillion) to debt service, and 16% (COP$62.8 trillion) to investment. In terms of GDP, while operating revenues increased by 1.8 pp and debt by 0.1 pp, investment decreased by 0.8 pp (Graph 1).

The project forecasts revenues of COP$391.4 trillion, of which 65.6% (COP$256.9 trillion) corresponds to current revenues, 28.9% (COP$113.4 trillion) to capital resources, and the rest to special funds (COP$17.7 trillion) and parafiscal revenues (COP$3.3 trillion). It is worth noting that current revenues incorporate tax collections of COP$246.3 trillion and that capital resources include COP$43.8 trillion from domestic credit, COP$24.0 trillion from external credit, and COP$24.0 trillion from Ecopetrol dividends. In general, the possibility of fully executing these resources will depend on factors over which there is a high degree of uncertainty, such as higher oil prices and the progress of the National Tax and Customs Directorate (DIAN in Spanish) in terms of management.

Figure 1. PGN Expenditures 2022-2023
(Percentage of GDP)

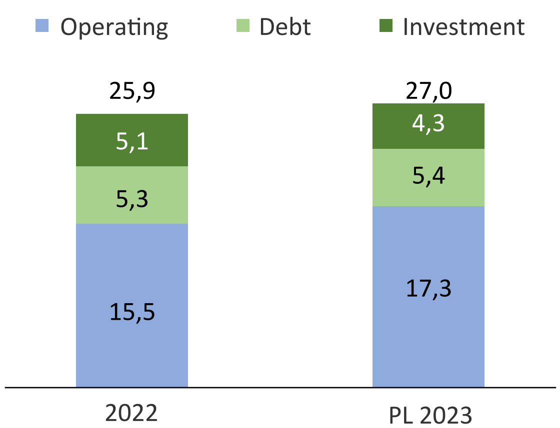
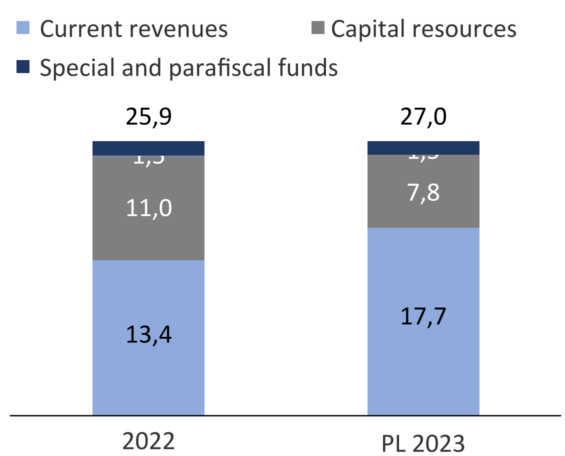


Figure 2. PGN 2022-2023 Income
(Percentage of GDP)



Source: Ministry of Finance and Public Credit - Annex to the Presidential Message of the Government Budget 2023.

The PGN draft for 2023 was prepared during the recovery of productive activity following the health and economic crisis caused by the COVID-19 pandemic. Quarantines and widespread closures in 2020 led to the contraction of the output and consequently to the loss of revenue. To moderate the social and economic impact of the pandemic, the Colombian Government decided to expand public spending with the financial support of the Emergency Mitigation Fund (FOME in Spanish - a Colombian emergency response fund), which was created for this purpose. The fall in revenues and the expansion of state spending brought the government's fiscal deficit to 7.8% of GDP and debt to 64.7% of GDP, which are considered critical levels to ensure the country's fiscal stability. In 2021, the macroeconomic outlook improved significantly in terms of economic growth, allowing for a recovery in tax revenues. However, by the end of 2021, the government's fiscal deficit had only been reduced to 7.1% of GDP, and debt stood at 63.8% of GDP. The higher indebtedness and the country's risk perception led to the loss of investment grade. As a result, there was an increase in interest rates on Colombian public debt instruments that was higher than in other Latin American countries. To generate the conditions to ensure a fiscal adjustment process in the medium term, the reform to the Tax Statute approved by Congress in 2021, known as the Social Investment Law, introduced a new quantitative fiscal rule on the structural net primary balance, whose strict compliance should lead to a gradual reduction of the deficit and the Colombian government's debt.

The dynamism of economic activity so far in 2022, together with the fiscal rule enforcement, allows us to anticipate a better fiscal situation at the end of the year. According to the estimates presented in the latest Medium-Term Fiscal Framework, the government deficit in 2022 would stand at 5.6% of GDP, and the debt would fall to 59.1% of GDP. Although these percentages are lower than those of the previous year, they continue to be high and partly reflect the difficulties in making further spending adjustments and the accumulation of large deficits in the Fuel Price Stabilization Fund (FEPC in Spanish) due to the sharp increase in international liquid fuel prices that has not been fully passed on to domestic fuel prices[1].

In legal terms, the draft PGN for 2023 complies with the provisions of the Organic Budget Statute and is consistent with the fiscal rule and the goals established in the Medium-Term Fiscal Framework for

[1] "The FEPC was created in 2007 to mitigate the impact of fluctuations in the international prices of liquid fuels (LFs) on the domestic market. Operationally, the Fund prevents the producer income - PI (reference price) from undergoing substantial fluctuations if there are drastic and sudden movements in the international prices of LFs (parity price). The dynamics between the two prices, multiplied by the amount of fuel sold in the period, determine the Fund's net position. Thus, when the reference price is higher than the parity price, a participation differential is generated (FEPC income). In contrast, when this difference is negative, a compensation differential is generated (expense)" (Medium-Term Fiscal Framework 2022, Page 68).

2022, which were defined based on the implementation of essential social investment programs without affecting the country's fiscal sustainability. For 2023, a total Colombian government deficit equivalent to 3.6% of GDP is estimated, with a structural net primary deficit of 1.4% of GDP, which is required by the new fiscal rule. Furthermore, according to the 2022 Medium-Term Fiscal Framework, compliance with the rule will allow the government debt to reach a level close to 55% of GDP by the end of 2025.

Current levels of public debt are high and generate vulnerabilities that can aggravate the consequences of adverse economic shocks and limit the capacity of economic policy to react. Because of the interaction with monetary policy, the credibility of fiscal policy plays an essential role in avoiding overburdening the macroeconomic adjustment on interest rates. First, fiscal sustainability is crucial for determining access to domestic and external financing for the public and private sectors. As already mentioned, during 2021, Colombia's risk premia increased relatively compared to other Latin American countries. In the most recent period, there has also been a significant increase in overall interest rates and a generalized increase in risk spreads for emerging economies. Second, the path of the fiscal deficit is a key variable in determining the composition of the adjustment among agents in the economy. A fiscal adjustment process that leads to a gradual decrease in the government deficit and debt minimizes the impact on private economic activity. The increase in interest rates payable by the government, together with risk premia, is reflected in a larger budget item to meet debt obligations and translates, in turn, into higher real interest rates and pressures on the exchange rate that affect the private sector and limit the action of monetary policy.

Finally, it is necessary to consider that the new government has just submitted to Congress a tax reform bill entitled "Social Equality Law," whose approval would lead to a revision of revenue and expenditure estimates as of 2023 and to adjustments in the PGN next year. In terms of macroeconomic stability and public debt sustainability, the budget must be approved this year in Congress and, in the following years, be consistent with the additional revenues obtained from this reform, thus allowing further progress in the fiscal consolidation process.