

CEPAL

Review

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Private internal debt in Colombia, 1970-1985

*Mauricio Carrizosa
and Antonio Urdinola**

In the first half of the 1980s one of the clearest developments in Colombia's financial sector as in that of several other Latin American economies, was the increasing indebtedness of private and public enterprises. A large part of the increased lending was of domestic origin and this led to an unprecedented growth in the financial assets held by the public and the intermediation systems. At the same time the formerly buoyant stock market went into its death throes; the great majority of shares came into the hands of a few large investors, for the small investor put his savings into the financial instruments issued by the intermediaries who were lending to business.

This article has three purposes. Firstly, to describe and analyse the evolution of the debt of the business sector in Colombia and of the financial sector which supplied it, distinguishing debt in the national currency from debt in foreign currencies and giving greater attention to the former. Secondly, to examine the links between the debt phenomenon and the development of economic activity and the production performance of business. Lastly, to study the effects of the domestic debt on the vulnerability of the financial sector. Obviously, high debt coefficients increase the risk of bankruptcy, and if this phenomenon becomes widespread it limits the capacity of financial bodies to maintain acceptable levels of risk by portfolio diversification. It is clear, as the article will show, that this is what happened to Colombia's financial intermediaries during the first half of the 1980s.

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I Evolution of business sector debt

This description of the evolution of the debt over time makes a distinction between non-financial and financial enterprises. The reasons for this distinction are clear: on the one hand, the debt of financial bodies is specifically regulated by legislation in terms of their net worth; on the other hand, a large part of business debt is supplied indirectly from the resources obtained by the banks, so that it is wrong to add together the debt of the two types of body.

1. *Debt of non-financial enterprises*

There exist statistics which show the evolution of the debt of corporations which are not financial intermediaries between 1950 and 1984. The figures show a trend for capital to be financed from borrowing (table 1). At the beginning of the 1950s the proportion financed by debt was less than a quarter of total liabilities. By the mid-1980s almost three-quarters of these liabilities did not pertain to the owners of the companies.

There is of course the familiar bias caused by the counting of fixed assets as historical costs; but even if this were corrected, it would hardly offset the upward trend of the debt, for other economic indicators support the descriptive hypothesis set out above. One of these indicators is the comparison, from 1970 onwards, of the interest and dividends paid by enterprises, which shows the increasing importance of interest (table 2). A second indicator is the significant growth in non-stock financial assets in relation to the gross domestic product, especially in the 1950s and from 1970. A third indicator is the significant decline in the 1970s in the commercial value of a sample of shares of all the incorporated companies which were once unincorporated expressed as a proportion of a total which also includes non-stock financial assets.¹ It is thus clear that the increasing busi-

¹The last two indicators are given respectively in Carrizosa (1985), p. 140, and in Carrizosa (1986), pp. 94-96. The indicator of interest and dividends is obtained from the income and expenditure accounts of the enterprises in the National Accounts of Colombia prepared by the National Bureau of Statistics (DANE).

ness debt had its counterpart in the rapid development of financial instruments intermediated by lending institutions and in the stagnation of stock issues as a means of mobilizing resources.

It is now necessary to consider the distribution of debt between national and foreign currencies. Unfortunately, this cannot be done directly since the financial statements submitted to the Office of the Superintendent of Companies make no distinction between the two types of

Table 1

COLOMBIA: CORPORATE DEBT
COEFFICIENTS, 1950-1984

	Index
1950	24.0
1951	27.0
1952	27.0
1953	32.0
1954	31.0
1955	29.0
1956	32.0
1957	32.0
1958	34.0
1959	35.0
1960	37.0
1961	37.0
1962	40.0
1963	40.0
1964	43.0
1965	43.0
1966	45.0
1967	44.0
1968	44.0
1969	46.0
1970	43.9
1971	47.4
1972	49.8
1973	53.7
1974	57.0
1975	60.5
1976	62.1
1977	61.6
1978	61.1
1979	65.1
1980	73.0
1981	71.2
1982	71.7
1983	71.2
1984	71.9

Source: 1950-1980: Restrepo (1985), p. 14.

1981-1983: Office of the Superintendent of Companies (1984), *Boletín mensual*. Nos. 3, 4, and 6.

Table 2

COLOMBIA: INTEREST COSTS AND
DIVIDENDS OF NON-FINANCIAL
PRIVATE COMPANIES AND
QUASI-COMPANIES, 1970-1983

(Millions of pesos)

Year	Interest	Dividends	Interest/ dividends
1970	3 930	7 099	0.55
1971	5 347	8 022	0.67
1972	6 458	12 270	0.53
1973	8 748	16 770	0.52
1974	10 804	23 084	0.47
1975	17 364	26 803	0.65
1976	22 054	36 196	0.61
1977	27 010	46 564	0.58
1978	35 460	50 096	0.71
1979	44 916	56 029	0.80
1980	69 751	79 051	0.88
1981	104 461	92 362	1.13
1982	140 233	117 463	1.19
1983	163 421	133 756	1.22

Source: National Bureau of Statistics (1985), *Cuentas Nacionales de Colombia, 1970-1983*, table 25, pp. 128-141.

debt. But it is possible and useful to compare the total external private debt of the non-financial sector with the total national-currency portfolio of the banking system and of private financial corporations. This comparison (table 3) indicates no specific trend in the relative importance of the two types of debt.² The relative proportion of the debt in foreign currencies declined for a time between 1975 and 1978. In fact, the external private debt expressed in dollars remained stationary at around US\$1 100 million up to 1978 and then grew vigorously up to 1982. The external debt expressed in dollars then stabilized and the increase in its peso value from 1982 was due basically to the increase in financial costs resulting from the devaluation.

To sum up, the aggregate figures show, firstly, an increase in the global indices of busi-

²However, it is possible that other non-traditional intermediaries, for example commercial finance companies, may have supplied an increasing amount of funds. But such funds still constitute a small fraction of the total market.

Table 3

COLOMBIA: EXTERNAL AND INTERNAL DEBT, 1970-1984*(Millions of pesos)*

	Private external debt	Banking system Loans in national currency	(2) / (1)	Private financial corporations Loans in national currency	(4) / (1)
	(1)	(2)	(3)	(4)	(5)
1970	10 065	12 922	1.28	2 339	0.23
1971	14 030	15 392	1.10	2 823	0.20
1972	16 203	18 125	1.12	3 819	0.24
1973	18 295	23 984	1.31	4 807	0.26
1974	28 922	32 951	1.14	5 813	0.20
1975	35 860	42 593	1.19	8 130	0.23
1976	43 447	54 085	1.24	11 884	0.27
1977	40 313	77 505	1.92	19 009	0.47
1978	48 093	95 413	1.98	25 134	0.52
1979	82 588	110 459	1.34	25 873	0.31
1980	20 782	165 541	1.37	42 184	0.35
1981	177 032	238 620	1.35	58 890	0.33
1982	251 357	286 946	1.14	62 817	0.25
1983	328 626	390 993	1.19	73 474	0.22
1984	415 812	477 206	1.15	79 783	0.19

Source: (1) Bank of the Republic.

(2) and (4) Banking Association of Colombia (1985).

ness debt and, secondly, no permanent changes in the distribution between debt of external and internal origin. It seems that the capacity for domestic intermediation of funds grew roughly in the same way as the access to debt in foreign currencies, at least during the 1970s.

A more detailed description must be given of the debt of non-financial companies. A sample was taken of corporations with a view to calculating coefficients of total debt and debt by type of creditor, together with indices of liquidity and short-term debt, which indicate changes in the global debt characteristics (table 4). The average shown in the last one confirms the upward trend of debt, except in the last year when the trend shows a considerable decline. There are some extreme cases of debt greater than total assets, indicating negative net worth.

The proportion of short-term liabilities in total external liabilities remained constant, on average, throughout the period (table 5). Current (short-term) liabilities represent a more or less constant proportion—about 60%—of the total debt. However, as the increase in total debt was not accompanied by a similar increase in liquid assets, the ratio of current assets to current liabilities declined significantly. As can be seen from table 6, this decline occurred during the 1960s and 1970s; the average liquidity index of corporations was around 1.5. In comparison with the 1960s, these companies now run a greater risk of being unable to meet their current obligations on time. It is therefore no surprise that, as will be discussed below, the matured portfolio of financial bodies should also have increased significantly.

Table 4

**COLOMBIA: EVOLUTION OF DEBT INDICES IN A SAMPLE
OF 42 NON-FINANCIAL ENTERPRISES, 1960-1985**

	Debt (percentage) ¹							
	1960	1971	1978	1980	1982	1983	1984	1985
Bavaria	33.4	30.7	57.5	58.8	77.0	51.8	43.6	
Cervecería Unión	20.6	20.5	43.9	58.6	63.2	61.2	59.6	46.5
Proleche		18.5	39.2	43.2	51.6	50.3	47.7	55.9
Cía. Colombiana de Tabaco	21.3	55.4	57.2	61.5	69.3	72.5	72.2	71.1
Cía. Molinera de Herrán	17.5	18.9	65.3	53.7				
Cía. Nacional de Chocolates	44.8	27.6	34.5	38.7	67.0	48.2	42.7	47.9
Industrias Alimenticias Noel	44.8	195	62.3	65.9	61.7	61.6	58.4	58.1
La Industria Harinera	25.0	13.7	46.2	61.4	66.4	76.1	73.4	74.9
Manuelita	39.5	20.3	52.1	62.6	81.4	79.3	799	78.2
Colcultidos	16.7	32.8	45.5	52.3	77.3	65.8	70.9	66.8
Coltejer	30	35.8	58.2	77.4	76.3	73.7	74.0	77.6
Fabricato	24.8	43.7	65.3	69.0	74.6	76.8	75.3	58.1
La Garantfa-A. Dishington	21.6	51.7	79.6	68.2	99.0	159.4	234.1	
Paños Vicuña Santa Fé	43.0	52.5	58.8	79.6	73.0	74.9	74.3	70.4
Sociedad Industrial Alicachín	23.6	36.9	53.3	78.1	92.1	127.7	156.9	
Tejicondor	41.2	44.5	57.9	69.5	80.6	84.9	70.2	69.4
Tejidos Única	55.3	59.3	55.9	66.8	67.7	78.8		47.1
Cartón de Colombia		38.8	56.6	68.0	74.3	66.5	64.3	62.8
Cauchosol	36.8	43.2	61.8	73.0	68.2			
Croydon	42.1	58.2	78.3	61.8	69.6		95.7	84.6
Cementos Argos	0.4	8.7	9.8	13.7	28.0	27.1	21.8	18.0
Cementos del Valle	20.1	76.8	71.8	70.4	71.1	69.5	70.8	70.9
Cementos Diamante	23.0	33.1	51.2	52.8	62.9	65.0	40.8	36.6
Manufacturas de Cemento	26.7	398	64.1	72.6	91.6	74.1	72.2	72.4
Eternit Atlántico	32.9	31.2	47.8	28.9	44.1	49.7	46.7	38.8
Eternit Colombiana	38.7	33.0	50.8	26.3	46.3	52.3	44.6	38.1
Eternit Pacífico	29.1	35.5	53.4	57.9	64.0	51.8	48.6	42.3
Ladrillera La Candelaria	15.0	31.4	51.5	70.9	73.9	72.5	67.6	
Tubos Moore	13.4	31.1	73.6	74.8	71.9	75.3	83.4	88.8
Vidriera de Colombia	16.7	45.1	84.4					
Acerías Paz del Río	6.1	38.5	53.0	73.7	94.3	73.5	80.6	85.6
Colmotores		87.8	84.9	90.1	88.9			116.8
Distrai		71.7	81.2	80.2	80.6	76.8	64.1	72.5
Furesa		25.8	78.7	71.6	80.5	78.3	82.3	79.5
Icasa		81.7	92.9	85.8	88.1	66.3	69.5	72.3
Industrias Metálicas de Palmira		23.4	63.5	58.1	70.0			94.9
Industrias Metalúrgicas Iderna		24.1	65.0	65.4	79.8	76.2	67.7	67.2
Muebles Arctecto		57.0	73.0	88.3	89.1	92.6	97.0	132.3
Avianca	57.2	73.3	81.2	75.0	81.8	89.4	93.5	93.2
Cine Colombia	23.9	24.9	34.9	33.5	48.6	46.8	51.5	56.0
Urbanización David Puyana	23.0	33.3	73.9	68.2	79.1	81.9	83.3	72.7
Hipódromo de Techo	25.0	31.3	39.0	82.5				
Average	28.3	39.4	59.7	63.6	72.4	73.3	73.7	68.2

Source: Financial statements of the companies. Office of the Superintendent of Companies, Commerce Seasion.

Not*: The figures for 1960-1982 were compiled in Figueroa Jaramillo (1983). Those for 1985 were compiled direaly by the authors.

¹Debt index = $\frac{\text{Total third-party liabilities}}{\text{Total assets}} \times 100$

²The arithmetical average.

Table 5
COLOMBIA: EVOLUTION OF RATIO OF CURRENT TO TOTAL
THIRD-PARTY LIABILITIES IN A SAMPLE OF 42
NON-FINANCIAL ENTERPRISES, 1960-1985

	1960	1971	1978	1980	1982	1983	1984	1985
Bavaria	48.9	59.2	45.5	30.3	24.3	29.8	32.0	
Cervecería Unión	78.5	83.9	75.3	71.9	66.5	62.0	53.3	60.7
Proleche		30.4	71.1	80.3	60.6	73.5	79.5	87.9
Cía. Colombiana de Tabaco	88.2	68.1	53.3	60.9	62.8	61.0	52.9	56.2
Cía. Molinera de Herrán								
Cía. Nacional de Chocolates	66.1	55.1	75.5	57.8	62.2	63.3	45.9	53.7
Industrias Alimenticias Noel	94.5	70.4	71.8	78.7	78.8	70.4	60.0	74.6
La Industria Harinera	43.3	6.4	79.3	90.0	89.6	89.7	92.1	91.4
Manuelita	76.4	67.1	26.9	53.7	25.7	27.5	36.0	36.6
Colcultivos	77.7	41.8	63.1	65.0	69.0	61.8	66.9	69.2
Coltejer	57.1	64.5	51.6	50.6	42.7	28.8	31.6	30.1
Fabricato	74.2	59.9	55.6	52.8	61.5	57.5	60.4	28.2
La Garantía-A. Dishington	100.0	42.3	56.0	58.7	61.5	61.3	66.9	
Paños Vicuña Santa Fé	51.3	71.4	35.7	55.7	54.3	54.9	55.8	62.6
Sociedad Industrial Alicachín	71.4	20.9	55.7	56.3	67.8	72.6	75.0	
Tejicondor	59.7	77.5	46.4	45.9	34.2	20.6	26.6	26.2
Tejidos Única	50.8	67.0	68.5	63.0	74.2	86.5		100.0
Cartón de Colombia		81.7	63.7	67.4	61.0	62.5	65.4	58.7
Cauchosol	68.0	15.1	95.7	94.2	91.5			
Croydon	74.5	62.8	72.7	69.5	65.0		70.2	70.3
Cementos Argos	42.8	33.7	74.7	68.3	65.0	64.3	63.7	67.6
Cementos del Valle	66.6		55.9	53.6	40.8	33.9	28.7	31.2
Cementos Diamante	72.6	79.8	60.6	62.1	60.7	66.9	60.6	53.2
Manufacturas de Cemento	58.3	20.0	52.7	61.0	33.7	37.5	60.4	57.8
Eternit Atlántico	17.3	48.3	54.8	60.0	69.9	77.0	69.9	60.9
Eternit Colombiana	55.1	43.3	62.9	67.0	59.2	81.1	75.6	64.6
Eternit Pacífico	47.8	40.8	52.3	61.0	77.8	65.7	55.7	57.3
Ladrillera La Candelaria		43.2	53.7	22.4	31.9	44.0	40.0	
Tubos Moore	57.1	30.5	35.2	30.9	26.1	39.5	34.5	36.7
Vidriera de Colombia	50.0	43.3	74.3					
Acerías Paz del Río	57.5	27.3	42.7	30.2	38.2	38.3	37.9	47.2
Colmotores		66.2	74.8	70.3	76.9			98.0
Distrai		42.9	38.5	37.9	53.1	62.0	53.7	52.5
Furesa		44.3	67.9	21.8	18.5	14.4	18.2	18.6
Icasa		69.9	67.5	68.6	68.5	63.9	68.7	67.8
Industrias Metálicas de Palmira		47.5	67.6	88.2	82.2			94.6
Industrias Metalúrgicas Iderna		75.3	82.2	79.5	89.1	85.8	73.5	82.5
Muebles Artecto		89.5	80.3	76.5	82.1	60.0	69.8	41.9
Avianca	58.5	34.3	22.3	37.6	33.6	64.3	77.2	80.7
Cine Colombia	79.2	56.6	62.8	49.5	44.9	40.4	55.7	62.1
Urbanización David Puyana	16.9	24.0	95.8	95.5	96.8	97.6	95.7	56.1
Hipódromo de Techo	39.2	48.5	81.6	96.9				
Average ⁰	59.4	51.4	61.6	61.0	59.0	57.7	57.4	59.9

Source: Financial statements of the companies. Office of the Superintendent of Companies. Commerce Section.

Note: The figures for 1960-1982 were compiled in Figueroa Jaramillo (1983). Those for 1985 were compiled directly by the authors.
⁰The arithmetical average.

Table 6

**COLOMBIA: EVOLUTION OF LIQUIDITY INDICES IN A SAMPLE
OF 42 NON-FINANCIAL ENTERPRISES, 1960-1985**

	Liquidity ^a							
	1960	1971	1978	1980	1982	1983	1984	1985
Bavaria	3.1	1.2	1.8	3.0	2.9	2.3	2.2	
Cervecería Unión	2.0	1.8	0.8	1.1	1.6	1.9	1.8	1.8
Proleche		2.9	1.2	1.1	1.3	1.3	1.3	1.1
Cía. Colombiana de Tabaco	2.5	1.7	1.8	1.6	1.3	1.3	1.5	1.4
Cía. Molinera de Herrán	9.7	6.5	2.0	1.8				
Cía. Nacional de Chocolates	2.4	3.0	1.9	2.0	1.6	1.7	2.5	2.1
Industrias Alimenticias Noel	1.4	1.4	1.4	1.4	1.3	1.4	1.8	1.7
La Industria Harinera	6.2	3.8	1.8	1.4	1.3	1.2	1.1	1.1
Manuelita	1.6	4.3	1.7	1.3	1.3	1.4	1.2	1.3
Colcurtidos	2.7	2.4	2.5	1.8	1.4	1.6	1.5	1.6
Coltejer	2.4	1.8	2.1	1.4	1.2	1.3	1.4	1.4
Fabricato	2.1	1.5	1.8	1.8	1.1	1.1	1.3	3.2
La Garantía-A. Dishington	3.3	2.2	1.6	1.9	0.8	0.4	0.2	
Paños Vicuña Santa Fé	3.1	2.2	3.2	2.6	1.8	1.7	1.7	1.5
Sociedad Industrial Alicachín	4.3	9.2	4.1	1.7	1.5	1.0	0.8	
Tejicondor	1.8	1.9	1.7	1.9	1.8	3.2	2.9	3.2
Tejidos Única	1.8	2.0	1.8	1.5	1.0	0.8		1.9
Cartón de Colombia		1.3	1.6	1.3	1.3	1.2	1.2	1.3
Cauchosol	2.5	3.3	1.4	1.3	1.4			
Croydon	2.2	1.0	1.4	1.6	1.6		1.1	1.4
Cementos Argos	20.0	1.9	0.9	1.1	0.8	0.9	1.4	1.1
Cementos del Valle	2.8	7.1	1.2	1.3	1.9	1.9	2.5	2.5
Cementos Diamante	1.4	2.5	2.0	1.0	0.7	0.7	0.8	0.9
Manufacturas de Cemento	2.1	2.9	1.6	1.6	2.6	2.4	1.1	1.2
Eternit Atlántico	10.0	4.0	2.6	2.7	2.5	1.5	1.7	2.4
Eternit Colombiana	3.0	2.3	1.9	2.2	2.5	1.3	1.9	2.4
Eternit Pacífico	5.0	3.5	2.8	2.2	1.6	1.6	2.1	2.3
Ladrillera La Candelaria	...	0.7	1.6	1.8	1.2	0.6	1.0	
Tubos Moore	2.0	1.5	1.2	2.3	2.9	1.9	1.5	1.2
Vidriera de Colombia	6.5	2.6	1.0					
Acerías Paz del Río	8.2	3.0	2.3	1.9	1.1	0.9	0.9	0.6
Colmotores		1.4	1.2	1.2	1.1			0.5
Distrai		2.0	2.4	2.1	2.0	1.8	2.0	1.9
Furesa			1.1	3.7	2.6	3.7	2.7	2.9
Icasa			1.5	1.5	1.3	1.4	1.3	1.3
Industrias Metálicas de Palmira			1.7	1.6	1.4			0.3
Industrias Metalúrgicas Iderna		2.2	1.3	1.4	1.1	1.1	1.7	1.5
Muebles Arrecto		1.5	1.5	1.4	1.1	1.5	1.1	1.2
Avianca	1.4	1.0	2.6	1.5	1.7	0.9	0.7	0.6
Cine Colombia	0.9	2.3	1.0	1.8	1.3	1.6	0.9	0.8
Urbanización David Puyana	15.3	2.3	2.3	1.2	1.1	1.1	1.1	1.9
Hipódromo de Techo	0.8	1.8	1.8	1.2				
Average	4.1	2.6	1.8	1.7	1.5	1.5	1.5	1.8

Source: ^a Financial statements of the enterprises. Office of the Superintendent of Companies. Commerce Section.

Note: The figures for 1960-1982 were compiled in Figueroa Jaramillo (1983). Those for 1985 were compiled directly by the authors.

Liquidity index = $\frac{\text{Current assets}}{\text{Current liabilities}}$
The arithmetical average.

Table 7

**COLOMBIA: AVERAGE COMPOSITION
OF THIRD-PARTY LIABILITIES
OF A SAMPLE OF ENTERPRISES
IN THE REAL-ESTATE SECTOR**

(Percentages)

	Finan- cial liabil- ities	Person- nel liabil- ities	Govern- ment liabil- ities	Miscel- lane- ous	Total
1971	36.1	18.0	14.6	31.3	100.0
1978	39.4	23.2	6.9	30.5	100.0
1980	40.0	22.7	6.6	30.7	100.0
1982	41.3	21.3	6.7	30.7	100.0
1983	43.6	21.3	5.3	29.8	100.0
1984	37.3	25.3	5.0	32.4	100.0
1985	41.9	22.1	5.9	30.1	100.0

Source; For 1971, 1978, 1980 and 1982: Figueroajaramillü (1985).

For 1983, 1984 and 1985: authors' calculations.

"Includes commercial and non-bank debt.

2. Distribution of total debt

In the previous sections an analysis has been made of the increase in the total debt of Colombia's business sector; this section will consider the holders of this debt, with respect to the non-financial sector.

Table 7 shows the variation between 1971 and 1985 in the composition of the third-party liabilities (debt) of the companies in the sample presented in the previous section. Between 1971 and 1978 the debt owed to the government declined from 14.6 to 6.9% of the total debt, owing largely to a series of tax amnesties for companies which brought their tax returns up to date. In contrast, there was an increase in financial liabilities from 36.1 to 39.4% for reasons which are explained in the next section, and especially in the personnel liability, which increases from 18 to 23.2%; this item consists basically of pensions paid by the enterprises and the entitlement to retirement pensions³ accumulated by currently employed staff. The other lia-

³The retirement pension is a benefit established under Colombian law equivalent to a monthly payment for each year worked, payable on the retirement of the worker; its cumulative value is updated on the basis of the last salary received.

bilities remain relatively stable, as is to be expected in view of their predominantly commercial nature (for example, suppliers' credit).

Between 1978 and 1983 there is a clear trend towards higher borrowing from the financial sector, which increases from 39.4 to 43.6% of the total, while the personnel liability declines from 23.2 to 21.3%* and the official (government) liability from 6.9 to 5.3 %; the commercial (miscellaneous) liability also declines slightly. The 1982-1983 financial crisis is reflected in a sharp relative decline in financial debt from 43.6% in 1983 to 37.3% in 1984, with increases in the proportion of personnel and commercial liabilities. The financial system had difficulty in maintaining the growth rate of new loans to the non-financial sector in 1984, especially owing to the closure of lines of credit by foreign partners.

In 1985 there was a return to figures similar to those of 1982, with financial liabilities amounting to 41.9% of the total.

3. Financial sector debt

Major financial reforms were introduced in the 1970s which led to the establishment of new intermediaries (savings and housing institu-

Table 8

**COLOMBIA: RATIO OF M₂ TO GROSS
DOMESTIC PRODUCT AND TO M₁,
BETWEEN 1970 AND 1985"**

(Percentages)

	M ₁ /M ₂	M ₂ /GDP
1970	86.3	18.9
1972	83.7	18.8
1974	69.5	20.6
1976	62.7	23.8
1978	57.2	25.9
1980	50.0	27.1
1982	43.8	29.8
1984	41.7	32.6
1985	39.8	34.1

Source: M₁ and M₂: Bank of the Republic. Gross domestic product: National Bureau of Statistics (DANE).

*M₁: Money in circulation plus current accounts. M₂: M₁ plus quasi-money (broad money supply).

⁴As the Institute of Social Security is beginning to take responsibility for an increasing proportion of pensions.

tions, commercial finance companies and fiduciary companies) and to an increase in the real rates of taxation of financial bodies with the removal in 1972-1974 of the legal ceilings which kept these rates at negative levels in real terms.

As a result, quasi-money (savings accounts, time deposits) increased swiftly in importance (table 8). The trends are clear. Between 1970 and 1985 money in circulation plus current

accounts (M_1) declined continuously: it fell from 86.3 to only 39.8% of the broad money supply (M_2); this means, among other things, that the composition of resources in the financial system shifted radically from free resources (current accounts do not bear interest in Colombia) to interest-bearing resources, thus increasing the likelihood of liquidity problems if the portfolio declines.

Table 9

COLOMBIA: COMMERCIAL BANK DEBT, 1970-1985

	Total liabilities (millions of pesos)	External credit resources (millions of pesos)	Net worth (millions of pesos)	External third-party liabilities (1-3) (millions of pesos)	External third-party liabilities/ Total liabilities (percentage)	Internal credit resources <4>(2)	Internal credit resources/ External liabilities (percentage)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1970 June	21 365		2 870	18 495	86.6		
December	22 996		3 302	19 694	85.6		
1971 June	25 348	7 022	3 632	21 716	85.7	14 694	67.7
December	25 533	7 071	3 860	21 673	84.9	14 602	67.4
1972 June	29 544	8 901	4 243	25 301	85.6	16.400	64.8
December	31 684	9 011	4 561	27 123	85.6	18 112	66.8
1973 June	38 029	10 090	4 992	33 162	87.2	23 072	69.6
December	44 568	10 114	5 367	39 201	88.0	29 087	74.2
1974 June	50 523	12 537	6 072	44 451	88.0	31914	71.8
December	58 363	20 191	6 740	51 623	88.4	31432	60.9
1975 June	66 466	21 341	7 429	59 037	88.8	37 696	63.9
December	73 992	22 228	8 485	65 507	88.5	43 279	66.1
1976 June	86 925	24 610	9 964	76 961	88.5	52 351	68.0
December	99 008	27 169	11 115	87 893	88.8	60 724	69.1
1977 June	127 021	24 199	12 780	114 241	89.9	90 042	78.8
December	138 151	27 483	14 073	124 078	89.8	96 595	77.8
1978 June	170 212	29 735	16 193	154 019	90.5	124 284	80.7
December	178 181	29 725	19 566	158 615	89.0	128 890	81.2
1979 June	251 047	31 092	22 005	229 042	91.2	197 950	86.4
December	252 376	49 412	25 714	226 662	89.8	177 250	78.2
1980 June	300 178	57 967	29 771	270 407	90.1	212 440	78.6
December	362 281	73 579	35 697	326 584	90.1	253 005	77.5
1981 June	409 873	79 590	40 187	369 686	90.2	290 096	78.5
December	491 634	91 026	47 227	444 407	90.4	353 381	79.5
1982 June	558 496	108 783	51 181	507 315	90.8	398 532	78.6
December	594 176	118 438	60 292	533 884	89.8	415 446	77.8
1983 June	685 682	161 181	61466	624 216	91.0	463 035	74.2
December	758 026	167 331	68 672	689 354	90.9	522 023	75.7
1984 June	837 968	195 579	71 039	766 929	91.5	571 350	74.5
December	909 494	206 824	71 563	837 931	92.1	631 107	75.3
1985 June	1 018 559	232 355	75 996	942 563	92.5	710 208	75.3
December	1 182 232						

Source: (1) *Revista del Banco de la República* (January 1986), 1970-1985, table 3-1.2.

(2) Calculations based on data of the Banking Association of Colombia (1985), table 5, p. 22.

(3) As for (2), but on the basis of data from table 4, p. 20.

Similarly, the relative availability of credit in the economy increased considerably from an M_2 /GDP ratio of 18.9% in 1970 to 34.1% in 1985. The financial sector then had to deal with three basic factors: a larger relative volume of resources to invest, a higher average cost of their resources resulting from the increase in the proportion of interest-bearing over current accounts, and a sharp rise in the interest rates paid and charged.

The greater availability of domestic resources also changed the internal and external proportions of the financial sector's debt. The only Colombian intermediaries authorized to incur debt in foreign currencies are the commercial banks and financial corporations (investment banks).⁵

Since in Colombia the total debt (or third-party liabilities) of financial intermediaries is regulated by law, it is not surprising that the ratio of commercial bank debt should have shown a slight but sustained increase between June 1970 and June 1985 from 86.6 to 92.5% (table 9, column (5)).

The proportion of domestic resources in the total bank debt moved cyclically (table 9, column (7)), depending on the greater or lesser degree of access to external credit determined by the government by means of the exchange controls which have been in force in Colombia since 1967. Between 1975 and 1979 the proportion of national resources increased sharply from 60.9 to 86.4% in step with the expansion of the national financial saving described above, which resulted from a coffee boom and reduced recourse to foreign loans. Between 1979 and 1983 there was a decline in the relative proportion of domestic resources (to 74.2%) owing to greater flexibility on the part of the government with respect to external debt. This trend was checked by the international crisis of 1982-1983, since when the reluctance of foreign banks to increase their loans to the third world has held the figure at about 75% for the commercial banks.

Table 10 demonstrates in another way the increasing dependence of the banking system on

⁵Since the distribution of the business debt between obligations in national and foreign currency shows no permanent change, it is concluded that the enterprises resorted increasingly to direct borrowing.

Table 10

COLOMBIA: RATIO OF INTEREST-BEARING INTERNAL RESOURCES" TO PRODUCTIVE ASSETS OF BANKING SYSTEM,* 1970-1984

	Percentages
1970	25.5
1971	30.6
1972	31.4
1973	32.2
1974	39.7
1975	47.3
1976	49.3
1977	54.0
1978	60.7
1979	60.2
1980	60.0
1981	63.6
1982	74.0
1983	70.8
1984	76.2

Source: Carrizosa (1985), pp. 110-111

*Savings deposits, time certificates of deposit, and resources of the Bank of the Republic.

^bLoans, discounts, various debtors and investments.

interest-bearing domestic resources —with consequences which were to emerge in the crisis of the 1980s.

The performance of financial corporations was similar to that of the commercial banks with regard to their total level of debt, which increased steadily from 77.8% in 1970 to 88.3% in 1985 (table 11, column (5)). The composition of this debt remained relatively stable up to 1978: domestic resources accounted for 85.89% of it between 1970 and 1978; this proportion subsequently declined to 61.5% in 1985. The financial corporations were less able to attract domestic savings and became increasingly dependent on external resources channelled through the Bank of the Republic to finance imports of capital goods. This dependence was to have serious consequences for them with the speed-up of the devaluation initiated at the end of 1984 as part of the adjustment programme agreed with the International Monetary Fund (IMF).

When their borrowing became 100% dependent on interest-bearing resources, the financial corporations found themselves in the same situation as other non-banking intermediaries: the savings and housing institutions and

the commercial finance companies. Accordingly, the crisis in the real-estate sector had a serious effect on the liquidity and even the solvency of some of them, as will be discussed in section III.

Table 11

COLOMBIA: FINANCIAL CORPORATION DEBT, 1970-1985

(Millions of pesos)

	Total liabilities	External credit resources	Net worth ^a	External liabilities (D-3)	External liabilities/ Total liabilities (percentage)	Internal credit resources (4)-(2)	Internal resources/ External liabilities (6)/(4) (percentage)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1970	8 891	813	1975	6 916	77.8	6 103	88.2
1971	11 241	1 271	2 323	8 918	79.3	7 647	85.7
1972	14 052	1 352	2 533	11 519	82.0	10 167	88.2
1973	15 899	1 694	3 173	12 726	80.0	11 032	86.7
1974	19 353	2 221	3 681	15 672	81.0	13 451	85.8
1975	24 481	2 731	4 415	20 066	82.0	17 335	86.4
1976	31 908	2 965	5 220	26 688	83.6	23 723	88.9
1977	44 997	4 218	6 080	38 917	86.5	34 699	89.1
1978	57 619	6 878	8 938	48 681	84.5	41 803	85.9
1979	70 039	9 774	10 696	59 343	84.7	49 569	83.5
1980	105 536	18 678	13 463	92 073	87.2	73 395	79.7
1981	142 919	25 561	16 711	126 208	88.3	100 647	79.7
1982	182 537	37 056	27 952"	154 585	84.7	117 529	76.0
1983	220 846	44 790	31 686	189 160	85.6	144 370	76.3
1984	265 391	75 189	35 593	229 798	86.6	154 609	67.3
1985	385 261	130 985	45 094	340 167	88.3	209 182	61.5

Source: (1) 1970-1977: Manager's report, statistical annex, pp. 80 and 64.

1978-1985: *Revista del Banco de la República*.

(2) 1970-1977: Manager's report, statistical annex.

1978-1985: Manager's annual reports to the Management Board.

(3) 1970-1971: *Ibid* (1). Net worth = paid-up capital + legal reserve + contingency reserves + year's profits.

1972-1977: Net worth = paid-up capital + legal reserve + contingency reserves.

1978-1985: *Revista del Banco de la República* and Manager's reports.

"The increase is due to the Government's contribution to Financiera Eléctrica Nacional (FEN).

II

Reasons for the internal debt

It is now necessary to offer an interpretation of the debt trends identified in the previous section and to examine their effects on the productive sector. With this purpose in mind, a presentation will now be given of the fundamental factors which determine the choice between debt and capitalization and the composition of the debt according to its origin (internal or external). This model will then be used to analyse the possible behaviour of demand and supply of domestic credit. At the end of the section an account is given of the effects of the increased debt on the productive sector and of the role played by the higher interest rates at the end of the 1970s and the recession in the first half of the 1980s.

1. *Determination of the structure of the financing of capital*

The most widely studied topic in the literature on the financial structure of enterprises is the distinction between owned capital and debt. The essence of this distinction lies in the rights of ownership pertaining to each form of financing. The value of and return on owned capital depends directly on the performance of the enterprise. In contrast, the factors which determine the value of and return on the debt are mainly a function of supply and demand in the credit market and are relatively independent of the performance of the enterprise. The link between the financial terms of the debt and the debtor enterprise is constituted by a risk premium covering the likelihood of inability to meet third-party obligations. But in any event it is significant that the agreed terms of the return on and value of the debt capital are relatively independent of the results achieved by the enterprise, which instead affect the value of dividends or the share price. In other words, the interest which an enterprise must pay or the debt capital which it must repay do not decline if its results deteriorate — a factor which imposes inflexibility in financial management.

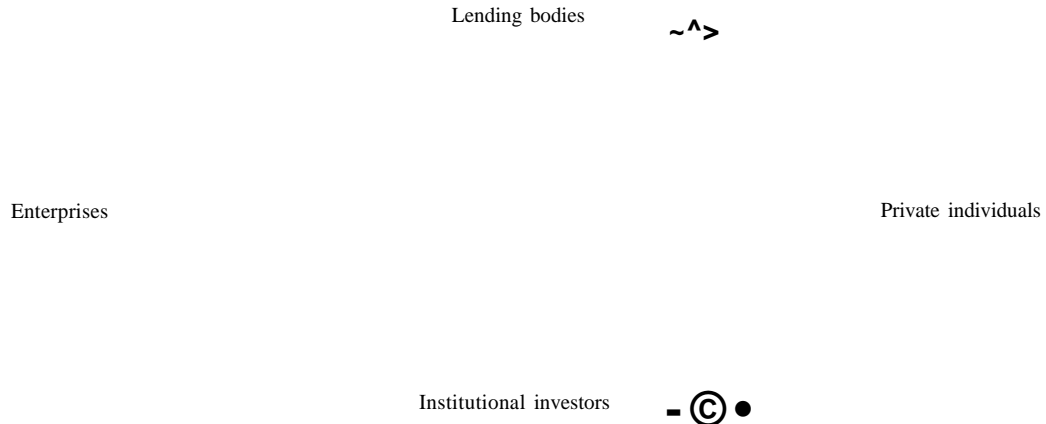
These two main options with respect to the structure of a company's assets basically reflect the alternative ways in which private individuals can finance business capital. This point is illustrated in the figure. A personal financial portfolio may consist of shares or bonds. These bonds or shares can be issued directly to individuals by the enterprises or initially to financial intermediaries and institutional investors. Broadly speaking, there are four main ways of financing. First, individuals may hold shares in corporations; second, they may hold instruments from institutional investors which in turn invest in company shares; third, individuals may hold company debt; and fourth, they may hold bonds and deposits in financial bodies which lend directly to enterprises. There are of course other means of financing capital which are not shown in the figure (for example, institutional investors can buy bonds instead of shares). But these four ways are the most important for the purposes of this study.

Within debt or business ownership there are other distinctions which must be pointed out. There are different types of stock (common or preference for example); different types of stock holders (natural persons, private juridical persons, public sector bodies); different types of debt (internal or external, long- or short-term); and different types of borrower. For the purposes of this study, which is concerned basically with domestic business debt, the theoretical analysis must be conducted in two stages, examining first the factors determining the total debt of enterprises and then the distribution of this debt between foreign and domestic debt.

a) *Issue of shares or contraction of debt*

The traditional approach to the study of the structure of the assets of an enterprise, either its net worth or its debt, is based on the familiar theory of the cost of capital. This theory analyses the factors which determine the cost of capital in the two financing options, with a view to comparing the incentives for choosing one or the

Figure
PRINCIPAL METHODS OF FINANCING CAPITAL



other. The concept of the cost of capital makes it possible to determine the cost to an enterprise of the resources obtained by borrowing and of those obtained by issue of shares. A basic analysis indicates that the interest rate is the fundamental variable, but this answer oversimplifies a problem which becomes very complex when the effects of taxation, inflation and distribution of profits are taken into account.

The role of these variables can be evaluated by means of a simple example which illustrates the concept of cost of capital: a businessman has to decide whether he should buy machinery to increase his production capacity. Assuming that there is no inflation or taxes, that our businessman distributes to himself all the profits, that he cannot place shares on the market and that his physical assets do not depreciate, it can be concluded that the cost of the capital is simply the interest rate in the credit market. This cost indicates the minimum additional amount which the new machinery must produce to justify borrowing to expand the operation. If the machinery does not produce this minimum, the businessman would do better to maintain his present production level or seek a more profitable line of activity.

When the effects of taxation (personal and company) and of inflation are included in the

analysis, the cost of capital for the issue of share (X_a) is calculated as follows:

$$X_a = \frac{r - q - I - qc}{-} \quad (D)$$

where r is the nominal interest rate, q is the inflation rate, c is the rate of capital gains tax, and

$$f = (1 - t) [1 - (p u + (1 - p) c)] \quad (2)$$

where t is the rate of company tax, q is the rate of tax on natural persons, and p is the distributed proportion of profits. The cost of capital financed by borrowing (Auerbach, 1983, pp. 905-940) is:

$$X_a = \frac{r}{1 - u} + \frac{q}{1 - u} + \frac{v}{1 - t}$$

It is to be expected that at the margin the two financing alternatives have the same cost. However, it is not clear which is the variable (or set of variables) to be adjusted to equalize these costs when the tax levels or inflation rate vary. In the model described the possibilities are limited to

This formula assumes that all interest is deductible but dividends (distributed profits) are not.

the discount rate or the proportion of distributed profits. To give an example, an increase in the company tax rate increases X_a and reduces X_j . Given a total distribution of profits (i.e., $p = 1$), the effect of an increase in r would be greater on X_a than on X_j , so that the equalization of the two would require a reduction of r . However, there is no need to dwell on this point for the purposes of this study. It is sufficient to point out, returning to the example, that an increase in t will stimulate borrowing and that it is this effect which one should seek to corroborate in the figures presented in the previous section.

It is necessary to indicate the expected effects of changes in the interest rate, the inflation rate and the tax rates. To facilitate the analysis it is assumed that companies distribute all their profits and that capital gains due to inflation are not taxed. Given these assumptions, an increase in the interest rate, with the inflation rate remaining constant, will increase the cost of issuing shares more than the cost of borrowing. The reason is that part of this increase is deductible as a cost in the case of borrowing, but it is not deductible when the return on capital is paid as dividends. To put it another way, profits are taxed twice and interest is taxed only once, so that an increase in the real interest rate increases the cost of share issues more.

In contrast, the effect of an increase in inflation, with the real interest rate remaining constant (i.e., $r - q$), depends on the values of company and personal tax rates. If the company rate is higher than the personal rate, the cost of borrowing goes down. The opposite happens if the personal rate is higher than the company rate. An increase in the inflation rate, given the assumptions described above, has no effect on the cost of capital through share issues, since it has been assumed that capital gains due to inflation are not in fact taxed.

An increase in company taxation increases the cost of borrowing less as it also generates, in this case, a deduction. But the heavier taxation increases even further the double taxation of profits distributed as dividends. On the other hand, an increase in the personal tax rate increases the cost of borrowing more, for it taxes at the personal level the inflationary movement of interest rates. The validity of this last conclusion depends of course on interest actually being

subject to personal taxation. This assumption is debatable in the case of Colombia, where the evasion of taxes on interest income seems to be greater than in the case of dividend income.

b) *Internal borrowing as against external borrowing*

The analysis so far has been concerned with the distribution of business liabilities between debt and capitalization, with the implicit assumption of homogeneous borrowing alternatives. However, one of the main purposes of this study is precisely to study the behaviour of domestic borrowing.

In the Colombian economy the distinction between domestic and foreign borrowing is virtually the same as that between debt in the national currency and debt in foreign currency, although there are some lending operations in the national currency using external resources, when the exchange risk is assumed by the Bank of the Republic.

In a credit market with no artificial or institutional restrictions on quantities or prices (interest rates for example), with absolutely certain forecasts of exchange rate movements, and with equality of tax treatment, businessmen would not care whether they borrowed in the national currency or in foreign currency, for the interest rate in the national currency would be equal to the sum of the external interest rate and the accurately forecast devaluation. However, if the forecast of devaluation is only slightly out, it is no longer a matter of indifference whether the debt is acquired in one or the other type of currency. For an enterprise whose prices are not adjusted in step with the exchange rate, the risk of losses through external borrowing is greater than for an enterprise with an internationally marketable product. Furthermore, there may be major restrictions on access to the different types of credit, and this factor is of greater importance in the case of Colombia. At times in the past institutional factors have determined access to credit in the national currency; at other times, the exchange rate policy or the credit policy of international lending bodies have limited the use of external resources. It is therefore necessary to review both the devaluation pattern in Colombia and the various policies

which have restricted the market in one way or the other during the last 20 years.

Colombia of course has been using the system of crawling peg devaluation since 1967. The devaluation rate is adjusted according to the availability or otherwise of foreign exchange. Up to 1975 the devaluation in real terms was fairly rapid and designed to increase the supply of foreign exchange following its sharp decline in the mid-1960s. During the second half of the 1970s real devaluation was slow (negative, in fact), because coffee and other products (including narcotics) generated an abundant supply of foreign currency. But from 1983 the devaluation was rapid as a result of the foreign exchange crisis which occurred in that year. The year of sharpest devaluation in this latter period was 1985, with a fall of 50% in the value of the Colombian peso without precedent in the crawling peg period. This episode had probably been anticipated by businesses for some time, although there had been doubt as to the precise moment when it would occur.

With regard to institutional restrictions, those of internal origin are due to the monetary policy, usually preoccupied with the possible effect on the monetary sector of foreign exchange obtained by external borrowing. In the second half of the 1970s when it was assumed that the slow rate of devaluation would stimulate the demand for credit in foreign currency, this demand was limited by the restrictions introduced by the Monetary Board. In the 1980s the limitations originated instead in the foreign lending institutions, which wished to make a sizeable reduction in their loan expansion in the Latin American area in general. Colombia was affected by this change in the perception of the risk, although it fared better than some other countries of the region.

Lastly, attention must be drawn to an important difference between the tax treatment of the cost of external debt and the treatment of the cost of internal debt. Up to 1978 the exchange rate adjustment of the external debt incurred to provide working capital was not accepted as a deduction. In contrast, the interest on borrowing in the national currency has always been fully deductible. This creates an imbalance in the determination of the cost of the debt, depending on whether it is in foreign or the national currency.

2. *Stimulation of the demand for credit*

Using equations (1) and (3) it is possible to calculate the evolution of the theoretical cost in Colombia of capital for corporations, depending on whether it is financed by borrowing or by share issues. This calculation was made in Carrizosa (1986). His results in the case of total distribution of a corporation's profits are given in table 12. This shows that the cost of capital obtained by share issues has usually been higher than the cost of capital obtained by borrowing. It is now necessary to analyse the reasons for this constant discrepancy.

Before 1953 there was no double taxation of profits in Colombia. Corporation shareholders paid no taxes on the dividends they received, but the corporations did pay taxes on their profits at progressive rates. Furthermore, limited liability companies did not pay taxes, while their shareholders paid income tax on their holdings in these companies. Both companies and natural persons were also affected by the tax on excess profits and other surtaxes which formed part of the taxation of income. Even though there was no double taxation before the 1953 reform, the cost of borrowing was still lower at that time than the cost of share issues. This was due to inflation (a phenomenon which increases the tax advantage of borrowing when interest payments are fully deductible) and to the low nominal interest rates up to 1974. With the 1953 reform the relative advantage of borrowing increased significantly, for this reform, in addition to introducing double taxation, increased the tax rates applicable to corporations more than those applicable to natural persons. Double taxation reduced the tax advantage of dividends; the greater increase in the company rates increased the effect on company taxes of the deductibility of interest payments.

From the 1953 tax reform up to the 1960 reform inflation increased the tax rates applicable to each level of the real income of natural persons and companies. An increase in the company tax rate increases the relative advantage of borrowing; an increase in the personal rate decreases that advantage, for it is applied to the totality of interest payments but does not affect the portion of profits already taxed in the corporation. The net effect of these forces reduced the relative advantage of borrowing for natural per-

Table 12

**COLOMBIA: THEORETICAL COST OF CAPITAL FOR A CORPORATION,
ACCORDING TO SHAREHOLDER INCOME^a**

Year	Share issues			Debt		
	Income of one million pesos (1)	Income of 2.5 million pesos (2)	Income of 10 million pesos (3)	Income of one million pesos (4)	Income of 2.5 million pesos ^b (5)	Income of 10 million pesos (6)
1953 ^c	4.18	4.18	4.18	1.40	1.98	3.08
1953 ^d	5.02	5.41	6.48	-0.31	0.77	3.77
1960 ^c	5.40	6.20	7.03	-0.21	2.40	4.69
1960 ^d	5.60	6.44	8.06	-1.17	1.00	5.16
1967 ^c	10.48	12.83	14.09	3.28	7.51	9.78
1967 ^d	10.88	13.22	14.57	4.00	8.22	10.65
1974 ^c	9.16	9.61	11.06	5.86	8.07	15.18
1974 ^d	8.93 (20.83/	11.79 (27.52)	14.20 (33.14)	-0.60	12.58	23.67
1982	28.25	32.68	37.88	17.66	26.96	37.88
1983 ^e	16.67	18.71	19.58	3.82	10.94	13.41
1985	16.67	18.70	19.58	4.59	11.18	14.54

Source: Carrizosa (1986), p. 75.

^aA total distribution of profits is assumed.

^bConstant 1985 pesos.

^cBefore that year's tax reform.

^dAfter that year's tax reform.

^eThe percentages in brackets assume a capital gains tax of 20%.

sons with high incomes, while the effect of inflation on the rates applicable to low incomes was insignificant.

The 1960 tax reform lowered the rates applicable to natural persons (except in the case of high incomes) and raised those applicable to companies, so that the relative advantage of borrowing was again increased. The positive effect of cumulative inflation on the real tax rates applicable to natural persons reduced this advantage between 1960 and 1967, as did the increases in these rates announced in 1967. Between 1967 and 1974 inflation and interest rates increased, and cumulative inflation again increased the tax rates applicable to each level of the real income of natural persons. This latter effect again reduced the advantage of borrowing, even though the greater increase in inflation as opposed to interest rates partially offset the

effect of heavier personal taxation on the cost of borrowing. The 1974 tax reform increased the tax rates applicable to medium and high incomes and reduced even further the advantage of borrowing, except for low incomes; this effect would have been greater if it had not been decided at the same time to raise the rates applicable to company profits. Between 1974 and 1982 the effect of cumulative inflation on personal tax rates again reduced the tax advantage of borrowing, but the increase in interest rates had a greater impact on the cost of obtaining capital by issuing shares, because the alternative of borrowing permitted the deduction of interest payments. Accordingly, the net advantage of this latter option was maintained. Subsequently, the 1983 reform eased the burden of double taxation on dividends and personal taxation of interest, with a net result in favour of borrowing.

The figures in table 12 show that the theoretical cost of issuing shares has generally remained above the theoretical cost of borrowing. In view of the additional fact that personal taxation of interest is more easily evaded than personal taxation of dividends, the advantage of borrowing over share issues is even greater. This advantage explains to a great extent why in Colombia companies have sought to borrow in the form described in the previous section.

Another less familiar aspect of the problem is the role played by borrowing as a means of restricting shareholding in companies and isolating them from control by small savers. Use of this mechanism is stimulated by increases in tax rates, for tax evasion is easier through close companies.

Although information about the distribution of the business debt between national and foreign currencies is very limited, the figures presented above in table 3 suggest that this distribution has undergone no permanent changes. The analysis of the choice between the two modes of debt should also take into account the changes both in the degree of exchange risk and in the access to the two types of resource. Moreover, *ex post* devaluation affects the true cost of external debt, an aspect reflected in the changes observed in the borrowing pattern. It was seen earlier that the relative importance of private external borrowing declined between 1975 and 1978, owing mainly to two factors: firstly, the slower rate of devaluation in the period reduced the increase in the peso value of the existing external debt; secondly, although this slower rate of devaluation increased the demand for external credit, the financial policy limited access to these resources, in order to check the accumulation of international reserves, a phenomenon which was threatening monetary stability.

It is also of interest to analyse the period 1982-1985. The available figures indicate that in this period the dollar debt stabilized and then fell. This was helped both by the greater perceived risk of sudden devaluation and by the gradual hardening of attitudes towards Latin America in the external credit markets. However, the peso value of this debt increased more quickly than the debt contracted in the national currency, owing to the rapid rate of devaluation.

Little more can be said on the basis of the global figures available. It seems clear, however, that the distribution of the debt between foreign and national currencies is very sensitive to the provisions of financial policy, the effective devaluation rate and the access allowed by external lending bodies. Nor is it surprising that, on average, the relative importance of external resources has undergone no permanent change.

3. Institutional aspects of the provision of credit by the financial sector

The financial reforms of the first half of the 1970s increased considerably the volume of financial savings and the numbers and types of bodies involved in intermediation. There was an explosion in financial activity and a proliferation of all kinds of enterprise, some regulated by the Office of the Superintendent of Banks and others under no kind of control seeking to attract personal savings by offering high real interest rates; these bodies, as has been indicated, were no novelty in Colombia (Carrizosa, 1985), for even before the 1970s there were high real rates in the free money market. The novelty lay in permitting (initially the savings and housing institutions in 1972 and thereafter the whole financial system) to pay high real positive interest rates for financial savings. The result was a dramatic increase in the ratio of M_2 to GDP, which almost doubled during the last 15 years (table 8).

The great increase in the acquisition of savings by financial intermediaries had a number of important consequences both for share values and for the concentration of loans, the proliferation of intermediaries and the quality of their portfolios.

a) Decline in share values

Since the country did not have a stock market with big institutional investors capable of appreciating the impact of such factors as net worth or profitability on the intrinsic value of shares, share prices came to depend on the capacity of a corporation to pay the small or medium saver a dividend competitive with the interest rates offered by financial intermediaries.

The increases from 1972 in the real interest rates offered to the saver by financial bodies had a devastating effect on shares: "in 1965 they accounted for 59% of the value of transactions on the Bogotá Stock Exchange; in 1970 the proportion was still 57%; in 1975, 25%; in 1980, 14%; and in 1982, 5.5%" (Figueroa, 1983, p. 6).

Corporations tried to protect themselves by distributing a larger proportion of their net profits, from 64.4% in 1970 to 77.3% in 1982 for the sample studied. "Despite this, and as was to be expected, dividends alone could not make shares competitive. Therefore, the share price index deflated by the index of implicit GDP prices shows a steady deterioration after the establishment of double taxation in the 1950s." (Figueroa, 1983, p. 6).

Between 1970 and 1975 the decline in the real value of shares worsened to a level between 23 and 33% lower than the 1970 level, reflecting the new interest rates paid from 1972 by the system which operated with units of constant purchasing power and by the financial system as a whole from 1974.

The real depreciation of share values brought their market prices down to a level much below their intrinsic value; this attracted the interest of business groups which saw a good opportunity to acquire the country's big open corporations at low cost, taking advantage of the fact that the shares of these companies were held by a large number of small and medium investors who were interested only in dividends, which were becoming increasingly less competitive with the interest rates offered by the financial sector.

From the 1970s Colombia underwent an intense process of concentration of the ownership of its main corporations.

Many of the company acquisitions in this period were made by industrial-financial conglomerates using resources obtained from the public at high real interest rates. It was assumed that these acquisitions would provide bigger profits than dividends alone by concentrating within the group a whole series of sources of profit (insurance, deposits, etc.); this situation, together with windfall profits from the sale of the fixed assets of the acquired enterprises, enabled the group to pay the interest to the savers and make a good profit in the process.

Lastly, the small size and the inadequacy of the national market in shares meant that real share values were weakened by measures such as double taxation and the freeing of interest rates, which in turn stimulated high-risk speculation with the public's savings.

The government was worried by the implications of this process and in 1979 it set up the National Securities Commission to regulate the acquisition of companies in the Stock Market and the public offer of securities in general; but it was too late, because an enormous volume of assets had already been taken over by a few conglomerates whose consolidated debt level through the process known as "pyramidation" was very high. These conglomerates, just like the independent companies which entered the 1980s with high levels of debt, proved to be incapable of withstanding the economic slowdown which began in 1980, as will be seen below.

b) *Concentration of loans*

The abundance of resources and financial intermediaries created strong competition in lending to clients who could show "in the books" sufficient profit margins to be able to pay the high interest rates charged by the intermediaries. Many of these intermediaries lacked the extensive banking networks needed for the wide distribution of their loans among consumers and small and medium enterprises or a wide geographical distribution, and accordingly they concentrated their lending on the more dynamic enterprises of the non-financial sector. As the fixed assets of these enterprises were mortgaged to the bodies which had acted as intermediaries in their acquisition (banks or corporations), the new loans were usually granted them without real guarantees, and this was to have a devastating effect in the future, as will be seen below.

The problem of excessively high debt levels in the balances of productive enterprises was solved by ingenious accountants by means of "commercial" revaluations of the fixed assets; the inclusion of this increased value in the net worth secured a considerable reduction in the companies' apparent debt. This method was also used by the financial bodies, as will be seen below, and its dangers came to light when later many of these assets had to be accepted instead

of payment, revealing the unreality of many "commercial" valuations.

What was even more serious, the competition among intermediaries in the swift and wholesale investment of their abundant and costly resources caused them to accept as standard practice the constant refinancing of short-term loans, so that loan applications were considered only on the basis of the clients' capacity to pay the interest but not to repay the capital. When the economy slowed down at the end of the 1979 coffee cycle and the banks began to find that their clients were having difficulty in paying the interest on time, they realized with alarm that it would be even less possible for them to repay the principal and that the high level of debt meant that the owners of the debtor enterprises were not interested in saving them with injections of capital. In other words, by concentrating its lending on a relatively small number of enterprises, the financial sector would end up as their owner when the cyclical decline of coffee affected the profit levels of the non-financial sector in the 1980s.

c) *Proliferation of intermediaries and taxation difficulties*

The proliferation of intermediaries and their offices made it impossible for the Office of the Superintendent of Banks to exercise effective control over their activities. This body had been set up in 1923 in order to carry out extensive, detailed and frequent audits of a fairly small number (20) of banks and insurance companies. With the passage of the years it acquired all kinds of supervisory functions for such dissimilar bodies as urban development corporations and stockbrokers.

In the mid-1970s the Office was supervising more than 300 bodies with 2 500 offices. However, its machinery for visits, analysis and control remained the same as in 1930, despite the increasing systematization of financial bodies. Accordingly, the Office could neither detect nor prevent the abuses, self-loans and theft which some unscrupulous businessmen committed with the public's savings, not to mention those which occurred in enterprises not supervised by the Office which also sought to attract public savings on a massive scale and quite irresponsibly

at very high real interest rates (20% and above). This led the government in 1982 to decree it a crime for bodies to acquire the public's savings on a massive and regular basis unless specifically authorized to do so, but it was too late.

Over the years the Office has had to intervene in and administer the bankruptcy of 32 financial bodies, and it was not equipped for this task either. The government has now instituted a thorough reform of the Office, including a reduction of the number of bodies supervised and of reports required, total systematization of data handling, and an improved programme of training and remuneration for the staff, now mostly young and with a high turnover rate. There is no doubt that many of the problems of the financial sector (such as laxity in granting loans, illegal self-loans, theft, etc.) could have been avoided if the Office of the Superintendent of Banks had been modernized ten years earlier.

d) *Inadequacy of accounting regulations*

Just as there was no proper machinery for control of financial bodies, so the country had no clear and comprehensive regulations governing the accounting of enterprises in the productive sector; there were big gaps in the interpretation of the accounting regulations in critical areas (such as the treatment of the effects of inflation on balances and profit and loss statements, presentation of suspense accounts, etc.) which gave accountants and auditors a wide margin of discretion; this prompted unscrupulous businessmen to use accountants and auditors who were "broad-minded", when not frankly dishonest. This is what creditors found when they came to check the truth of the financial statements of their defaulting debtors, and many prosecutions resulted.

The administrative inadequacy of the Office of the Superintendent of Companies, responsible for supervision and control of corporations and the larger limited companies was, in conjunction with the ineffective accounting rules, another critical factor in the errors committed by the banks when they made loans on the basis of these massaged financial statements. As in the case of the Office of the Superintendent of Banks, the Office of the Superintendent of Com-

Table 13
**COLOMBIA: DISTRIBUTION OF INVESTMENT INCOME, REAL
 INTEREST RATES, AND DEVIATION OF GROSS DOMESTIC
 PRODUCT WITH RESPECT TO THE TREND
 GENERATED BY POPULATION
 GROWTH, 1970-1983**

(Percentages)

Year	Dividends and profits/ Income from property (private company) (1)	Real interest rate (2)	GDP deviation owing to population trend (3)
1970	60.0	2.5	(5.5)
1971	57.1	5.2	(4.3)
1972	63.3	2.3	(1.4)
1973	63.9	(1.1)	1.0
1974	66.7	0.4	2.8
1975	59.6	0.2	1.2
1976	61.1	3.1	2.0
1977	62.4	1.7	2.2
1978	57.7	3.8	6.7
1979	54.6	8.4	8.2
1980	52.7	9.6	8.6
1981	46.5	12.4	7.2
1982	45.1	13.0	4.5
1983	44.5	8.8	1.8

Source: (1) DANE, National Accounts of Colombia: income and expenditure accounts of private non-financial enterprises.

(2) Carrizosa (1985), p. 96.

(3) Logarithmic regression of the gross domestic product in terms of population.

panies did not have the technology nor did it give its poorly paid staff sufficient training to cope with the enormous increase in the number and complexity of the enterprises under its supervision; this does much to explain investors' mistrust of the statements of net worth made by companies and of the reliability of valuations as a factor in determining share values in addition to distributed dividends.

In 1986 the government issued Decree 2160 on accounting regulations, with a view to correcting the most obvious shortcomings in this area, although this did not provide any basic solutions to the thorny problem of the accounting of inflation.

4. *Effects on the productive sector*

One of the interesting problems caused by the increase in borrowing discussed here relates to its effects on the performance of the productive

sector. The point which has to be examined, therefore, is the effect of debt on the likelihood of the enterprises becoming bankrupt. A high level of debt increases the risk of bankruptcy as a result of recession or higher interest rates. It must be assumed that the high bankruptcy rate is inversely related to the proportion of profits in total investment income for the economy as a whole. The lower this proportion, the higher the probable number of bankruptcies.

The value of this proportion from 1970 to 1983 is given in table 13, column (1). Column (2) of the table gives estimates of the real interest rate. Column (3) indicates the percentage difference between the value of the GDP and the long-term GDP trend associated with population increase. In the period under study there were two stages of vigorous economic growth (1970-1974 and 1976-1980), one short recession in 1975 and another long one from 1980 onwards.

It is interesting to analyse this latter recession. The figures in the first column of the table show both the high level of debt and the effect of the economic recession and the high interest rates on profits since 1980. For many enterprises the recession meant losses which prevented them from meeting their obligations to the financial system. The coincidence of sharp recession, high real interest rates and high levels of debt produced a situation in which part of the productive sector could not remain solvent and transferred its losses to the lending bodies, making them pay for the risk they had incurred by lending without due caution, with the support by omission of an Office of the Superintendent of Banks which was incapable of evaluating the ratio of capital to risk assets in these lending bodies.

By contrast, the relatively low debt indices of earlier decades enabled enterprises to absorb the blows of recession with less financial damage. The Colombian economy had undergone profound recessions in the past (in 1967, for example), but it had never before experienced such widespread bankruptcy. Not since 1950 had the

banks had such high indices for their matured or doubtful debt portfolios. This point will be considered in the next section.

From another standpoint, it must be wondered whether the phenomenon of bankruptcy has a feedback effect on the productive sector. An enterprise which cannot pay its obligations to the banks and goes bankrupt ceases to produce; although its operations may continue to be profitable, the enterprise is not institutionally viable, owing to the conflict of entitlement which the bankruptcy proceedings have to settle. The result can be different in a well-capitalized enterprise since the losses are absorbed by the shareholders, for whom the loss on the share's value may be temporary in the case of an enterprise viable in the long term. It is very difficult to determine how many bankrupt enterprises in Colombia could have continued to operate if they had a solid capital base instead of being converted into scrap or distrained and mortgaged goods awaiting the unfolding of the whole gamut of legal and institutional procedures involved in bankruptcy.

III

Role of company debt in the difficulties of the financial sector during the 1980s

1. *Evolution of the portfolios of finance bodies*

In earlier sections we saw how the joint effect of an unlimited demand for credit on the part of the non-financial sector and a great increase in the resources available in the financial sector owing to the 1972-1974 reforms pushed the borrowing of the country's main non-financial enterprises to very high levels at the beginning of the 1980s.

We also saw that the profit margins of companies in the productive sector began to fall as a result of the slower growth rate, so that these companies could not continue to pay the high real interest rates prevailing in the country. The over-borrowed enterprises then began to fall behind in their interest payments and this problem was initially solved by the finance bodies

through the continual refinancing of principal and interest, increasing even further the debt levels of their clients. This was due to the need not to leave the portfolio hanging due, for otherwise these items would have to be included among the doubtful debts. Under Colombian law, debts not backed by real guarantees have to be covered by portfolio-protection arrangements equivalent to 100% of the value of the debts plus the interest due but not paid, and the same must be done for that part of the doubtful debts which is not fully backed by real guarantees (mortgages, liens, etc.).

It was explained earlier that the finance bodies had granted loans to many over-borrowed enterprises without real guarantees, for these enterprises were usually mortgaged to the creditors who had financed the construction or

Table U
**COLOMBIA: PROPORTION OF MATURED AND DOUBTFUL
 PORTFOLIOS IN THE TOTAL PORTFOLIO, 1970-1985**
 (Percentages)

Year	Commercial banks		Financial corporations		Commercial finance companies		Savings and housing institutions	
	Matured portfolio	Doubtful portfolio	Matured portfolio	Doubtful portfolio	Matured portfolio	Doubtful portfolio	Matured portfolio	Doubtful portfolio
1970 June		3.1						
December		2.6						
1971 June	6.6"	2.6						
December	6.2"	2.5						
1972 June	5.3"	2.7						
December	5.3"	2.9						
1973 June	5.4°	3.1	1.9					
December	4.6°	3.5	1.6*	6.5				
1974 June	4.6°	3.5	1.6					
December	6.0 ^a	3.0	2.3	5.9				
1975 June	5.4"	4.0	2.5	5.6			4.9*	0.1
December	4.8°	4.1		6.1			5.1*	0.2
1976 June	4.9 ^a	5.8	3.8	6.1			9.4"	0.4
December	4.5"	4.0	2.3	5.6			10.6*	0.8
1977 June	5.0°	4.8	2.3	5.6			8.4*	0.6
December	4.5°	4.1	2.4	4.0		0.1	11.6*	1.3
1978 June	5.2 ^a	4.2	3.0	3.7			11.5*	2.8
December	4.3	4.2	2.3	3.6		0.4	5.3*	2.3
1979 June	6.1°	3.5	5.1	4.2			6.1	2.2
December	5.2°	4.5	4.7	5.6		0.9	7.8	2.9
1980 June	7.1	3.7	5.5	6.5			8.0	2.3
December	6.2	3.2	3.8	4.8		1.3	7.2	2.3
1981 June	8.1	3.8	4.1	5.6	9.8	1.1	8.8	1.8
December	7.6	3.7		4.1	7.8	1.4		1.4
1982 June	10.1	5.0	5.4	4.7	8.2	1.4	10.4	1.4
December	11.5	7.5	6.6	7.3	10.0	5.0	9.5	1.8
1983 June	13.1	8.8	7.5	8.2	13.4	13.8	8.5	1.6
December	11.4	7.5	10.0	14.4	9.7	15.7	6.6	1.6
1984 June	12.2	10.0	5.4	14.2			8.5	2.4
December	9.5	15.2	7.4	14.2			5.8	2.5
1985 June	12.2	18.7	5.4	14.6			8.5	3.4
December	6.9	16.8	5.2	21.4			4.9	3.6

Source: *Revista del Banco de la República* (January 1986).

"Refers to the banking system, excluding the Caja Agraria and the Banco Central Hipotecario (BCH).

"Refers to loans due as a proportion of total loans and discounts of savings and housing institutions.

import of the fixed assets. Thus the first reaction to the crisis by the financial sector was to close the eyes and refinance, in the hope of an economic recovery. When this did not occur, harassed businessmen continued to request more loans to pay their interest, not to mention the permanent refinancing of the principal.

Finally, the banks had to settle the problem once and for all by leaving the obligations due, in

order to force the businessmen to seek alternative means of recapitalization by punishing them with penalty payments and threats of distraint.

Table 14 shows that in June 1980 the matured portfolio of the commercial banks exceeded for the first time the limit of 7%, without this being reflected at first among the doubtful debts. But given the economic situation,

this alarm signal was not enough, and the banks' matured portfolio continued to increase from that year until 1983; at this level the problem had already become one of accumulated bad debts, as can be seen from their rapid increase from 1982 to a peak of 18.7% in June 1985.

The main reason why the problems were shifted to the area of bad debt and therefore to the profit and loss statements of the financial sector in accordance with the mandatory regulations governing such cases was the sudden proliferation of concordats in the productive sector.

When the banks brought pressure to bear on overextended businessmen by refusing to refinance the interest payments or the principal, the businessmen refused to capitalize their companies owing to the enormous burden of the debt and the uncertainties about the economy's development, and they preferred to use the formula of preventative concordat to protect themselves against the finance bodies and other creditors.

Colombian law provides that once an enterprise requests a preventative concordat with its creditors, the creditors cannot distrain upon it or call in their real guarantees until a decision about the future of the enterprise has been taken by a majority representing not less than 70% of the value of the amount owed. This amount must first be accepted by the enterprise or, in the event of a dispute, determined by a judge.

Throughout this process the owners retain control and management of the enterprise. In many cases they themselves complicate the proceedings (by contesting the validity of debts, for example), so that years can pass without a meeting of creditors capable of taking decisions about the enterprise's future: to liquidate or administer directly.

In some cases the time gained by the businessmen is used to strip the enterprise from within, leaving the creditors with a shell full of liabilities.

The widespread use of the concordat has had enormous effects on the financial sector, for according to the rules of the Office of the Superintendent of Banks, once an enterprise requests a concordat, the debts, *due or not*, are included among the bad debts, with the additional problem that even in the case of obligations backed by real guarantees cover must be provided for 50% of the value of the interest due but not paid.

Accordingly, from 1983 the banks' bad debts have increased more quickly than their matured portfolio.

Finance corporations were affected in the same way as the banks from 1979 when their matured portfolio began to increase until it reached a peak of 10% of the total in December 1983, then declining once more (table 14). As in the case of the banks, the bad debts exceeded the 7% limit for the first time in December 1982, when the Office of the Superintendent of Banks began to demand greater strictness in the treatment of the matured portfolio. After stabilizing for a while at 14% the corporations' bad debts increased to 21.4% owing to a large number of new concordats which, as was explained above, fall directly under this heading even when the obligations are not due.

The savings and housing institutions, thanks to their special regulations which permit them to give only first-class mortgages, did not have the problems of the other financial intermediaries, as can be seen from table 14. Their bad debts did not begin to have an effect until 1984 when the recessionary adjustment policies reduced the ability of wage-earners to service their housing loans, a problem which has grown worse since that time.

The commercial finance companies, which in many cases had concentrated their lending in the same way as the banks (usually without real guarantees in view of the generally short terms of their loans), experienced problems very similar to those of the commercial banks, as can be seen from the sharp increase in their bad debts from December 1982. Their difficulties were greater because, unlike the other financial intermediaries, they lacked direct sources of liquidity in the Bank of the Republic, so that problems of this kind tended to become crises of solvency which led to official intervention and bankruptcy.

2. Evolution of the profitability of finance bodies

The accounting problems described above concerning the treatment of the effects of inflation on fixed assets mean that the concept of the net worth of Colombian companies is an unreliable basis for calculating their profitability; accord-

ingly, we have preferred to work with the concept of gross financial margin as a proportion of productive assets, which excludes from the denominator all kinds of unproductive assets, such as deferred accounts receivable and investments in fixed assets. This relationship is outlined in order to show how the deterioration in the portfolio of finance bodies, which compelled them to provide cover for the interest and principal of their bad debts, was increasingly threatening their profitability. In the case of the commercial banks, the gross profit margin of the investments began to decline from a very high level of 8.2% in 1980 to 3% in 1985 (table 15).

The finance corporations, with more real guarantees in their whole portfolio for the full period of the terms for which they lent a large part of their resources, did not find their profitability affected until a later stage, but the flood of bankruptcies and concordats from 1983 onwards

finally had an even more dramatic impact on them: in 1984 the profit margin was 1.8%, but by 1985 it had turned negative at -1.2%. Their greater relative borrowing in foreign currency became a serious problem when the real devaluation rate increased from 1984.

The fall in financial profit margins was no more than a reflection in the books—in the profit and loss statements—of the portfolio crisis caused by the inability of the productive sector to pay its debts, as was explained earlier; the result was the eventual illiquidity of many finance bodies, complicated by panic on the part of savers when they learned of the bad practices or various kinds of illegal lending in some of the bodies; from 1982 this led to widespread intervention by the government and the establishment of a special legal regime permitting the immediate nationalization of a finance body with the reduction almost to zero of the value of the contributions of the previous owners. By this procedure the government acquired control of the finance bodies of the Grupo Grancolombiano, the biggest group in the country, and of a series of banks, finance corporations, etc., as a result of which the State now controls more than 70% of banking assets.

The difficulties of other banks compelled the government to set up capitalization funds in the Bank of the Republic, through which a large amount of money has been issued to subsidize the capitalization of the financial sector; but this has complicated the management of the means of payment, with harmful effects on an already very unequal distribution of income.

It must be added that although the nationalizations and the acquisition by the State of fiduciary control over a number of large finance bodies saved them from bankruptcy and thousands of savers from losing their deposits owing to the lack of assets to cover liabilities, the cost to the nation has been high. In other cases the Office of the Superintendent of Banks simply ordered the liquidation of the insolvent finance bodies, as was explained above; but as it was not capable of managing the 32 bodies which it had to administer, the Office had serious difficulties in exercising effective control over its own liquidators and in providing due protection for the savers. It must be pointed out that there is no deposit insurance in Colombia and that when a

Table 15

COLOMBIA: RATIO OF THE GROSS
FINANCIAL MARGIN OF BANKS
AND PRIVATE FINANCIAL
CORPORATIONS TO
PRODUCTIVE ASSETS,
1970-1985

(Percentages)

Year"	Banks	Finance corporations
1970	7.8	3.8
1971	6.9	3.8
1972	6.7	3.7
1973	8.9	3.7
1974	7.0	3.9
1975	7.1	4.6
1976	6.9	4.8
1977	6.6	3.5
1978	6.3	3.2
1979	6.9	2.9
1980	8.2	4.9
1981	7.5	6.1
1982	6.6	7.6
1983	6.2	6.2
1984	3.8	1.8
1985	3.0	-1.2

Source: Banking Association of Colombia (1985), pp. 26 and 44.

"June of each year.

financial body finds itself in difficulties, the only alternatives are State control or ownership. In 1985 the National Finance Institution Guarantee Fund came into being with the object of solving the liquidity problems of such bodies before their liquidation or nationalization becomes inevitable; in view of the sector's critical situation, it has been necessary in practice to continue the process of State financial control by means of numerous inputs of capital from the Fund, resources of the Bank of the Republic and the savings of the National Coffee Fund.

Although the National Finance Institution Guarantee Fund has powers to create a system of deposit guarantees, it has not yet done so, owing to the magnitude of the problems and the uncertainty about the real situation of many intermediaries.

3. *De capitalization and concentration*

From the accounting standpoint, the losses of the finance bodies must be set against their paid-up capital and reserves. The sharp variation in

the structure of the net worth of the country's banks is therefore no surprise (table 16). In 1970 the paid-up capital represented 57.7% of the banks' net worth, the legal reserve 33%, the contingency reserves 3%, the book valuation 6.1%, and the exchange rate adjustment 0.02%. In other words, about 94% of the banks' net worth in 1970 consisted of cash inputs or retained profits, while only 6% was provided by the book valuation of fixed assets or foreign currency.

By 1985 the proportions had altered radically as a result of the decline in the profitability of shares; in 1978 the government authorized the inclusion of the book valuation of assets to be included in the net worth in order to comply with the borrowing regulations, with the result that the accounting phenomenon already described for the productive sector was repeated in the financial sector. Shareholders naturally tried to make use of this mechanism before putting in new money, which from 1972 was more profitably invested in fixed-income bonds, as was pointed out above. Accordingly, in 1985 paid-up

Table 16

COLOMBIA: NET WORTH OF THE BANKING SYSTEM, 1970-1985

(Millions of constant 1970 pesos)

End of:	Paid-up capital	Legal reserve	Contingency reserves	Book valuation	Exchange rate adjustment	Total
1970	1 856.3	1 064.1	94.8	195.9	5.7	3 216.9
1971	1 795.9	1 141.9	131.5	175.8	10.3	3 255.3
1972	1 636.2	1 171.7	165.0	193.8	13.2	3 179.9
1973	1 341.2	1 147.1	111.5	191.9	15.9	2 807.8
1974	1 182.8	1 067.2	89.3	220.6	24.3	2 584.3
1975	1 154.6	1 164.1	79.0	273.3	37.4	2 708.4
1976	1 194.2	1 222.4	87.4	266.5	40.9	2 811.5
1977	1 306.1	1 294.4	89.5	296.6	56.3	3 042.9
1978	1 286.7	1 333.1	143.3	625.9	62.6	3 451.6
1979	1 102.8	1 313.0	107.2	956.5	81.8	3 561.3
1980	1 066.6	1 440.9	113.2	1 231.8	126.7	3 979.1
1981	910.4	1 381.5	161.3	1 673.0	194.4	4 320.4
1982	844.9	1 235.9	159.6	1 987.3	271.7	4 499.4
1983	755.3	1 151.3	109.5	2 235.5	454.9	4 706.5
1984	671.0	868.5	100.0	2 106.7	344.2	4 090.4
1985	720.0	694.3	91.8	1 752.7	605.7	3 864.4

Source: Banks' balances and calculations of the Banking Association. The figures have been deflated by the wholesale price index.

Table 17

**COLOMBIA: GINI COEFFICIENTS OF THE DISTRIBUTION
OF SHAREHOLDING IN SIX INCORPORATED
FINANCE COMPANIES**

	Banco de Colombia	Banco de Bogotá	Compañía Suramericana de Seguros	Colseguros	Banco Comercial Antioqueño	Banco del Comercio
1970						
1971						
1972						
1973						
1974		0.80		0.80	0.61	0.91
1975	0.82	0.80		0.81	0.66	0.92
1976						
1977	0.84	0.85	0.84	0.81	0.66	0.92
1978	0.86	0.82	0.91	0.88	0.69	0.91
1979	0.88		0.90	0.89	0.78	0.90
1980	0.84		0.93	0.90	0.76	0.93
1981	0.85		0.94	0.94	0.88	0.94
1982	0.79		0.73	0.84	0.84	0.78
1983	0.94	0.94	0.90	0.94	0.88	0.94
1984						

Source: Bogotá Stock Exchange (1984), Manual del Mercado Bursátil, Bogotá.

capital and reserves constituted less than 40% of the banks' net worth, while 61 % was provided by book valuations of very dubious real significance.

What is striking is that even though these accounting mechanisms were used, the losses reduced the real value of the banks' net worth from a maximum of 4 706 million 1970 pesos in 1983 to 3 864 million in 1985. Even in the peak year of 1983 the increase over 1970 was only 4.6% (2.95% a year compounded) in real terms, over a period of 13 years in which M_2 increased at a dizzying speed in comparison with the gross domestic product.

In addition to the real decapitalization of the banks from 1983, this period also saw the culmination of a process of concentration of shareholding which, as we said, developed in all the country's big corporations in the 1970s.

A sample of four big private banks and two insurance companies (table 17) shows that in all of them the index of shareholding concentration

increased between 1974 and 1983; in all except one of the banks the number of shareholders declined, for shareholding became concentrated in companies which bought the holdings of individual shareholders who then invested the proceeds in fixed-income bonds. This process was followed by the operation of the companies through the mechanism of the group or conglomerate, with the resulting concentration of loans and profits.

The previous government made efforts to democratize the finance bodies by means of decrees establishing mandatory time-limits for this; these deadlines have had to be extended time and again owing to the sector's poor returns and the public's lack of confidence in it; moreover, the subsidized loans from the capitalization funds established to bring new investors into the financial and productive sectors have only accentuated the process of concentration, for in practice the issues of shares and of bonds convertible into shares have been taken up only

by the same shareholders who control the issuing company.

The goal of the previous and the present government of capitalizing the productive and financial sectors, making them more democratic along the way, has not only not been achieved, it is actually impossible before the solution of the major structural problems noted in earlier chap-

ters with respect to the development of the national capital market; nor is any improvement possible in the current low profitability of the majority of corporations in comparison to the rates of interest paid to the saver; nor is it possible to overcome the savers' lack of confidence in the moral qualities of many of the administrators and businessmen.

IV

Summary and conclusions

This article has demonstrated clearly the trend towards greater indebtedness in Colombia's business, financial and non-financial sectors from 1950 to 1985. This debt was distributed in relatively constant proportions between internal and external debt throughout the period from 1970, during which the present exchange control regulations have been in force. The short-term debt also remained relatively stable as a proportion of the total debt of non-financial enterprises, according to a sample analysed in detail.

During the period under study enterprises increased their debts to the financial sector and the labour sector, although this latter debt has remained relatively stable since the mid-1970s. The reason for the increasing debt of the productive sector lay therefore in the financial field.

To explain this phenomenon use was made of a theoretical model of the cost of capital which links the tax, interest and inflation factors and indicates that the demand for credit on the part of corporations has been strongly stimulated, at least since 1950, by tax and inflation factors. In particular, the taxation of company income, inflation and the easier opportunities to evade personal taxes on interest have all encouraged borrowing.

The supply of capital was directed basically into shares up to the end of the 1960s, owing to the freezing at negative real levels of the interest rates which the financial intermediaries could offer. The reforms of the 1970s changed this situation and rapidly increased the supply of credit based on quasi-money acquired at high real rates by the finance bodies.

Investment costs and concentration in conglomerates produced an accumulation of loans which facilitated dangerous levels of debt in the country's main companies, which believed that their gross profits were sufficient to cover the financial costs and that the supply of credit would permit the permanent renewal of the loans.

The decline in the growth rate of the Colombian economy from 1980 surprised a large part of the productive sector with high financial costs which were increasingly difficult to meet; then followed the payment delays and defaults which finally led to concordats and to bad debts in the finance bodies. This in turn caused substantial losses as a result of application of the regulations concerning bad-debt provision in financial intermediaries, which led to the official control of banks and corporations and finally to their nationalization in some important cases.

A number of significant conclusions can be drawn from this summary:

a) If the company tax regulations allow the deduction of interest paid but not dividends distributed, there is an incentive to borrow as a means of obtaining capital. This incentive will be greatest when the nominal interest rates are highest and when it is easiest to evade personal taxation of interest income.

b) However, if enterprises in the productive sector are actually to incur increased debt, the financial intermediaries must have sufficient resources and the will to assume the risks of this debt. The first condition is met in imperfect

capital markets in which the increase in share values is not perceived by investors as part of the return and which instead allow intermediaries to offer high interest rates to attract savings.

The willingness to run the risks depends on the degree of concentration of the enterprises in industrial-financial conglomerates, on the dispersal and size of the intermediaries, on their professionalism, on the control effectively exer-

cized by the State, and on the economic outlook.

The factors stimulating the demand for credit grew stronger in Colombia during the period 1970-1985, and at the same time there was an institutional response designed to satisfy this demand not by means of share capital but by means of debt capital. The result was the crisis in the productive sector when the economy began to slow down in 1980.

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