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Growth of public debt in Coahuila, México

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Abstract. The objective of this work is to show that the accelerated growth of Coahuila's public debt occurred because the local legislation failed to limit the amounts borrowed, permitting the entirety of the Unconditional Transfers (UCT), specifically the General Participation Fund (GPF), to be granted as security for the loans. The results show that during the period 2000-2016, the average annual growth in the public debt was 21%. In addition, 94.3% of the GPF was pledged as security, leaving 5.7% of this income source to meet local public spending needs. Furthermore, of the seven loans obtained in 2018 and 2019, five of them were used for refinancing purposes and the other two to address liquidity shortfalls.

Keywords. public debt, transfers, subnational governments

1. Introduction

This paper looks at evidence of the public debt in the northern Mexican state of Coahuila. The work analyses the debt phenomenon that prevails in the public finances of Coahuila by reviewing the existing framework and the data on current loans registered with the Ministry of Finance and Public Credit (SHCP).

In Mexico, the main guarantee that federal states provide for loans are the funds they receive from Unconditional Transfers (UCTs), called federal participations in the Fiscal Coordination Law (LCF, 2018). With regard to these transfer payments, the funds that play the role of guarantor are the General Participation Fund (GPF) and the Municipal Development Fund (MDF).

The use of transfer payments in Mexico seeks to reduce the inequality gaps between the regions of the country. In this regard, Delgadillo (2012, p. 197) states that “there are regional asymmetries because the concentration of economic activities is in the center and the north of the territory.” These transfer payments can be of two types: conditional and unconditional. According to Oates (1977), the recipient government must apply the funds from conditional transfer payments in accordance with the use and purpose already established, while unconditional transfers can be spent according to the recipient's priorities.¹ Searle and Martinez-Vazquez (2007) argue that unconditional transfers can be used more openly and can

¹ Mexico's Fiscal Coordination Law (2018) defines the rules for unconditional transfers in Chapters I to IV and for conditional transfers in Chapter V.

be applied as an instrument through which central governments can address vertical and horizontal fiscal imbalances.

For Rosen (2008, p. 458), the definition of public debt is the sum of all previous budget deficits, while Piketty (2014, p.524) considers it as an instrument useful for financing armed conflicts. For his part, Stiglitz (2000: 697) refers to public debt as the exercise of spending more than what is collected in taxes and other income, whereas Faya (2008, p. 155) argues that the state turns to it to comply with certain legal formalities regarding public expenditure. Bahl and Duncombe (1993) define indebtedness as the total amount of debt within a state's total income during a given period.

Ellis and Schansberg (1999) find that, in the long term, a higher percentage of young people in the population has a positive influence on the level of debt. For Clingermayer and Wood (1995), debt responds to economic, political and institutional factors, while Letelier (2018) argues that the political opportunism increases the likelihood of indebtedness. Carpizo (2012) shows that the political configuration of state governments has a major effect on the range of public debt.

This paper is divided into five further sections. The next section contains a brief review of the golden rule of debt, while Section 3 deals with the method employed. Section 4 refers to the regulatory framework and Section 5 presents the empirical evidence and findings.

2. The golden rule of debt

The proper administration of public debt at various levels of government is an ongoing challenge in Mexico. In this regard, Germany was the pioneer in the 1970s in establishing debt controls (Jimenez and Ruelas, 2016). These authors mention that Australia, Canada, New Zealand and the United Kingdom have strong controls on subnational public debt, with laws that require commitments on the part of local governments, such as monitoring fiscal policy strategies and being obliged to publish them so that taxpayers know the progress of fiscal management, or the lack thereof.

Thus, the Golden Rule (GR) is defined as the mechanism by which governments can only go into debt to fund capital expenditures. In addition, the GR has as a corollary that there must be a balance or surplus in current account balances. In fact, many nations have implemented variations of this GR with varying degrees of success (Jimenez and Ruelas, 2016).

In the opposite case, when borrowing is used to finance current expenditures, according to Stiglitz (2000), output drops as a result of falling investment, shifting the burden not only of the debt but also of current expenditures to future generations. In Canada and the United States, central governments have historically had to circumvent political pressure to provide loans to subnational governments that have found themselves in serious financial difficulty (Ter Minassian, 1997; Ter Minassian, 2007).

In this regard, Finot (2005, p. 30) asserts that spending controls and limits on subnational borrowing have been established in Brazil with the Fiscal Responsibility Law (2000) and in Colombia with the Debt Control Law (1997) and the Territorial Spending Rationalization Law (2000). In Mexico, the implementation of fiscal discipline for expenditure and debt is lagging far behind, since it took almost 20 years for the arrival of the Law of Fiscal Discipline for Federal Entities and Municipalities (2016), through which local governments are now required to manage their indebtedness well.

3. Method

The selection of the object of study was made by non-probabilistic sampling. The debt statistics cover the period 2000-2016, while the loans granted correspond to the years 2011,

2018 and 2019. Thus, a descriptive methodology has been used, consisting of a review of the legal framework, debt statistics, the main long-term loans, Fitch Ratings, the guarantees granted and the list of related loans published in the Public Registry.

The hypothesis advanced in this work is that local legislation on borrowing will not be effective to limit the amounts borrowed from banking institutions, thereby accelerating the growth of Coahuila's public debt and compromising the resources of the GPF, which is the main source of UCT revenues.

4. Regulatory Framework for Coahuila's Debt

The legal framework with respect to subnational indebtedness is based on fraction VIII of Article 117 of the Political Constitution of the United Mexican States (CPEUM, 2018) in which it states that states and municipalities may not incur debts or loans except when they are intended for productive public investments and refinancing. (p.120)

The Alert System of the Ministry of Finance and Public Credit (SHCP, 2018) did not exist in 2011 when the loans analyzed here were incurred. However, thanks to the emergence of the Law of Fiscal Discipline of Federal Entities and Municipalities (LDFEFM, 2016), it was possible to obtain the data needed to prepare this work

4.1. Revenue Law and Public Debt Law of Coahuila

Article 6 of the Revenue Law of Coahuila for the 2014 fiscal year provides that the State Government of Coahuila, through the Ministry of Finance, will restructure or refinance the debt it has incurred with the financial system, and that these were authorized by the State Congress, in all cases in accordance with Decree No. 534 (Official State Government Gazette No. 66, August 19, 2011) and Decree No. 536 (Official State Government Gazette No. 77, September 29, 2011).

Similarly, Article 7 of the Public Debt Law for the State of Coahuila (LDPEC, 1996), authorizes the State Government, according to Decree No. 109 (November 9, 2012), to incur loans with the National Bank of Public Works and Services (Banobras), for the amount authorized by the State Congress and not exercised, in the amount of nine hundred and fifty million pesos.

As for the guarantees offered by the State of Coahuila, Article 71 (LDPEC, 1996) states the following:

The State and the Municipalities may, with the prior authorization of the Congress issued by law or decree, affect as a source or guarantee of payment, or both, the financing they obtain directly or those in which they act as guarantors, joint debtors, subsidiaries or substitutes, the goods of the private domain of their property or their income derived from contributions, the collection of quotas, partnerships, rights, products, uses, federal participations or any other income they may have in accordance with the applicable legislation including its accessories... (LDPEC 2014).

Practically all types of revenue were provided as security for the loans, the common denominator being the GPF, a circumstance that provides ample certainty to Coahuila's creditors; however, uncertainty has now arisen, increasing the cost of investment in the short term.

5. Evidence: recent borrowings

In order to borrow funds, the subnational governments of Mexico often provide the GPF as security, which in 2016 was in the order of 350 billion pesos (INEGI, 2018). In this country,

both the population and the indebtedness of federal entities such as Coahuila has grown. This is a problem that could exert fiscal pressure on local public finances in the near future.

5.1. Growth of the debt

As shown in Table 1, during the period 2000-2016 the average annual growth of Coahuila's public debt was 21%, while during fiscal year 2016 the amount of debt represented 7.4% of the subnational debt of all Mexican states.

Table 1. Public Debt of Coahuila

Average Annual Growth in Public Debt and its National Share Period 2000-2016		
Table		
Federal Entity	Average Annual Growth in Public Debt (period 2000-2016)	Proportion of the National Total* (to the year 2016)
Coahuila	21%	7.47%

SOURCE: Prepared by author with data from state and municipal public finances (information obtained from <https://www.inegi.org.mx/programas/finanzas/> on September 4, 2018).

During the period 2000-2016, the debt had an average annual growth of 21%. The loans granted on November 13, 2018 were used to refinance the public debt. This consisted of extending the maturity date, interest rate and payment guarantee through the GPF, 94% of whose revenues are pledged to meet such commitment. It should be noted that as of December 31, 2018, the debt level was 36.552 billion pesos (Public Registry, 2019).

5.2. Allocation of the General Participation Fund (GPF)

In the case of the 9-billion-peso loan, 23% of the GPF resources were pledged; approximately 13% for the 5-billion-peso loan; 28% for the 11-billion-peso loan; 9% for the 3.5-billion-peso loan; and 20% for the 8-billion-peso loan. Altogether, 94.3% of the GPF was committed for the five loans. In other words, the state government will only have 5.7% of this monthly revenue source, whose purpose is to level out the local public spending needs. Despite this, Coahuila has a stable credit rating of 'BBB+(mex)' (Fitch Ratings, November 2019) and collects high state revenues, as these were 17.5% of total revenues during the period 2014-2018.

5.3. Debt Alerts for Coahuila

According to the Alert System (SA, SHCP, 2018), indicator 1 shows that Coahuila's ratio of debt to freely disposable income is 195%. Indicator 2 says that it has a high indebtedness of 19.7%, exceeding the limit of 15% established by the Alert System. Indicator 3 is not a concern as Coahuila has paid the loans procured for a maximum period of one year.

5.4. Long-Term Loans

Data were taken from the Alert System of SHCP. The amount of these loans, granted in 2011 and guaranteed by the UCTs, are equivalent to a cumulative sum of 36.993 billion pesos (see Table 2). The largest loan was the one procured in 2011 in the amount of 6.878 billion pesos.

Table 2. Long-Term Borrowing by the State of Coahuila

Loans granted in 2011					
Creditor	Registration the SHCP	with P05-	Source of payment	Amount borrowed (pesos)	Balance as of the first quarter of 2017
Multiva	431/2011, 15013	P05-	General Participation Fund	6,878,417,489.00	6,824,381,762.65
Multiva	P05-0715089		General Participation Fund	4,157,002,513.00	4,157,002,513.00
Interacciones	436/2011		General Participation Fund	3,788,815,532.00	3,788,815,532.00
Interacciones	P05-0715087		General Participation Fund	3,381,748,007.00	3,381,748,007.40
Interacciones	425/2011		General Participation Fund	1,198,636,988.00	1,198,636,988.10
Banorte	426/2011, 430/011		General Participation Fund	6,432,596,507.00	6,432,596,506.00
Banobras	P05-0715088		General Participation Fund	4,160,000,000.00	4,160,000,000.00
BBVA	423/2011,		General		
Bancomer	424/2011		Participation Fund	3,633,198,396.00	3,633,198,396.00
Santander	428/2011, 437/2011		General Participation Fund	2,064,287,384.00	2,064,287,384.00
HSBC	444/2011		General Participation Fund	1,298,334,860.00	1,298,334,860.00
Total				36,993,037,676.00	36,939,001,949.15

Source: Prepared by the author based on debt data from the Single Public Registry of Financing and Obligations of Federal Entities and Municipalities, consulted on August 28, 2019.

5.6. Subnational debt compared to transfers

Table 3 shows a scenario where the subnational debt of the 32 states compared to the UCTs represented 45%. However, in the case of Coahuila, the debt was 198% of the aforementioned transfers, or 153 points above the total subnational debt.

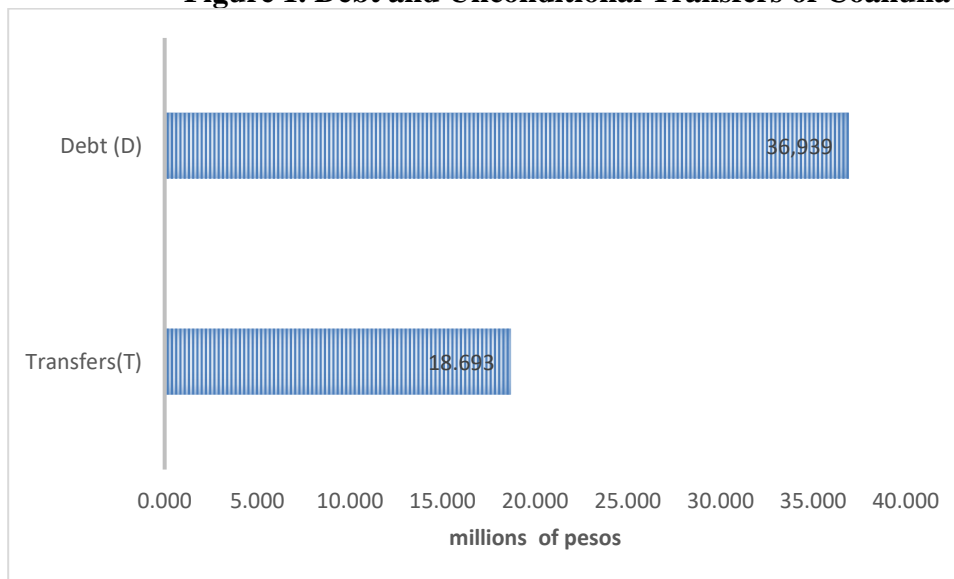
Table 3. Debt Compared to Unconditional Transfers

Debt of Coahuila - January-December (2017), millions of pesos					
Concept	Transfers (T)	Debt (D)	D/T	State GDP (SGDP)	D/SGDP
National	772,417.56	350,000.00	45%		
Coahuila	18,629.80	36,939.00	198%	612,486.00	6%

Source: Prepared by the author based on information from: Ministry of Finance and Public Credit (2019), Timely Public Finance Statistics, Participations to Federal States and the GDP, found at <https://www.inegi.org.mx/programas/pibent/2013/default.html#Tabulados>, consulted on August 28, 2019.

With regard to the magnitude of the debt as a function of Coahuila's GDP, the ratio is 6%, exceeding the institutional limit of 1% of GDP. This even exceeds Argentina's subnational bond issue debt of 3.4% of GDP (ECLAC, 2018). Coahuila is an atypical case as the debt is nearly double the amount received through these indicated federal revenues, i.e., the debt/UTC ratio is 198% (see Figure 1).

Figure 1. Debt and Unconditional Transfers of Coahuila (2017)



Source: Prepared by the author based on data from Table 3.

5.7. Destination of borrowed funds: refinancing and liquidity

The loans requested in the years 2018 and 2019 have been reviewed. As can be seen, none of these loans are intended for investment spending that will lead to the improvement of infrastructure and public services for the benefit of the population.

Table 4. Loans registered in the Single Public Registry (2018-2019)

Financing and obligations of Coahuila								
Entity	Lender	Type of obligation	Date of contract	Amount borrowed (MXN)	Maturity date	Source	Percent age affected	Use of funds
Coahuila	HSBC	Short term	11/12/2018	\$550,000,000.	10/12/2019	Unsecured	Does not apply	Insufficient liquidity
Coahuila	HSBC	Short term	13/02/2019	\$200,000,000.	12/02/2020	Unsecured	Does not apply	Insufficient liquidity

Coahuila	BANOB RAS	Simple Loan	13/11/2018	\$9,000,000,000.00	07/11/2043	GPF	23.2%	Refinancing
Coahuila	MULTIVA	Simple Loan	13/11/2018	\$5,000,000,000.00	05/11/2048	GPF	12.9%	Refinancing
Coahuila	MULTIVA	Simple Loan	13/11/2018	\$11,000,000,000.00	05/11/2048	GPF	28.4%	Refinancing
Coahuila	BANOB RAS	Simple Loan	13/11/2018	\$3,559,700,000.00	08/11/2038	GPF	9.2%	Refinancing
Coahuila	BANORTE	Simple Loan	13/11/2018	\$8,000,000,000.00	07/11/2043	GPF	20.6%	Refinancing

Source: Prepared by the author based on debt data from the Single Public Registry of Financing and Obligations of Federal Entities and Municipalities, consulted on August 28, 2019

In fact, two unsecured loans were intended to address the liquidity shortage, while the remaining five were for refinancing purposes. The extending of two short-term loans and five simple loans for a total amount of 37.309 billion pesos shows the heavy burden that the state treasury of Coahuila now faces.

Finally, there is the issue of whether the state has been governed by different political bodies. Since 1929, Coahuila has had 23 governors, who have all emerged from the same political party; in other words, there has effectively been no change in government in the state in about 90 years (Wikipedia, 2019). According to evidence from other researchers (Letelier, 2011; Carpizo, 2012; Mitchell, Hughes, and Campbell, 2014) this is a key factor not only in the procurement of loans but also in the size of budgets. Thus, to the extent that a governing party clings to power for decades, as is the case in Coahuila, and also obtains a majority in the Congress, it will be favored with more loans, regardless of whether more than 100% of the UCTs are pledged, as was the case with the GPF.

The social cost of having increased the size of Coahuila's debt does have effects, taking as an example the 11-billion-peso loan that expires in 29 years. The weight of this loan has already fallen on those babies born on November 13, 2018, when it was procured, given that they must now bear the financial burden of this instrument.

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