Fiscal Policy Throughout the Cycle: The Colombian Experience

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This paper reviews the relationship between the business cycle and public finances in Colombia. The evidence shows that cyclical movements in output systematically affect the situation of public finances. Hence, the distinction between the cyclical and permanent (i.e. structural) components of the fiscal balance may allow fiscal authorities to determine the extent to which the fiscal stance in a particular year reflects their discretionary actions. Our findings indicate that the cyclical component of the central government balance in Colombia has in general been fairly small. For instance, during the recession and recovery period 1999-2003, the cyclical component attained, on average, -0,5% of the GDP which explained only 8% of the actual overall deficit. More recently in 2006, the cyclical component amounted to +0,8% of the GDP, equivalent to 17% of the actual fiscal imbalance. Governments are not usually neutral during the business cycle. Ideally, they ought to practice a counter-cyclical fiscal policy to moderate the magnitude of output fluctuations. However, in emerging economies, counter-cyclical fiscal policies are inhibited by domestic and external factors, such as credit restrictions, quality of institutions, fiscal rules, corruption, voracity effect, etc. Using a standard approach we find that fiscal policy in Colombia has been pro-cyclical over the last 45 years or so, with the primary surplus falling (and the deficit rising) as a share of GDP by approximately 1/5th of a percentage point when the output gap improves by one percentage point.

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