

The Changing Role of the Public Sector: The Colombian Case

Working Paper No. 42 Keep in mind

The series Working Papers on Economics is published by the Office for Economic Studies at the *Banco de la República* (Central Bank of Colombia). It contributes to the dissemination and promotion of the work by researchers from the institution. This series is indexed at Research Papers in Economics (RePEc).

On multiple occasions, these works have been the result of collaborative work with individuals from other national or international institutions. The works published are provisional, and their authors are fully responsible for the opinions expressed in them, as well as for possible mistakes. The opinions expressed herein are those of the authors and do not necessarily reflect the views of Banco de la República or its Board of Directors.

AUTHOR OR EDITOR Alberto Carrasquilla

Several Observers of Latin America have underscored the notion that an emerging "consensus" regarding the role of the State in the economy surfaced during the 1980's (v.g World Bank, 1993; Williamson, 1993). Starting from an emphasis on issues regarding stabilization, there are three main and related threads to this account; firstly, the adequate size of the public sector. Second, the adequate scope of public sector activity. Lastly, the area of regulation and inversion in economic life.

The main conclusion is that the public sector in Latin America: (a) had grown to excessive size over the previous decades; (b) encompassed an excessive, and at times inadequately ranked, set of policy priorities and objectives; (c) had overregulated economic life in areas ranging from international trade and finance, to labor and financial markets. Several studies point to the fact that growth and welfare are adversely affected by this state of affairs and that policy should be aimed at modifying it.

The issue of economic "reform" has been the dominant theme in public policy discussion within the region for the last ten years. There is convincing evidence supporting the view that many countries in the region shifted policy in an explicit policy decision to face the aforementioned problems. With initial efforts aimed at correcting the problem of instability, i.e. inflation and the basic macroeconomic imbalances which explain it, policy makers embarked upon more global attempts to alter the dominant development strategy of the past few decades.

Within this context, numerous studies report substantial advances in stabilization (Dornbusch and Edwards, 1994), privatization efforts (Baer and Birch, 1994); while others document shifts in public sector priorities, and still others international trade and payments, the treatment of FDI and the functioning of labor and financial markets.

The purpose of this paper is to report advances and limitations in the three fronts in a country which has not been among the most widely studied in the region. Our main point is that Colombia has been a gradualist and modest reformer as measured by the standards of neighboring countries. One prominent reason is the fact that the "initial conditions" were not as troublesome as elsewhere and thus the size of the required stabilization and reform sequence were smaller by comparison. In other words, the inexistence of "hard" budget constraints forcing drastic shifts in fiscal priorities and the inexistence of severe fiscal and external imbalances requiring rapid privatization. The fact that these initial conditions were not severely out of line with sustainable medium term criteria is, in itself, an interesting stylized fact.

We thus begin the paper by documenting some salient features of the Colombian public sector and its relation to macroeconomic variables. The focus in this part is the fact that "initial conditions" were not as in other countries

of the region.

The size of the public sector has not been regarded as a high priority problem; rather, the public sector has increased its participation in GDP to an important extent. This is the subject of the second part of the paper.

In the third part, we posit the idea that little can be shown in the budget data with regard to a shift in public sector priorities.

In the fourth part we analyze indicators relating to regulation and inversion, where shifts are clearer. We finish with a summary of main findings and conclusions.