Public Spending as a Social Tool of the State:
Lessons in Times of COVID-19 for Colombia

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Abstract

In 2020, a global pandemic was declared due to a dangerous disease called COVID-19. To avoid contagion and the saturation of the health system, lockdowns were carried out, interrupting general economic activity, bringing definitive closures of commercial establishments, and sudden job losses. The only way to overcome this socioeconomic problem is through the action of the public administration, employing economic policy tools framed within the social State of Colombian law.

The national Government has an institutional capacity measured by public spending, which has been used in previous economic crises. For this, a history of the crises of the last thirty years is presented, the highest public spending on them is analyzed, and comparisons are made. Also, other variables such as inflation, employment, and public debt are reviewed, which allows a comprehensive understanding of the role of economic policy. The results show that such a complex situation must be faced quickly and promptly, unifying the efforts

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of the different economic authorities to achieve joint objectives and that public spending is a good index of economic stimulus.

**Keywords:** COVID-19, Public spending, Economic policy, Economic cycle, Government.

**Introduction**

Public finances, as in charge of taxes and public spending (Cárdenas Santamaría, 2013), are a government activity that allows a reallocation of the initial allocations of resources with greater efficiency, that is, reaching the Paretian equilibrium (Stiglitz & Walsh; Microeconomics, 2009) through the collection of taxes and redistribution in the public budget.

However, the State's role in society has been criticized regarding economic intervention. For example, Milton and Rose Friedman (1980) agree with Adam Smith that government obligations are limited to providing national security, administering justice, and performing specific public works but never directing the economic activities of individuals. In effect, they praise Smith's idea of the market. This system combines the individual's freedom with voluntary economic cooperation, stigmatizing the Government by predicting that the combination of political and economic powers would lead to tyranny.

Paul Samuelson and William Nordhaus (2010) define business cycles as fluctuations in the economic activity of the Gross Domestic Product - GDP, income, and the labor market, either generating rises or falls, compared to their long-term economic growth trend. In other words, over time, the growth or decrease of GDP determines the period of the economic cycle in expansions and contractions; when the latter is more pronounced and lasting is called depression. In turn, the average of these variations generates the trend of economic growth.

The behavior of the economic cycle in Colombia has been similar to that of the world since, for the nation, the average of the last three decades has been 3.5%, while for the eastern world, it has been 3.6%. However, the behavior of other variables as a whole may be the one that allows more or less development in a region if it is understood as a multidimensional process that, according to Michael Todaro (1988), in addition to economic growth, must seek to decrease of inequality, unemployment and the suppression of extreme poverty that lead to a transformation of the social structure.
In graph 1, the long-term economic cycle of Colombia can be observed with a trend line that maintains a slow growth towards 4% compared to world economic growth that presents a less volatile form.

**Graph 1.** Percentage of natural GDP variation of Colombia, Latin America, and the world 1990 - 2019.

![Graph 1](image)

Source: Calculations made by the author based on International Monetary Fund - IMF (2020).

Over the last thirty years, the falls suffered by the economic cycle are related to the different international financial crises, which are hitting national economies harder today due to greater globalization. Nini Johana Marín Rodríguez (2017) has pointed out the major financial crises at the end of the 20th century and the beginning of the 21st century as follows:

- **1990 - 1993** The increase in foreign investment in Mexico.
- **1992 - 1997** The real estate and stock bubble in Thailand, Malaysia, Indonesia, and several other Asian countries.
- **1995 - 2000** The bubble in the US OTC.
- **2010 - 2012** European crisis.

To the above list, we must add the oil price crisis of 2014 and the crisis generated by the COVID-19 pandemic of 2020, which, although this pandemic is an infectious disease caused by a coronavirus (Organización Mundial de la Salud, 2020), has led to a global economic

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2 Over-the-counter (OTC) markets for financial instruments (BBVA, 2020).
crisis due to mandatory quarantines, established by each country, which interrupted economic activity to avoid contagion.

These negative impacts on national economies make each Government respond with procedures, and a set of tools, to alleviate the social crisis and channel the path of economic growth through what is known as economic policy (Navarrete Vela, 2012).

This article aims to investigate the depth and opportunity in the use of public spending by the Colombian Government to counteract the effects of economic and social crises, emphasizing the latter of 2020 due to COVID-19 compared to measures taken by other countries.

To achieve the above, the major crises and their effect on the country are listed, the impact on GDP and other macroeconomic variables are indicated, determining how much was the highest public spending, measured as a percentage of GDP, compared to other periods of negative growth and its difference with those of economic normality. This analysis covers the last thirty years, considering that Colombia had a new Political Constitution in 1991 that sets an agenda for a social rule of law that guarantees a just political, economic, and social order (Asamblea Nacional Constituyente, 1991).

**Market Crisis, GDP, and Economic Cycles**

The market has been understood as where supply and demand for goods and services converge at specific prices (Méndez Morales, 1996), but it is more than this. For Jürgen Kocka (2014), the market economy is capitalism itself. Although the State has been identified as its antagonist, thanks to the latter, the foundations of the welfare state were laid: cooperation between organized interests and the State.

Through these last thirty years, the process of globalization of the economy and finance has allowed an accelerated flow of information, affecting everyone at the same time as setting the space (Bauman, 2010 [2001]), coexisting with a crisis which due to the above, expand more rapidly.

**Last Decade of the 20th Century**

That is how the financial and monetary crisis in Mexico, related to the processes of globalization and integration of international emerging markets (Cuadra Montiel, 2015),
coincides with a fall of 3.1% of GDP in Colombia in 1996. After the Asian financial crisis, the nation had consecutive falls in GDP of 2.8% and 4.8% between 1998 - 1999. Professors Roberto Álvarez and José De Gregorio (2014) from the University of Chile affirm that after this crisis, considered at the time as the worst after the Great Depression, countries like Colombia implemented the inflation regime and flexible exchange rates as part of their economic policy.

First Decades of the 21st Century

At the beginning of the 21st century, the country endured the first drop of 1.2% in GDP in 2001, caused by excess speculation in the shares of technology companies, called dot-com or internet, which are listed on NASDAQ with a fall in its index of 124.9% (Asenjo Tejedor, 2012). Then, between 2008 - 2009, the country suffered another contraction; this time, it was 3.4% and 2.2% of GDP, respectively, caused by the subprime mortgage crisis in 2007 and, later, bankruptcy in 2008 from the big bank Lehman Brothers (Bodemer, 2017). Finally, to complete, the international financial crisis was extended due to the euro crisis in 2010 (Stiglitz, 2016), which, along with unemployment of 10% in the euro area, led to high-interest rates on debt securities, especially in Greece and a lack of financing, bringing with it a fall in Colombian GDP of 3% in 2012.

The last decade is peculiarly associated with the first national export product, oil. From 2014 to 2017, although the GDP in Colombia did not stop growing, they were four straight years of lower growth; the respective falls were 0.6%, 1.5%, 0.9%, and 0.7, a 3.7% total for this period. The explanation is found in the combination of the consecutive low price of oil and its decrease as a proportion of exports, as shown in table 1, reflected in the decrease in metric tons, which would have been more drastic had it not been for the devaluation of the Colombian Peso (COP).

Table 1. Oil exports as a percentage of total exports. Colombia 2013 - 2017.

<table>
<thead>
<tr>
<th>Concept</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oil and derivates</td>
<td>55,22%</td>
<td>52,84%</td>
<td>40,44%</td>
<td>33,98%</td>
<td>35,00%</td>
</tr>
<tr>
<td>Metric Tones (millIons)</td>
<td>47,650</td>
<td>49,143</td>
<td>48,432</td>
<td>43,935</td>
<td>40,485</td>
</tr>
<tr>
<td>Average Brent Price</td>
<td>108,44</td>
<td>97,52</td>
<td>54,40</td>
<td>46,00</td>
<td>55,71</td>
</tr>
<tr>
<td>µ $/dollar</td>
<td>1.869</td>
<td>2.000</td>
<td>2.743</td>
<td>3.051</td>
<td>2.956</td>
</tr>
</tbody>
</table>
The average price of a barrel of Brent oil figures in dollars.

Source: Calculations made by the author based on DIAN - DANE (2020), Investing (2020), and Banco de la República, Gerencia Técnica y Superintendencia Financiera de Colombia (2020).

Colombia ends the second decade of the 21st century with a rebound in its GDP; in 2018, it exceeded the rest of Latin America by 1.4%, and in 2019 by its growth of 3.3%, given that, on average, Latin America stagnated at 0%.

However, December 2019 brought more than just Christmas gifts. In Wuhan, Hubei province in China, an acute respiratory disease phylogenetically related to SARS-CoV appeared, COVID-19, which became a global pandemic on March 11, 2020 (Castro L., 2020). That forced prolonged confinements to avoid contagion and saturation of the health system, interrupting economic activity bringing definitive closures of commercial establishments, expulsion in the labor market with IMF forecasts (2020) of a slowdown of -4.4% of the World GDP and for Colombia of -8.2%.

**Okun's Law and Economic Policy**

The contractions are not simply transitory falls in GDP; they produce price instability and unemployment, generating economic and social problems. In graph 2, the behavior of both variables is observed in the period 1990 - 2020.

**Graph 2.** Annual inflation and average unemployment rate in Colombia 1990 – 2020*.

![Graph 2](image)

Source: Calculations made by the author based on DANE (2020) and Gran Encuesta Integrada de Hogares - GEIH (2020).

* Data up to September 2020.
Although the two variables have a downward trend, it is notable that inflation has a steeper negative slope. In effect, inflation has decreased by 68.67% compared to its average, while the unemployment rate, in the same period, 1990 - 2020, increased by 1.4% compared to its average.

In the twelve selected years of crisis (1996, 1998 - 1999, 2001, 2008 - 2009, 2012, 2014 - 2017, and 2020), 67% of the cases had the behavior described by the short-term Phillips curve, that is, the lower inflation, the higher the unemployment rate (six cases) and the higher the inflation, the lower the unemployment rate (two cases). Therefore, in graph 3, the monetary policy exercised by the Banco de la República can be analyzed using the intervention rate.

Graph 3. Average Banco de la República intervention rate in Colombia 1995 – 2020*.

Source: Calculations made by the author based on Banco de la República, Subgerencia Monetaria y de Inversiones Internacionales, Mesa de Dinero. (2020)

* Data up to September 2020.

In the same twelve years of study, the reference rate tends to fall by 50%, while in 67% of the cases, the reference rate decreases or rises according to the inflation rate; this confirms that the monetary policy responds more to the objective of controlling inflation than as a response to incentivize investment and reactivate economic activity.

According to Arthur Okun, there is a very sure relationship between GDP growth and the decrease in the unemployment rate, known as Okun's law (Blanchard, 1997). Mario Andrés Ramos (2017) finds an estimate of Okun's law for Colombia, in which for every 1% increase in its GDP, the unemployment rate decreased by 0.45% in approximately eight quarters.
In this section, the variables inflation, unemployment rate, intervention rate, and GDP, through the Phillips curve relations and Okun's law for Colombia, clearly indicate that the preeminence of economic policy should be focused on safeguarding employment through intervention rates that favor investment and credit, allowing higher growth in GDP and employment in the long term and not inflation targeting, this inflation targeting is used by the IMF adjustment programs (Sarmiento Palacio, 2011).

**Pandemic, Socioeconomic Crisis, and Economic Policy**

The pandemic caused by COVID-19 is not the only one that humanity has suffered; it has not been the first, nor will it be the last. However, the public policy determined by national governments will lead society to make it less challenging to live with one, protecting its fellow citizens in matters of health, employment, food, and housing.

Between the years 2014 - 2015, there was an epidemic outbreak of Ebola in Liberia and Sierra Leone; Joseph Stiglitz (2015) comments that this episode, in particular, is a crisis in which we can only turn to one body to overcome it, the State. Also, the problems are accentuated due to inequalities and that, despite the dismantling of public institutions, they, through governments, solve this type of crisis. COVID-19 may provide lessons for the future in terms of public policy, including the economic one.

Public spending is one of the instruments used by governments to solve crises. Graph 4 shows the evolution of Central National Government (CNG) spending in Colombia between 1994 and 2017.

**Graph 4.** Total payments of the Fiscal Balance of the GNC as a percentage of GDP. Colombia 1994 – 2019.

Source: Calculations made by the author based on General Directorate for Macroeconomic Policy (DGPM, is Spanish Acronym) – Ministerio de Hacienda y Crédito Público (2020).
Before the pandemic, these twenty-six years that cover eleven falls in GDP allow us to verify whether there has been more lavish public spending as a fiscal policy, according to the relationship between public spending and growth theorized in the Keynesian tradition (Keynes, 2006 [1936]). The average variation of public spending, period 1994 - 2019, in the expansionary economic cycle was 0.07% of GDP, while in contractions, it was 0.61% of GDP, that is, an increase in growth in the variation of public spending in periods of crisis. The most considerable changes in spending, of up to 1.6% of GDP, occurred in contractions, and the slightest changes, which were negative, occurred in expansion cycles. In 73% of the periods of contraction, there was a growth of public spending; on the other hand, in 50% of the periods of expansion, there was, on the contrary, a decrease.

The total growth of CNG spending has been continuous, reaching 71.64% after twenty-six years. However, it is notable that interest on debt has grown faster than the other components of spending with 158.16%, followed by the operating one with 74.16% and, finally, the investment with 9.47%.

In March 2020, a week after the COVID-19 pandemic was declared, the national Government declared a state of economic, social, and ecological emergency through Decree 417 (Presidencia de la República de Colombia, 2020). Through this State of exception, measures were adopted, such as the creation of the Fondo de Mitigación de Emergencias (Emergency Mitigation Fund, FOME It is Spanish Acronym) with an initial $ 14.8 billion, most of which was provided by the Fondo de Ahorro y Estabilización (Savings and Stabilization Fund, FAE it is Spanish Acronym) with $ 12.1 billion, and the Fondo Nacional de Pensiones de las Entidades Territoriales (National Pension Fund of Territorial Entities, FONPET it is Spanish Acronym) with $ 2.7 billion; resources allocated in the pandemic to strengthen the health system and to finance the social spending of vulnerable households, Decree 444 (Presidencia de la República de Colombia, 2020).

In tax matters, legal entities were facilitated to postpone the filing of the income statement for the taxable year 2019; likewise, the payments had the opportunity to be made in two installments, the second was extended to June and July 2020, Decree 520 (Ministerio de Hacienda y Crédito Público, 2020). Furthermore, in the case of legal persons considered as micro, small, and medium-sized companies, the payment of the second installment of their respective income statements for the taxable year 2019 was extended until November and December 2020, Decree 655 (Ministerio de Hacienda y Crédito Público, 2020).
On April 10, the Center for Economic Policy Research (CEPR) published in COVID ECONOMICS 3 the article Economic policy responses to a pandemic: Developing the Covid-19 economic stimulus index (Elgin, Basbug, & Yalaman, 2020), showing the policies' economic response to the pandemic in different countries. The countries with the most significant fiscal effort, as a percentage of their GDP, which exceeded 10%, were: Austria 17.8%, Belgium 12.3%, France 15.3%, Luxembourg 15.6%, Malaysia 16.22%, Malta 12.3%, Qatar 13%, Singapore 10.5%, and the United States 10.5%, with an average economic stimulus index of 2.66. For its part, Colombia appears with a relatively minimal fiscal effort of 0.4%, which meant a negative economic stimulus index of -0.84.

Then, in May, the national Government dictated another state of emergency through Decree 637 (Presidencia de la República de Colombia, 2020) ; covered by this second State of exception, the Government allowed itself to create the Programa de Apoyo al Empleo Formal (Formal Employment Support Program, PAEF its Spanish acronym), Legislative Decree 639 (Ministerio de Hacienda y Crédito Público, 2020) , almost two months after the global pandemic was declared.

The PAEF is an aid for legal entities up to 40% of the current legal monthly minimum wage (SMMLV, it is Spanish Acronym) for all employees, a subsidy that has been extended until March 2021 with the issuance of Law 2060 (Congreso de Colombia, 2020), now also to cover employment generated by individuals and others, with the extension, of the subsidy up to 50% of the SMMLV for some exceptional cases. In addition, Law 2060 includes that in the Programa de Apoyo para el Pago de la Prima de Servicios (Support Program for the Payment of the Premium for Services, PAP it is Spanish Acronym), Legislative Decree 770 for the payment of the premium for June 2020 (Ministerio del Trabajo, 2020), a new subsidized pay of the same value of $ 220,000 per employee, now for the December 2020 bonus.

The economic outlook is devastating; a safe vaccine and its distribution have no specific date. Therefore, a continuous interruption in economic activity, in the event of a new wave of outbreaks, will lead more and more people to the loss of employment or the definitive closure of companies, hence the need for state support and its effectiveness. Before the pandemic, for employment to grow and inequality to decrease, Eduardo Sarmiento Palacio (2017) had already suggested, through fiscal policy, a capital tax and a 50% subsidy to the SMMLV of the poorest 40%, affecting the allocation of resources minimally and thus maintaining the Paretian equilibrium. Today, faced with the rush to find solutions, the astonishment is that public spending has not been enough.
With the IMF forecast for Colombia's GDP growth at -8.2%, the estimate for this year, 2020, will be $ 974.668 trillion. The FOME, with more resources allocated, became, in theory, a fund of $ 40.527 trillion, of which, as of October, the actual balance was $ 24.437 trillion. On November 3, 2020, $ 16.090 trillion had been effectively disbursed in public spending, among which are health programs, payroll subsidies, economic support for households living in poverty, and transfers to social programs; calculations made by the Fiscal Observatory of the Pontificia Universidad Javeriana (2020). With inflation of 1.44% and unemployment of 16.8% in Colombia, 1.65% of the expected GDP in terms of public spending is insufficient; the data in April already envisioned that this spending should be higher than 10%.

Graph 5 shows the behavior of the external public debt as a percentage of GDP in the last 26 years. In expansionary economic cycles, the variation of this debt, on average, was -0.95% of GDP; on the other hand, in economic contraction cycles, the average variation was 2.11% of GDP. This result is considered consistent with the tax smoothing model of the theory of optimal taxation in fiscal policy, described by Leopoldo Fergusson and Gustavo Suárez (2010), as a tool to face the use of higher public spending without incurring tax increases.

**Graph 5.** External public debt as a percentage of GDP. Colombia 1995 – 2020*

![Graph 5](https://example.com/graph5.png)

Source: Calculations made by the author based on Banco de la República, Subgerencia de política monetaria e información económica. Sección Sector Externo (2020).

* Data up to June 2020.

Previous, the national Government has decided not to increase taxes or borrow from the Banco de la República from its international reserves, as proposed by the president of Asociación Nacional de Empresarios de Colombia (National Association of Colombian
Entrepreneurs, ANDI (It is Spanish Acronym), Bruce Mac Master, to reactivate the economy (Ortega, 2020). Instead, it has obtained from the IMF (Departamento de Comunicaciones del FMI, 2020) an extension of the credit of approximately USD 6,400 million, among other reasons, due to the pandemic caused by COVID-19. As a result, the total amount available for Colombia is SDR 12,267 million, equivalent to USD 17.2 billion, about $ 66.629 trillion at the date of approval and representing 6.84% of the expected GDP.

The Global Revenue Statistics Database of the Organización para la Cooperación y el Desarrollo Económicos (OCDE, 2020) reports that Colombia had tax revenues in 2018 of 19.5% of GDP, a lower collection compared to the averages for Latin America and OCDE, 23.1% and 34.3% of its GDP, respectively. On the other hand, in an analysis of the incidence of taxes keeping the budget balanced (Stiglitz, 1995) for Colombia, it is noted that due to the low level of collection and the lack of resources to face the COVID-19 pandemic, the country has a tax space of at least $ 35 billion in new taxes in imminent tax reform for the year 2021.

**Conclusions**

The Colombian economic cycle follows the global behavioral pattern; however, it presents periods of greater volatility as it depends on raw materials prices, such as oil, with long-term economic growth below 4%. In total, the average variation in GDP in the pre-pandemic period, 1991 - 2019, is 0%.

With the Political Constitution of 1991, a political, economic, and social order was guaranteed by the social rule of law in Colombia; hence the national economic authorities, the Ministry of Finance and Public Credit, and the Banco de la República are responsible for administering this new order in fair proportions, through economic policy. However, unfortunately, the result in thirty years is not so good because, including 2020, it is divided; the country has grown in half of the years and decreased in the other half.

The monetary policy exercised by the Banco de la República has only pursued the inflation objective, raising or lowering the reference interest rate, hindering further long-term growth, and increasing unemployment. With sustained growth of GDP of 5% per year, unemployment would decrease by at least 0.68% more in a period of every two years, and, in approximately ten years, the unemployment rate would stabilize at an average of 8.3%, according to Okun's law for Colombia.
On the other hand, fiscal policy has responded more effectively to periods of crisis by increasing public spending, which is 8.7 times higher than the variation caused in periods of economic expansion. The Ministry of Finance and Public Credit increased public spending in most periods, which showed a decrease, with increases of up to 1.6% of GDP.

After COVID-19 was declared a pandemic, Colombia allocated a fund for payments related to the socioeconomic crisis, including resources belonging to the regions. The worst crisis the country had had in the last thirty years was that of 1998 - 1999, with a 7.6% recession in the two years and higher public spending in the second year of 1.59% of GDP. The 2020 pandemic predicts a depression of 8.2% in the national economy in a single year, much greater than the 1998-1999 biennium, which is why the fund was created, which already has a balance of $40.527 trillion; of this amount, $16.090 trillion has been spent, corresponding to 1.65% of the expected GDP, this is 0.6% more than in 1999.

Being the steepest contraction in thirty years, it is not justified that the public spending executed to safeguard the economy is slightly higher than the largest pre-pandemic crisis. Furthermore, although the presentation and payment of income tax for legal entities were made more flexible, together with the payroll and premium subsidy, such as the use of optimal taxation so as not to burden taxpayers with more taxes due to this situation, the economic stimulus index for Colombia it is negative, other countries had allocated more than 10% of their GDP to attend to COVID-19, one month after the pandemic was declared.

It cannot be ignored that the CNG is trying to combat the adverse socioeconomic effects of the pandemic; however, they have been late and scarce. Monetary policy does not coincide with fiscal policy to unify criteria of economic growth and decrease in unemployment, the lack of collection of tax revenues, per the region, means that 3.6% of GDP has been lost in public resources that exceed 45% of what has been carried out so far to address COVID-19.

Finally, tax reform is imminent to recover the more excellent resources spent in this year 2020; however, as the recent history of the last thirty years indicates, it is necessary to choose to achieve the average collection of tax revenues in the region, reconcile monetary and fiscal policies, and, lastly, make more significant savings efforts in the following years to address short-term problems in the future, through increased public spending in a social state of law.
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