

Box 2

Inflexibility of Public Spending in Colombia: Analysis of the Composition and Evolution of the Government Budget, 2000-2024

Spending inflexibility is a structural feature of Colombia's Government Budget (PGN). This condition reflects the existence of earmarked revenues, the establishment of spending commitments through the Constitution and the law, and the state's permanent obligations related to pensions and debt service. A rigid budget significantly limits the government's capacity to reallocate spending, respond to emergencies, and make fiscal policy adjustments in order to achieve objectives of economic stability, growth, or improved income distribution.

The 1991 Political Constitution strengthened the decentralization process in Colombia by allocating an increasing percentage of the nation's current revenues (ICN in Spanish) to the regions. These commitments came to represent nearly 45% of the ICN by the end of the 1990s, significantly reducing the flexibility of the PGN and introducing a factor of instability into the central government's finances, which led to a constitutional reform in 2001.

Constitutional Reforms

Legislative Act 01 of 2001 established the General Participation System (GPS), a mechanism through which the Nation must transfer resources to territorial entities, whose annual amount was to be calculated based on the average growth of the ICNs over the previous four years. However, on a transitional basis, the reform stipulated that the GPS allocation would initially increase based on the observed CPI, plus a few real percentage points, and that by 2008 it should recover the share of ICN that territorial transfers had in 2001. Given the fiscal risk posed by this increase in the GPS, another constitutional reform was approved in 2007, which extended until 2016 the annual adjustment formula based on the observed CPI plus a real increase. According to this reform, starting in 2017 the original formula reinstated, based on the average growth of ICNs over the last four years.

At the end of 2024, the Congress of Colombia approved another legislative act to once again modify the formula for calculating the GPS. Under this reform, starting in 2017 the GPS must gradually increase until it reaches 39.5% of the ICNs. To implement this measure, a law will need to be enacted to define the responsibilities of each level of government, primarily in the areas of education, health, drinking water, and basic sanitation.

Rigidity of Public Spending

The *Medium-Term Fiscal Framework* for 2025 (MTFF-2025) indicates that 86.4% of the primary expenditure of the Central National Government (CNG) in 2024 is inflexible. When debt interest payments are included, this share rises to 89.1%. However, this pronounced rigidity of the PGN is not new. A study conducted by Echeverry, Fergusson, and Querubín (2004)¹ warned that nearly 96% of budget appropriations were already predetermined in 2003, and that the growing expansion of social spending, together with the burden of pension payments and debt service, severely constrained the state's budgetary flexibility.

1 Echeverry, J. C.; Fergusson, L.; Querubín, P. (2004). "La batalla política por el presupuesto de la Nación: inflexibilidades o supervivencia fiscal", CEDE document, No. 2004-01, Economic Development Studies Center (CEDE in Spanish), Universidad de los Andes.

The most rigid components of public spending are the GPS and other legally mandated allocations to the territories; debt service—especially interest payments, which are not subject to adjustment; pension payments; and health expenditures. Salaries also exhibit a high degree of inflexibility, as they are protected by labor and contractual regulations. Paradoxically, the investment item, which should be the driver of development and the main instrument for boosting productivity and economic growth, turns out to be the most flexible and, therefore, the first to be cut during periods of fiscal restraint. This finding is supported by Vallejo and Zapata (2019)², who show that investment expenditures in Colombia remained positively synchronized with GDP between 2001 and 2018, reflecting a distinctly procyclical behavior. Unlike operating expenses, investment expenditures were more closely aligned with fluctuations in the economic cycle.

International Comparison

From an international perspective, Colombia exhibits a higher level of budgetary rigidity than the Latin America average. A study by Moody's (2017)³ analyzed the inflexibility of public spending in 16 Latin American countries and examined their fiscal adjustment capacity. Using an expenditure flexibility index, the study highlighted that Brazil and Colombia were among the least flexibility countries, with more than 85% of their budgets committed to mandatory spending (salaries, transfers, and interest payments). In contrast, Ecuador showed the highest flexibility, with only 49% of mandatory spending, followed by countries such as Peru and Panama, which also exhibited more adaptable budget structures. Only Guatemala, Panama, and El Salvador managed to reduce public spending as a share of GDP between 2010 and 2016, which highlights the challenges faced by many governments in the region to consolidate their public finances when there is a high level of rigid spending.

To assess the inflexibility of public spending in Colombia, a budgetary flexibility index was constructed for this box based on the methodology developed by Moody's, using information from the PGN between 2000 and 2024. The exercise compiled detailed data for more than 180,000 budget items. Public spending was initially classified into four broad categories: 1) operating expenses, which include wages and salaries as well as purchases of goods and services; 2) current transfers, such as pensions, health, and legally mandated allocations to the territories; 3) capital expenditures of the PGN; and 4) debt service (interest payments and amortizations). Subsequently, each category was examined for its degree of rigidity, considering as flexible those expenditures that can be more easily adjusted in the short term (for example, capital expenditures and the portion of operating expenses not associated with salaries or tax obligations). Under this criterion, most inflexible expenditures correspond to public sector salaries, certain current transfers (mandatory), and interest and amortization payments on public debt.

Before beginning the analysis of the inflexibility of the PGN, it is worth noting that there is a difference between budget appropriations⁴—which is the variable used in this Box—and CNG expenditures presented in the MTF-25 and described in section 2.3 of this *Report*. Appropriations correspond to the maximum amount of spending authorized by Congress for a fiscal year, while CNG expenditures reflect actual payments made, accrued obligations, and other accounting records during that period. In other words, the budget defines what may be spent, but in practice not all of it is executed or paid within the same year: part of the resources may remain as budgetary reserves (uncommitted obligations) or as accounts pay-

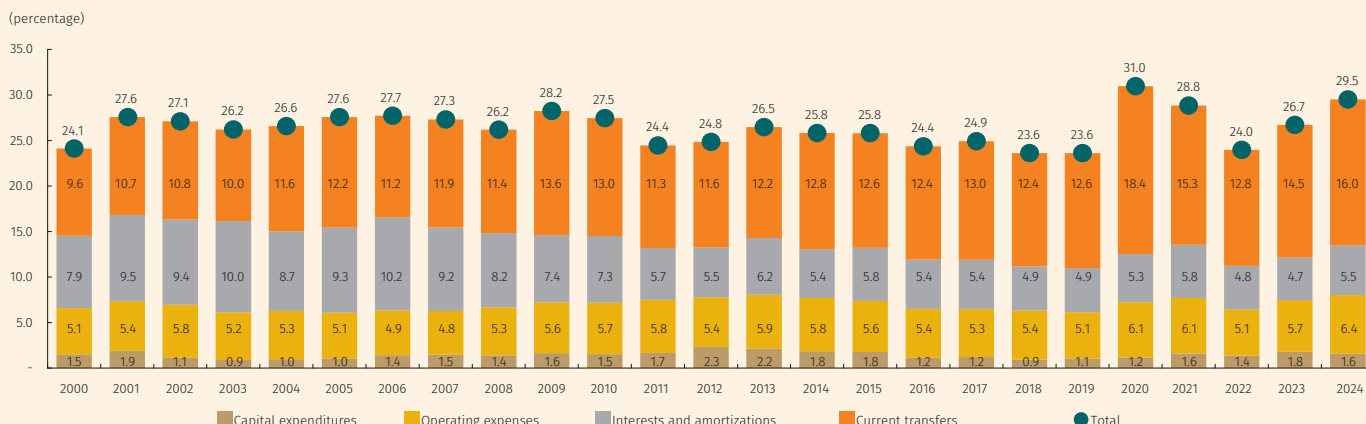
2 Zapata-Álvarez, S.; Vallejo-Rubiano, F. P. (2019). "Sectoral Procyclicality of Public Expenditure and GDP in Colombia," *Notas Fiscales*, No. 28, Ministry of Finance and Public Credit.

3 Moody's Investors Service (2017, 18 October). "High Compulsory Spending Levels to Impede Fiscal Consolidation, Especially in Brazil."

4 Budget appropriations are the maximum expenditure amounts authorized by the Congress of Colombia for the National Government to execute during a fiscal year through the Annual Budget Law. These appropriations establish the legal ceilings for committing and executing public funds across different categories, such as operating expenses, investment, and debt service, and constitute the starting point of the budget execution process.

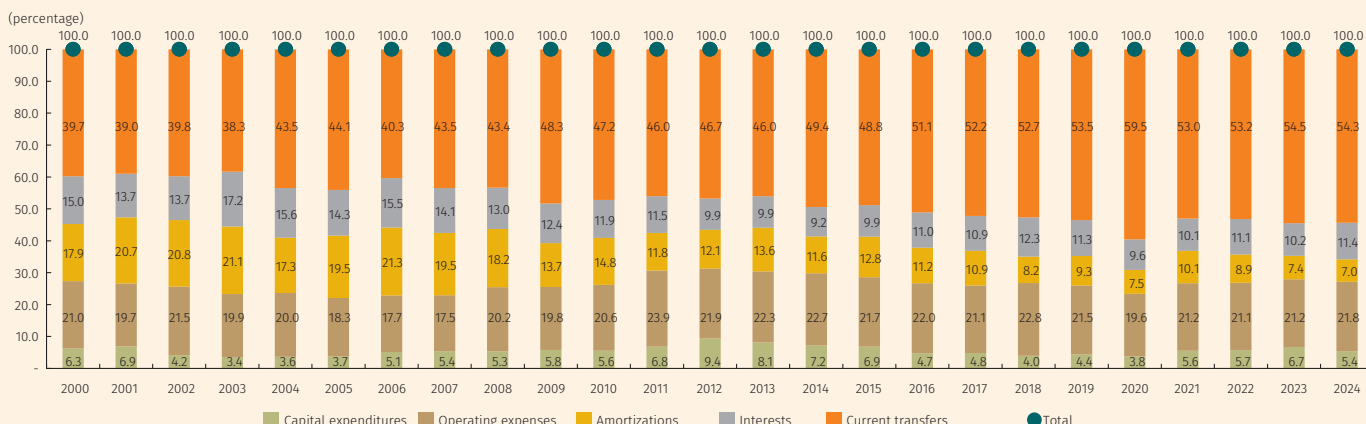
Graph B2.1
Budget Appropriation Following Moody's Rating (2000 – 2024)^{a/}

A. Percentage of GDP



a/ This corresponds to the current appropriation of the General Budget (PGN in Spanish) as of December each year. For 2024, it corresponds to the current appropriation as of November. These data are preliminary.
Source: Ministry of Finance and Public Credit; authors' own calculations.

B. Percentage of PGN



a/ This corresponds to the current appropriation of the PGN as of December each year. For 2024, it corresponds to the current appropriation as of November. These data are preliminary.
Source: Ministry of Finance and Public Credit; own calculations.

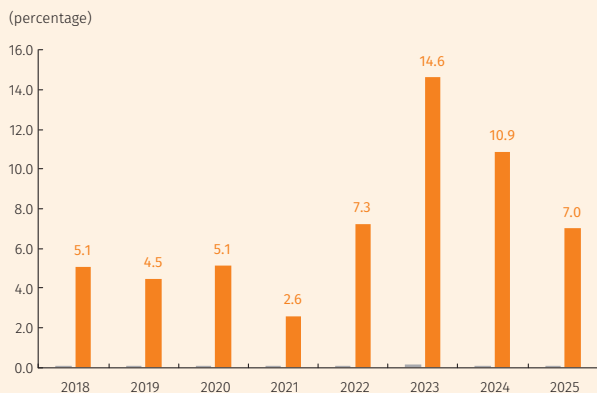
able (unsettled obligations). Additionally, CNG expenditure includes transactions such as interest accruals, as well as other adjustments that are not necessarily executed through the cash flow of the General Directorate of Public Credit and the National Treasury, nor are they explicitly included in the approved budget. However, they exclude debt amortizations and payments made with the own resources of national public establishments, among others⁵.

As shown in Graph B2.1, current transfers have been the fastest-growing component of public spending over the last twenty years, rising from 9.6% of GDP (39.7% of PGN) in 2000 to 16% of GDP (54.3% of PGN) in 2024. Within this item, an average of 33% corresponds to statutory transfers to subnational governments, and 31% to the National Government's pension commitments. It is worth highlighting the increase in transfers to the health sector, whose share of total current transfers increased from 5.9% to 16.4% between 2000 and 2024. This change reflects the impact of Law 1607 of 2012, which eliminated the obligation for companies to pay health contributions for workers with incomes of up to ten minimum wages, transferring this responsibility to the state.

5 The difference between the PGN appropriations and the CNG expenditures is analyzed in detail in the study by Rincón-Castro, H.; Zapata-Álvarez, S. (2025), "Presupuesto de la Nación y el balance fiscal del gobierno central: ¿cómo se relacionan y qué los diferencia?", forthcoming in Banco de la República's Working Papers on Economics series (*Borradores de Economía*).

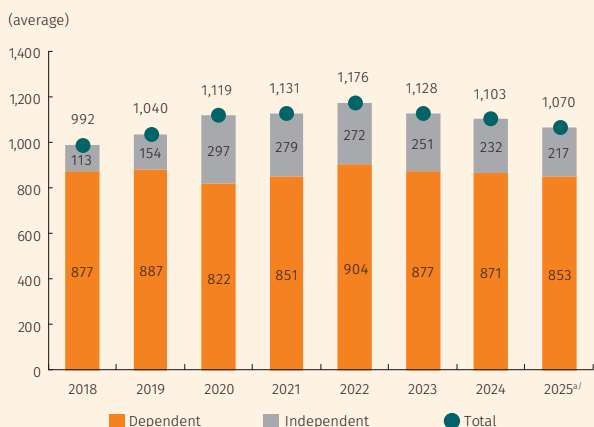
Graph B2.2
Salary Increases and the Evolution of the Number of Public Sector Contributors, 2018-2025

A. Salary Increase – Public Employees in the Executive Branch (%)



FSource: Annual decrees on salary increases.

B. Annual Average of Contributors – Public Administration and Defense^{a/}



a/ Number of contributors as of March.
Source: *Tablero de control para el seguimiento de los aportes al Sistema de la Seguridad Social* (Control dashboard for monitoring contributions to the Social Security System or UGPP in Spanish).

When examining operating expenses, it is observed that their most representative component is salaries, which have accounted for an average of 53% of the total for this item during the period analyzed. A more detailed analysis shows that, on average, personnel expenses accounted for 2.9% of GDP between 2000 and 2024, equivalent to around 11% of budget appropriations. Although this category has been relatively stable as a share of GDP, it has been increasing in real and nominal terms. Between 2000 and 2024, this item rose from around COP20 trillion (t) to more than COP50 t at constant prices, and from COP6 t to COP50 t in current terms. In recent years, this growth has been mainly due to salary increases and, to a lesser extent, to an increase in the number of employees.

To illustrate this trend, Graph B2.2 shows salary increases and the evolution of the number of public sector contributors between 2018 and 2025⁶. During this period, salaries of executive branch employees grew by an average of 7.1% annually, with more pronounced increases of around 9.9% annually between 2022 and 2025. Regarding the number of contributors in the public administration and defense sector, there was a net increase of 78,000 individuals between 2018 and 2025, although a decline is observed between 2022 and 2025, mainly attributable to a reduction in independent contributors (mostly contractors). Similarly, it should be noted that, according to the technical analysis document on the MTF-2025 by the Independent Fiscal Rule Committee, spending on service contracts and their volume remain below the historical average (2018-2024). As of June 2025, COP 14.1 t and 394,600 contracts have been executed, both below the averages of COP 17.6 t and 486,500 contracts, respectively. This indicates a lower activity level in the use of this contractual modality.

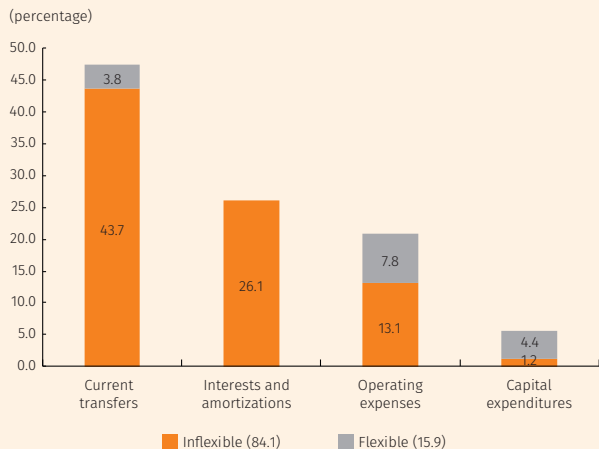
Within capital expenditures, investment in road, river, rail, and airport infrastructure was the main component, accounting for 40% of the total in this item. On average, this type of investment represented 0.6% of GDP during the period analyzed. This category also includes housing subsidies, which accounted for approximately 11% of capital expenditures, and mass transit systems, with a share close to 6.0%. These components have maintained a consistent presence within the composition of capital expenditures during the period studied.

Estimated budgetary inflexibility, according to Moody’s index, reached an average of 84.1% of total public spending between 2000 and 2024. Excluding interest payments and debt amortizations, this proportion falls to 78.6%. As shown in Graph B2.3, most of the inflexible spending corresponds to current transfers, which on average accounted for 43.7% of the PGN in the period analyzed. It is important to note that the approval of various laws establishing permanent spending obligations has reinforced this budgetary rigidity (Melo, Ramos, and Gómez, 2020)⁷. In turn, flexible current transfers—those subject to adjustment—account for only 3.8% of the PGN on average. Among these, the most important are those denominated “transfers subject to prior approval” in the Finance sector, which are not freely earmarked, as their execution is subject to obtaining a favorable opinion from the

6 The total number of contributors in the public administration and defense sector includes all its workers. However, public educators are grouped under the education sector, and the available information does not allow them to be distinguished from private-sector educators.

7 Melo-Becerra, L. A.; Ramos-Forero, J. E.; Gómez, C. (2020). “ El Presupuesto General de la Nación: una aproximación a las partidas de transferencias e inversión”, *Borradores de Economía* (Working Papers on Economics), No. 1136, Banco de la República.

Graph B2.3
Average Composition of Public Spending by Budgetary Flexibility in Colombia's PGN (2000-2024)^{a/}



a/ These data are preliminary.
 Source: Ministry of Finance and Public Credit; authors' own calculations.

Ministry of Finance and Public Credit. Indeed, in the 2024 PGN cut, which amounted to COP 28 t, nearly COP 9 t corresponding to this item were adjusted. Meanwhile, budgetary deferral of the 2025 PGN, totaling COP 12 t, included COP 1.1 t associated with this component.

Thus, it is evident that government expenditure exhibits significant rigidity under the current constitutional and legal framework. In response of this situation, the MTFF-25 proposes a “fiscal pact” to enable the processing of structural reforms in Congress aimed at reducing expenditure inflexibilities. The objective of these reforms would be to ensure the sustainability of public finances and to reinstate the fiscal rule starting in 2028, thereby granting the state greater budgetary flexibility to meet its economic and social development objectives.