Colombia: interest hike means blowout?

by Valerie Rush

Economic specialists in Colombia are predicting that the latest hike in interest rates could prove to be the pin that pricks the over-inflated bubble known as the Colombian banking system. During the first week in November, banks increased their interbank lending rate by 2%, while interest on loans to customers rose 1.5% to a whopping 41.5%.

Banks claimed that the reason for the interest rate increase was the need to recoup losses incurred when the State Council ordered private banks to make obligatory purchases of the Class A bonds of the Agricultural Fund, which serves to subsidize agriculture through relatively low interest rates. But the banks got their cake, and got to eat it, too, when Finance Minister Luis Fernando Alarcón Mantilla announced the phase-out of "development credit," through a "flexible interest rate" policy that immediately raised the cost of such loans from 18% to 33%. Pressure to eliminate such subsidized credit has been applied for years by the World Bank and International Monetary Fund.

Alarcón's justification for ending development credits was straightforward. In an address to the national banking association, Asobancaria, he said, "The financial system cannot continue to assume the costs of the so-called development credits. . . . Subsidized credit does not benefit the majority of Colombians . . . and generally those who use it are small groups who do not represent common aspirations." Alarcón went on to describe how such subsidized credit has bad effects on the economy, "by arbitrarily cheapening the cost of capital, and leading to technology and investment choices that do not adequately reflect the relative prices of capital and labor."

Digging one's own grave

Francisco Ortega, general manager of the Colombian central bank, used his speech to Asobancaria to target the decrepit national railroad system and heavily indebted Idema, the state food distribution agency: "Monetary control will always be defective as long as special needs are met by expansion. No matter how prioritized the activities that would benefit from such loans, one should not forget that the damage that is caused to the functioning of the financial sector by such assignment of economic resources has enormous significance; the damages are immensely greater than the advantages."

While such policies as elimination of development credit are touted as measures designed to save the hard-pressed Colombian financial sector, the reality is that they will sink it. Currently the banks have accumulated nearly $1 billion worth of outstanding, unpayable loans to the productive sector. Agriculture, in desperate need of such subsidized credits as the Class A bonds, would plunge into bankruptcy with their phase-out. The impact of such defaults could mean a chain reaction of bank collapses. The same with industry, which has stripped itself to the bone to pay even a portion of its overdue debts.

Comptroller General of Colombia Rodolfo González García identified the fundamental problem in his Oct. 27 financial report to the President, in which he denounced the government's willingness to sacrifice its own economic development initiatives to pay off the foreign debt. "The ambitious programs of social expenditure of the government, contained within its development plan, find themselves facing a crisis of uncertainty. The heavy expenses that originate in the servicing of the foreign debt, and the commitment of the government to reduce the fiscal deficit, confirm that it has chosen the path of sacrificing domestic expenditure and investment."

Aggravating the financial crisis domestically is the continued blindness of the Barco administration to global reality. In the immediate aftermath of the "Black Monday" crash of the New York stock market, President Virgilio Barco's economic secretary, Enrique Peñalosa Lozano, declared that Colombia would benefit in the form of repatriated capital and more loans! He would be well advised to glance back at the last stock market crisis, in 1929, which dealt a devastating blow to the Colombian economy and ultimately forced it into debt moratorium. Between 1929 and 1933, government income fell by 65%, public expenditure by 62%, state investment by 29%, and exports by 54%.

Income from coffee, Colombia's primary export product, fell 45% between 1929 and 1933, despite an increase in physical volume of coffee exports by 23%. It is noteworthy that Colombia has already lost $1.06 billion in coffee income in the first nine months of 1987, a figure comparable to the entirety of the long-awaited "jumbo" loan whose disbursement by international creditor banks has been unexpectedly postponed until "some time next year."

Despite the postponement—the loan was being counted on to meet the November wage bill for public employees—Peñalosa Lozano insists that the international banks retain full confidence in Colombia, which he describes as "tremendously solid." He has yet to either confirm or deny the report that Chemical Bank, one of Colombia's leading creditors, has just announced a total suspension of operations in the country.

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