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COLOMBIA

IDB COUNTRY STRATEGY 2015-2018[1]

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[1] This strategy expires on 6 August 2018.

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ABBREVIATIONS

CCLIP	Conditional credit line for investment projects
CDC	Country Development Challenges
CGN	Contaduría General de la Nación [General Accounting Office]
CIGERH	Comisión Interinstitucional para la Gestión del Recurso Humano [Interinstitutional Human Resources Management Commission]
Colciencias	Departamento Administrativo de Ciencia, Tecnologia e Innovación [Department of Science, Technology, and Information]
Colfuturo	Fundación para el Futuro de Colombia [Foundation for Colombia’s Future]
DANE	(Departamento Administrativo Nacional de Estadística [National Administrative Department for Statistics]
DIAN	Dirección de Impuestos y Aduanas Nacionales [Department of National Taxes and Customs]
DNP	Departamento Nacional de Planeación [National Planning Department]
ICA	Industry and commerce tax
ICBF	Instituto Colombiano de Bienestar Familiar [Colombian Family Welfare Institute]
IIC	Inter-American Investment Corporation
INTOSAI	International Organization of Supreme Audit Institutions
INVIAS	Instituto Nacional de Vías [National Highways Institute]
IPSAS	International Public Sector Accounting Standards
LAC	Latin America and the Caribbean
MAPS	Methodology for Assessing Procurement Systems
MFA	Más Familias en Acción [More Families in Action]
MHCP	Ministry of Finance and Public Credit
MIF	Multilateral Investment Fund
OCI	Internal Control Office
OECD	Organization for Economic Cooperation and Development
OMJ	Opportunities for the Majority Sector
PBL	Policy-based loan
PISA	Program for International Student Assessment
PND	National Development Plan
PPP	Purchasing power parity
R&D	Research & development
RAIS	Régimen de Ahorro Individual con Solidaridad [Solidarity-Based Individual Savings Regime]
RPM	Régimen de Prima Media [Average Premium Regime]
SCF	Structured and Corporate Financing Department
SIIF	Sistema Integrado de Información Financiera [Integrated Financial Information System]
VAT	Value-added tax
WEF	World Economic Forum

I. EXECUTIVE SUMMARY

1.1 **In August 2014, a new political cycle began in Colombia,** forming the backdrop for the Bank's preparation of a new country strategy for the 2015-2018 period. The document presented below is the result of analytical work carried out by the Bank in close dialogue with government authorities, business sectors, civil society, and diverse sectors of Colombian society. Design of the country strategy has coincided with preparation of the National Development Plan (PND) approved in May 2015. The Bank has supported, in several areas, the preparation of the PND, in order to align the country strategy with the country development objectives presented in the plan (see link and Annex I). The government's priorities include concluding peace negotiations and preparing a broad public sector agenda for accelerating equitable development in the country.

1.2 **The country strategy is guided by a long-term vision.** The Bank's dialogue with different sectors of Colombian society has helped to build a long-term vision that underlines Colombia's opportunity to become a high-income country over the next 20 years, with a robust middle class and the elimination of extreme poverty. This vision guides the country strategy, which is built on structural themes that will require a medium and long time horizon to address. The advancement and consolidation of this vision will require robust macroeconomic policies—particularly fiscal and monetary—as well as a growing role for the private investment that has supported growth.

1.3 **The country strategy is a pilot exercise under the new country strategy guidelines** (document GN-2468-7). This document begins with a summary of Colombia's economic context, followed by a synopsis of Bank actions in Colombia under the previous strategy. It continues with a presentation of the strategic vision and the objectives and priority policy areas that comprise it, which address Colombia's major development challenges: (i) increase productivity; (ii) improve public management effectiveness; and (iii) ensure greater social mobility. Lastly, the document presents an estimate of the government's financing requirement; the Bank's potential contribution to that requirement; and issues related to country strategy implementation and risks. The technical details, analyses, and proposals summarized in this country strategy can be found in the Country Development Challenges (CDC link), together with the bibliography.

II. COUNTRY CONTEXT

There has been a favorable shift in Colombia's macroeconomic indicators over the last 20 years. At 4.8% in the 2010-2012 period, Colombia's growth rate was two percentage points higher on average than in the 1990s (surpassing LAC-5 and EME-6 by around one percentage point).[2] The country also succeeded in controlling inflation, which fell from an annual rate of 22% to 3%. The public debt (34% of GDP) and fiscal balance (-1.5% of GDP) stood at sustainable levels in 2014, comparable to those of EME-6 and LAC-5. Investment (mostly private) rose from 14% of GDP in 2000 to 24% of GDP in 2012, and savings climbed from 16% to 20% of GDP. The observed gap of 3.6% of GDP between savings and investment was covered in large part by foreign direct investment, indicating a certain vulnerability should the positive flow of capital decelerate.

2.2 **Progress with respect to social indicators was also highly positive.** Unemployment fell from 16% to 9% over the 2002-2014 period. Inequality (as measured by the Gini coefficient) improved marginally over the same period, from 0.57 to 0.54. Poverty, in turn, fell substantially, from 50% of the population in 2002 to 29% in 2014, and extreme poverty dropped from 18% to 8% over the same period. Similarly, there was a strong expansion in the middle class, which absorbed a significant share of previously poor households and grew from 37% of the population in 2003 to 55% in 2012.[3]

2.3 **External conditions contributed to the positive economic and social performance.** The terms of trade improved by 75% between the mid-1990s and 2013, driven by an increase in the value of exports (particularly oil and minerals). Capital flows grew substantially, rising from an average of US$3 billion in the 1990s to US$20 billion on average over the 2009-2013 period. However, since mid-2014 it has been apparent that the commodity-driven expansion is coming to an end. The terms of trade, which were stable over 2011 and 2012, began to deteriorate in 2013 and 2014. The new stage in the world economy could limit capital flows to developing countries and reduce the pace of private investment required by Colombia.

2.4 **In the current context, trends in oil prices constitute a challenge for the external and fiscal accounts.** The abrupt decline in the price of hydrocarbons since the middle of 2014 has affected the value of exports of these products, which currently account for 53% of total exports. The fiscal balance could also be significantly affected. The 2015 budget originally projected an oil price of US$98 per barrel. The new projection made by the government in December 2014 reduced the expected price to US$48 per barrel, representing a drop of 49%. As a result, the fiscal deficit for 2015 was revised upwards, from 2.2% of GDP to 2.6%.[4] Given recent exploration results,[5] it may be difficult to maintain production stable at one million barrels per day. A scenario in which there is a 10% fall in production would mean an additional reduction of 0.2% of GDP, raising the deficit to 2.8% of GDP.

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2 LAC-5 includes Brazil, Chile, Colombia, Mexico, and Peru. EME-6 consists of South Africa, Korea, Indonesia, Malaysia, Thailand, and Turkey.

3 IDB. Castellani et al. (2013).

4 Ministry of Finance and Public Credit (2015).

5 Ahumada (2014).

2.5 **Colombia also faces commercial risks due to a decline in the growth rates of its main partners in the region.** According to IMF projections,[6] a 1% reduction in growth rates in its main trade partners could lead to a decline of 0.5 percentage points in GDP growth for 2015. The decline in Venezuela as an export market for Colombia should also be noted. In 2000, 10% of external sales were to this neighboring country, while in 2013 the figure was 4%.[7]

2.6 **Despite progress in the economy, the process of convergence with the developed countries has languished.** Although Colombia has grown by more than 4% per year since 2000, this is insufficient to ensure convergence with developed countries' income levels. In 1990, Colombia's per capita GDP was 29% of the average for Organization for Economic Cooperation and Development (OECD) member countries. By 2000, in the wake of the economic crisis in the late 1990s, this figure had fallen to 20%, and by 2011 it had recovered only partially to 24%. Current per capita income is 80% lower than that of the developed countries such as the United States. The gap analysis contained in the CDC shows that the most significant factors underlying this situation are: (i) low factor productivity; (ii) low public management effectiveness; and (iii) limited social mobility and a weak middle class. Improving Colombia's competitiveness and reducing "country cost" requires overcoming the country's economic, institutional, and social vulnerabilities.[8]

2.7 **Economic productivity.** There is a significant productivity gap between Colombia and the middle- and high-income countries. The average annual change in GDP growth per worker remained at around zero between 1990 and 2011. Countries with similar income levels experienced productivity growth of between 1% and 3%. In comparison, productivity grew by more than 4% in Peru and more than 6% in China.[9] In the 2007-2011 period, productivity in Colombia[10] grew moderately (by over 1%), driven in large part by the extractive industry.[11]

2.8 **GDP growth in Colombia has been driven mainly by factor accumulation (labor and capital).** From 1961 to 2011, per capita GDP grew on average by 2% per year, as follows: total factor productivity contributed 0.1 percentage points; physical capital accumulation, 1.4 percentage points; and the combined effect of population growth, employment, and human capital accumulation, 0.5 percentage points.[12] The limited productivity of the Colombian economy is explained, among other things, by low rates of innovation relative to elsewhere in the world. Education and job training systems suffer from major quality and relevance problems in terms of building advanced skills. There are substantial infrastructure gaps, and those entering the labor market with low levels of education are generally employed in the informal sector. To correct this situation, Colombia

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6 IMF (2014b).

7 United Nations (2014).

8 For the most recent studies on this issue, see CDC, World Economic Forum (2014), and OECD (2013, 2015).

9 Authors' calculations based on IDB. Fernandez-Arias and Daude (2014).

10 Measured as GDP per worker.

11 OECD (2015).

12 World Bank (2014b).

needs to give priority to (i) promoting innovation and development in business and agriculture; (ii) supporting quality education and job training; and (iii) improving the quality and financing of infrastructure and urban development in the country.

2.9 **Public management effectiveness.** Colombia's institutional performance places it in 123rd position out of 144 countries—below the average for LAC-5 and EME-6 in areas such as government efficiency, transparency, and citizen security. According to an IDB study,[13] efficiency in the use of available physical and human capital in Colombia over the 1996-2011 period was 74% of the average efficiency level achieved by the OECD countries and less than 50% of efficiency levels in countries that were most developed in this respect. More than half of inefficiency in the use of production factors in Colombia can be explained by problems of public management.[14] Priority issues that need to be addressed to improve institutional productivity include: (i) increasing State revenues at both the national and subnational levels; (ii) improving the quality of expenditure and public investment management capacity; and (iii) enhancing the efficiency and quality of justice.

2.10 **Social mobility and consolidation of the middle class.** Colombia has traditionally been a country with very low social mobility. However, there has been a significant change over the last decade, with a reduction in poverty leading to a marked expansion of the middle class. The moderate poverty rate decreased by 21 percentage points between 2002 and 2014, while the extreme poverty rate dropped 10 percentage points, falling by more than half over the period. According to IDB estimates, the middle class expanded by 18 percentage points between 2003 and 2012. The favorable social developments were spurred by changes in employment and wage earnings and an increase in transfers to the low-income population. These trends can be attributed to two factors: economic growth and redistributive policies. Economic growth accounted for 70% to 80% of the reduction in extreme poverty over the 2002-2013 period, and 80% to 90% of moderate poverty.[15] The growth of the last 20 years has driven the expansion of Colombia's middle class. Nonetheless, this income group faces hardships in terms of access to quality public services and the level of economic informality, among other things. The pension system is characterized by low coverage and high costs. Though health system coverage is broad, low service delivery capacity at the primary care level creates a bias in favor of specialized care. A recent IDB study shows that there are gaps in the delivery of basic services in Colombia.[16] For example, only 58% of the population is connected to the public water supply system.[17] These limitations are particularly hard on the vulnerable middle class—the one-third of the middle class that is closest to the poverty line.[18] Fostering social mobility and growth in the middle class will require: (i) further reducing poverty, with emphasis on extreme poverty; (ii) reducing informality levels in the economy;

13 IDB. Giménez et al. (2015). Average efficiency in Latin America and the Caribbean is 45%, compared with 48% in Colombia and 65% in OECD member countries.

14 As measured by the government effectiveness index in Worldwide Governance Indicators, World Bank (2014c).

15 Cruces and Gasparini (2013), World Bank (2014b), and authors' calculations.

16 CDC, Chapter II.

17 Instituto Nacional de Salud [National Health Institute] (2013).

18 IDB. Castellani et al. (2014).

(iii) consolidating a sustainable and inclusive pension and health system; and (iv) providing equitable access to quality basic services.[19]

III. THE IDB IN COLOMBIA

3.1 **IDB Country Strategy with Colombia 2012-2014 (document GN-2648-1).** The country strategy focused on the following sectors: (i) transportation; (ii) science, technology, and innovation; (iii) trade; (iv) access to financial services; (v) education and vocational training; (vi) social protection; (vii) health; (viii) water and basic sanitation; (ix) urban development and housing; (x) risk management; and (xi) governance and modernization of the State. The following areas for dialogue were also included: (i) agriculture; (ii) environmental management and adaptation to the consequences of climate change; (iii) entrepreneurship promotion policies; (iv) fiscal policy; (v) citizen security; (vi) energy efficiency and renewable energy; (vii) government policy monitoring and evaluation systems; (viii) information and communication technologies; (ix) international cooperation, in particular South-South cooperation; and (x) integration.

3.2 The Bank used a wide variety of instruments to address the aforementioned priority areas, both financial (investment and programmatic loans) and nonfinancial (knowledge products, technical cooperation, and fee-for-service). As the Office of Evaluation and Oversight (OVE) acknowledges in its Country Program Evaluation for Colombia, 2011-2014, the Bank's operational program showed a high degree of adaptation to the country's needs in a context of shifting priorities and changes in the country's access to international financial markets. The IDB also positioned itself as a strategic partner, leading the technical dialogue in priority areas for the country, such as tax reform and the pension system.

3.3 **Approvals.** During the country strategy period, 23 sovereign guaranteed operations were approved for US$2.648 billion, including 6 policy-based loans (PBL) for US$1.65 billion (62% of total financial support). Around 80% of financing was concentrated in three sectors: governance and modernization of the State (US$708 million), health (US$650 million), and vocational training (US$500 million). A total of 52 technical cooperation operations were approved for US$26 million. In addition, 16 non-sovereign guaranteed operations (loans, guarantees, and equity investments) were approved for US$146.4 million: 2 operations (US$7.2 million) from the Structured and Corporate Financing Department (SCF); 4 operations (US$45.3 million) from the Opportunities for the Majority Sector (OMJ); 6 operations (US$86.5 million) from the Inter-American Investment Corporation (IIC); and 4 operations (US$7.4 million) from the Multilateral Investment Fund (MIF). These operations primarily support the area of access to financial services. In terms of nonreimbursable technical assistance, the MIF approved US$9.4 million; the SCF, US$400,000; and the OMJ, US$150,000, supporting various models to facilitate financial inclusion, entrepreneurship, and access to job markets and health care.

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[19] Among the major challenges faced by vulnerable middle-class households is the quality of education. Given the importance of education to productivity in the economy, the topic is addressed within that strategic area.

3.4 **Active portfolio.** The active sovereign-guaranteed portfolio[20] comprises 24 investment operations for US$1.545 billion, with an average age of 2.7 years. A third of the operations were approved in 2013, and the disbursement level is 25.4%. The average size of investment operations is US$67 million. There are also two active PBLs for US$400 million and US$500 million, approved in 2014 and 2015, respectively, and with disbursements expected in 2015. The investment portfolio is concentrated in four sectors (90% of the total): water and sanitation (35%); transportation (30%); support to financial institutions (14%); and public management and finances (11%). The rest is in State reform (4%), education (3%), science and technology (2%), and trade and integration (2%). Disbursements totaled US$1.732 billion over the 2012-2014 period, 30% of which corresponded to the investment portfolio. The active private sector portfolio[21] consists of 16 operations with an exposure of US$93.1 million, of which 79% corresponds to the IIC, 15% to the SCF, and 6% to the OMJ. This portfolio is concentrated in financial services (62%) and energy and transportation infrastructure (31%). The MIF portfolio contains 42 operations for US$48.2 million, with an undisbursed balance of US$25.3 million. It is concentrated in microenterprises and small businesses, local economic development in post-conflict areas, and youth employment creation. The active technical cooperation portfolio includes 56 operations for US$34 million, with an undisbursed balance of US$15 million. The average size of these operations is US$607,000. There are also three investment grants for US$8.5 million, with an undisbursed balance of 50%. The technical cooperation portfolio is distributed across the following sectors: environment (24%); energy (16%); social investment (12%); State reform (10%); transportation (9%); urban development (7%); health (6%); water and sanitation and fiscal management (4% each); and education (3%); with the rest in agriculture, science and technology, trade, and tourism (5%).

3.5 **Dialogue in strategic areas.** The Bank has contributed to the policy dialogue in areas such as tax reform, active productive development policies, the pension system, and agricultural and health policies, generating in-depth knowledge products and policy discussions at the highest level. It has also been a critical partner in exploring new modalities for education in the country, as well as in investment financing, e.g. through public-private partnerships and support for fourth-generation (4G) concession contracts, and for the Metro and the Bogota perimeter corridor. The Bank has also provided support for several of Colombia's strategic development initiatives at the regional level (such as the Pacific Alliance and the Andean Electric Interconnection System), as well as border crossings and the country's accession to the OECD.

3.6 **Results achieved and in progress.** The main results obtained over the country strategy period were in (i) transportation, (ii) health, (iii) modernization of the State, (iv) vocational training, (v) sustainable development and climate change, (vi) territorial development, and (vii) the private sector. In the area of transportation, national policies for logistics and road safety were developed and implemented, both of which are strategic within the framework of the Pacific Alliance. In the area of urban transportation (50% of sector approvals), Bogota's integrated mass transit

[20] Portfolio data current as of October 2015.

[21] As of 18 June 2015.

system was strengthened with 100 low-carbon buses, and strategic public transportation systems were developed in four intermediate cities (Armenia, Pasto, Popayán, and Santa Marta). The fee-for-service modality was used to advise the State-owned airline SATENA[22] on its restructuring process.

3.7 *Health.* The delivery of health services for remote and rural communities was strengthened; the availability of strategic information for the Ministry of Health on system membership, revenue collection, and payments to agents was improved; the Institute for the Evaluation of Health Technologies was created; and technical inputs for the development of a new pharmaceutical policy were generated, all through two loans under a programmatic series and four technical cooperation operations.

3.8 *Governance and modernization of the State.* The main results are: (i) consolidation of the State's capacity to manage contingent liabilities, with support for the launch of the Agencia Nacional de Defensa Jurídica del Estado [National Agency for Legal Defense of the State]; (ii) strengthening of public expenditure systems linked to royalties, with the creation of a technological platform (MapaRegalías) that integrates the planning, implementation, and monitoring of public investments linked to royalties; and (iii) improved delivery of public services, with the design of integrated customer care units.

3.9 *Vocational training.* The main result has been the reform of the Human Capital Formation System, achieved through: (i) creation of the Interinstitutional Human Resources Management Commission (CIGERH); (ii) development of a Sector Statistics Plan for Human Resource Management and administration of a business survey on productivity and human resources training; (iii) development of a pilot project for standardization, evaluation, and certification of skills in the Medellín technology, information, and communications sector; and (iv) an analysis of CIGERH entities and preparation of a proposal for a new institutional structure.

3.10 *Sustainable development and climate change.* In the area of climate change, the Bank has supported mitigation and adaptation interventions in the country. Concerning adaptation: (i) the Ministry for Environment and Sustainable Development was strengthened in adaptation management, and knowledge was generated on the impact of climate change in Colombia; (ii) support was provided to arrange investment funds from the Special Climate Change Fund at the Global Environment Facility to finance adaptation actions aimed at guaranteeing water supply and regulation services in high Andean ecosystems. Interventions in the area of climate change included: (i) a study on the economic impacts of climate change; (ii) strengthening of the Ministry of Environment's Technical Group on Climate Change Mitigation and Adaptation; (iii) tapping of international funds to finance adaptation actions; and (iv) design of the new Adaptation Fund responsible for reconstruction in regions affected by the La Niña phenomenon. In the area of mitigation, the Bank has worked actively with the Clean Technology Fund to structure financing mechanisms that will promote investments in climate change mitigation. The Bank is also supporting Colombia in the creation of a cross-sector initiative that will facilitate coordination between national agencies, finance

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[22] Servicio Aéreo a Territorios Nacionales [National Territory Air Service], a company responsible for providing air transportation services to isolated communities.

environmental conservation projects, and promote sustainable long-term rural development.

3.11 *Territorial and subnational development.* Support was provided to strengthen subnational entities in the areas of public financial management, quality of expenditure, fiscal data, revenue collection, and reporting. The operations program was based on a conditional credit line (CCLIP) with Financiera de Desarrollo Territorial, S.A. This effort led to the following achievements: (i) increases in subnational tax revenue; and (ii) adoption of a single system of indicators for rating risk events in the use of resources under the General Revenue-Sharing System. The Bank is currently supporting development in San Andrés through a comprehensive program of water and sanitation, basic infrastructure, entrepreneurship, fiscal management, and tourism. As part of the Emerging and Sustainable Cities Initiative, diagnostic assessments and roadmaps were prepared for six cities, and studies were launched for an additional four cities. A US$100 million loan has been approved for Barranquilla, and another operation for five more cities is being considered for approval.

3.12 *Private sector.* Non-sovereign guaranteed operations have complemented sovereign guaranteed projects in several strategic areas. The main results have been as follows: (i) support for mortgage financing with COMFAMA for the construction of 400 low-income housing units; (ii) improved access to financing through an innovative project with Empresas Públicas de Medellín that uses the service payment system as a credit history (benefiting more than 160,000 households); (iii) financing for more than 300 small and medium-sized enterprise projects; (iv) clean, renewable energy projects expected to generate 244 GWh per year; (v) "smart capital" support for 24 highly innovative start-ups in the areas of communications, health, and clean technology; and (vi) leadership of the group of banks that financed the new El Dorado international airport in Bogota.

IV. STRATEGIC VISION, OBJECTIVE, AND STRATEGIC AREAS

Colombia: Becoming a high-income country with social mobility

4.1 **Over the last 20 years, Colombia has graduated from the ranks of low-income countries to become a middle-income country.** In the mid-1990s, per capita income was US$6,000 on a purchasing power parity (PPP) basis, while in 2014 it topped US$12,000.[23] As a result, the country now belongs to a group of comparable countries in the region, such as Brazil, Mexico, Peru, and Costa Rica. Factors contributing to this significant achievement have been consolidation of the macroeconomic policy framework, a receptive environment for private investment, and improvements in public security. The middle class now includes 55% of Colombian households.[24]

4.2 **Colombia has the opportunity to become a high-income country with a strong middle class approaching 70% of the population over the next 20 years.** Colombia belongs to a group of Latin American and Caribbean countries

[23] Constant 2011 prices.

[24] IDB. Castellani et al. (2013). Calculations based on net family income of US$10 to US$50 (PPP) per day, adjusted according to family composition and adult equivalent (OECD scale).

that have the potential to reach a per capita GDP of US$30,000 (PPP) and join the ranks of the developed nations, with a diversified and internationally competitive economy, a stable and transparent political system, and greater social mobility opportunities. For this to occur, the economy would need to grow by 6% per year on a sustained basis, higher than the average 4% rate recorded over the last decade.

4.3 **This will require, among other things, a significant increase in public investment.** The Colombian government has invested an average of 3.6% of GDP in infrastructure in recent years. A target of 6% economic growth would require a doubling of this investment effort, with levels of around 7% per year (see Box 1). A more secure environment is creating favorable conditions in the country for meeting this target, with public and private agents increasing access to the country's territory. For an estimate of the cost of the additional public investment proposed in this country strategy, see the following link.

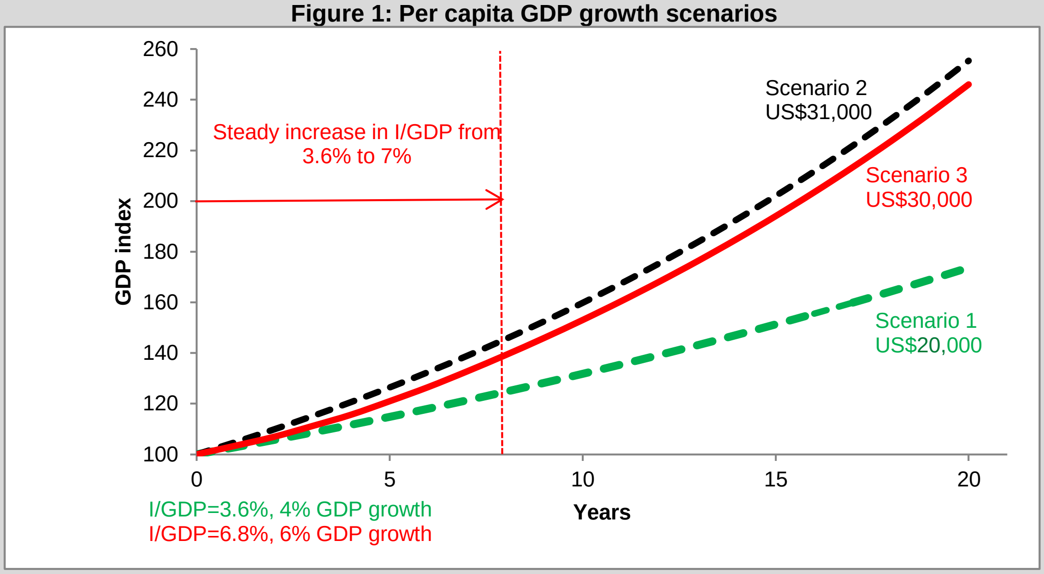
4.4 **This agenda will require a fiscal compact to generate greater tax revenues.** Central government tax revenue stands at between 14% and 15% of GDP. Subnational governments collect between 2% and 3% of GDP, bringing general government tax revenue to between 16% and 18% of GDP. This is below the international standard for similar economies (around five percentage points higher than in Colombia) and for developed countries (with average revenue of 26% of GDP).[25] The country needs to increase its tax revenue in order to double public investment and achieve these development objectives. Comprehensive tax reform, with the objective of progressively increasing revenues, would improve fiscal sustainability and generate funding for public investment to support economic growth. To this end, the country should agree on a fiscal compact with the goal of investing in faster economic growth, improving the population's quality of life, and graduating to developed country status within the course of one generation.

[25] IMF (2013). General government data, excludes social security contributions and capital revenue.

Box 1. Becoming a high-income country within 20 years

Increased public investment is the government's main tool for accelerating economic growth (see below for the methodology used). Three growth scenarios were estimated in relation to the volume of investment. **Scenario 1** keeps investment at the 2012 level of 3.6% of GDP. The result, after 20 years, is per capita GDP of US$20,000. This is clearly better than the current income level of US$12,000, but it is far below potential for the country and is still within the range for middle-income countries. **Scenario 2** assumes investment of 7% of GDP over a 20-year period, starting in year 0. In this case, per capita income reaches US$31,000 at the end of the period, within the range for developed countries. However, this scenario is unlikely given current fiscal constraints on public investment financing. **Scenario 3** recognizes that an increase in tax revenue is required to provide the State with additional funding for investment, and that the process of instituting reform and generating a steady increase in revenues will take time. This realistic scenario takes into account the complex political economy of a structural fiscal reform such as the one required in Colombia. Accordingly, a period of seven years has been calculated for increasing collections and public investment, bringing national and subnational tax revenue to around 20% and 5% of GDP, respectively (currently 15% and 3%), with public investment at 7% of GDP. The scenario assumes that once the planned level of investment is attained in year 7, the rate then remains constant for 13 years. Based on the assumptions under this scenario, it is estimated that the country could achieve per capita income of US$30,000. This scenario is more viable than the second one (which assumes investment of 7% of GDP from year 0), and the result is broadly similar in terms of per capita income. This exercise shows that it is possible to escape the middle-income trap (scenario 1), attain a growth path of 6% per year, and increase per capita income from US$12,000 currently to US$30,000, thus moving the country into a high economic development bracket within a 20-year time period.

Figure 1: Per capita GDP growth scenarios



Source: Authors' calculations based on Lozano and Rodríguez (2009), Ilzetzki et al. (2013), and Fedesarrollo (2014).

To calculate the impact of public investment on GDP growth, the fiscal multiplier estimated by Ilzetzki et al. (2013) for a group of developing countries was used. The authors estimate a structural vector autoregressive model that includes public investment, GDP, private investment, and other control variables (interest rates, inflation, fiscal revenue) with the aim of incorporating, for example, the crowding-out effects of public investment on private investment and problems of fiscal sustainability. The fiscal multiplier is defined at *t*=0 as $m = \frac{\Delta Y_t}{\Delta I_t}$, where *m*, *Y*, *I*, and Δ are the fiscal multiplier, GDP, public investment, and the differential operator, respectively. Accordingly, the effect on the rate of growth ($\theta_t = \frac{Y_{t-1}}{Y_{t-1}} - 1$) of public investment as a proportion of GDP (*i*) is equal to $\theta_t = \frac{1-m\times i_t}{1-m\times i_{t-1}} - 1$.

4.5 **The country strategy is consistent with the IDB Group's institutional strategy.** The major themes analyzed in this country strategy are consistent with the objectives of the update to the IDB Group's institutional strategy,[26] particularly in terms of reactivating domestic sources of growth through economic productivity; developing institutional capacity and the rule of law; and reducing social exclusion and inequality. The country strategy is also aligned with the GCI-9[27] general and strategic objectives of reducing poverty and inequality, contributing to sustainable growth, and fostering development through the private sector.

Strategy objective and strategic areas

4.6 **Objective.** The objective of the 2015-2018 country strategy is to support strategic areas that will contribute in the short and medium term to achieving the strategic vision of transforming Colombia into a high-income country with social mobility within two decades. To achieve this objective, the country's vulnerabilities will need to be addressed with respect to sustained growth, increased productivity, improved institutions, and greater social mobility. The following sections lay out the challenges identified in the strategic areas and the strategic objectives, with proposals for addressing them. The strategic areas and respective strategic objectives correspond to the country's major development challenges as identified in the Bank's analytical work and agreed upon with the government and in line with the PND. The proposals included in the strategic objectives are policy recommendations for the government. The Bank may provide operational support for some of these recommendations in agreement with the government during each programming exercise.

4.7 **Strategic areas.** There are multiple hurdles to growth in Colombia, constituting what is known as "country cost." However, these bottlenecks can be grouped into the three closely-linked strategic areas mentioned above: (i) **economic productivity;** (ii) **public management effectiveness;** and (iii) **social mobility and consolidation of the middle class.** Reducing country cost and enhancing growth prospects will require sustained effort over the next 20 years. These strategic areas were identified based on an analysis of gaps between Colombia and international comparators, including middle-income countries in the region (LAC-5), emerging economies (EME-6), and OECD member countries. Each strategic area is discussed below, together with the evidence concerning gaps and proposals to close these gaps over the short, medium, and long term. The proposals are accompanied, where necessary, by a quantification of fiscal costs.

4.8 **The challenges for the country include cross-cutting issues that affect productivity, public management effectiveness, and social mobility.** These issues are (i) gender and diversity; (ii) climate change; and (iii) integration. All of these are considered in the country strategy, under the strategic areas in which they have greatest impact. As a whole, this country strategy seeks to contribute to a sustainable Colombia through the various strategic areas, strategic objectives, and crosscutting areas.

[26] Update to the Institutional Strategy 2010–2020: Partnering with Latin America and the Caribbean to Improve Lives (document AB-3008).

[27] Report on the Ninth General Increase in the Resources of the Inter-American Development Bank (document AB-2764).

4.9 **The private sector is key to Colombia's development.** Given the country's level of development and the magnitude of the challenges, the private sector must play an important role in Colombia's transition from a middle-income country to a high-income one. Increased productivity will also depend on business investment and dynamics, and on good corporate governance. Greater social mobility—expanding and consolidating the middle class—will depend in large part on the private sector's ability to absorb the work force (thus reducing the economically marginalized population) and provide the high-quality goods and services demanded by the population. **The IIC will contribute to implementation of this strategy.** Where market failures are present, the Corporation will act to promote private investment, improving its efficiency and development effectiveness, strengthening financing for small and medium-sized enterprises, and identifying synergies with sovereign guaranteed operations. The Bank's private sector has demonstrated experience in the following areas of intervention:[28] (i) enterprise and innovation financing; (ii) support for value chains in the agricultural sector and environmentally sustainable agroindustrial projects; (iii) transportation infrastructure, with interventions in public-private partnerships, airports, ports, and urban transportation; (iv) urban development, strengthening the mortgage market; (v) health, with public-private partnerships and strengthening of value chains; and (vi) basic services, with innovative green energy solutions and the introduction of innovative mechanisms aimed at financing water and sanitation for vulnerable population groups.

Economic productivity

4.10 This strategic area focuses on increasing the supply of public goods and progressively reducing subsidies in a more educated society. It encompasses the following strategic objectives:[29] (i) spur innovation and development in business and agriculture; (ii) achieve quality education and giving priority to the most vulnerable sectors of the population; and (iii) raise the quality of infrastructure in order to reduce transaction and transportation costs in the economy.

4.11 At the same time, it is important to develop markets by continuing to develop integration policy. Colombia has significant preferential access to the Andean Community countries, and it has signed free trade agreements with its main export markets, the United States and the European Union (in force since 2012 and 2013, respectively). It is in the process of implementing similar agreements with Canada and the European Free Trade Association, and it has signed others with Korea, Panama, Israel, Costa Rica, and the Pacific Alliance.

4.12 ***Spurring innovation and development in business and agriculture.*** Key areas within this strategic objective are innovation, access to financing for the private sector, and agricultural development.

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[28] For further information on private sector potential and challenges in Colombia and the Bank's role, see IDB (2015e).

[29] Given the way in which this document is organized, the issue of labor informality is discussed under the final strategic area (social mobility), though it affects both social mobility and productivity.

Innovation: Essential requirement for growth (see CDC, paragraphs 3.2 to 3.7)

4.13 **A competitive environment generates incentives for innovation**. A competitive environment and an open market are incentives of great importance for innovation processes. Without excluding other factors, policies to promote growth and productivity gains through the creation and adoption of new technologies are more effective in a market environment that stimulates competition. Based on international standards, Colombia ranks 128th out of 144 countries with respect to innovation, and 136th out of 144 in terms of a favorable environment for market competition.[30] **Weak investment in research and development (R&D) dampens growth potential**. Spending on R&D is 0.22% of GDP, below the average of 0.75% for Latin America and the Caribbean and the OECD average of 2.36%. The private sector finances around 30% of R&D, which is insufficient when compared with more developed countries at the knowledge frontier, in which the share of private enterprise is over 60% (e.g. Finland, Korea, Israel). **For its level of development**, **the availability of skilled human capital for R&D in Colombia is insufficient.** Colombia has 346 researchers per 1,000,000 population, compared with 4,712 in Spain, 1,514 in Argentina, and 872 in Brazil.[31] Sixty-two percent of companies intending to innovate found the lack of qualified personnel to be an obstacle,[32] meaning that the insufficient availability of human resources may become a constraint on the capacity of the innovation system.[33] **The institutional framework for the sector is complex and disjointed**. There is no clear separation between the strategic roles of policy design and policy execution. In other words, the policy decision-making level coexists with the execution level within the same institutions (i.e. Colciencias, Ministry of Trade). The result is limited effectiveness in both policy design and implementation.[34]

4.14 **Proposals.** The development of more competitive markets is a recommendation in many of the proposals under the various areas of this country strategy. The following policy actions are suggested specifically to spur innovation: (i) **steadily increase investment in the sector to 2.3% of GDP**—close to the OECD level—which will require maintaining or increasing the budgets of public agencies that leverage private investment; (ii) **increase private sector participation through new financial and nonfinancial instruments** similar to those used by other countries in the region, such as Brazil and Chile; (iii) **develop human capital** through a massive program of grants aimed at producing 4,000 new researchers each year, making use of existing national regimes such as Colfuturo and Colciencias[35, 36]; and (iv) **restructure the institutional framework** by separating

30 Source: Authors' calculations based on World Economic Forum (2014).

31 Red de Indicadores de Ciencia y Tecnología [Network of Science and Technology Indicators] (RICYT) (2011).

32 Survey of Technological Development and Innovation in Manufacturing, 2013 (National Administrative Department for Statistics, DANE).

33 OECD (2014).

34 IDB (2014a).

35 The OECD (2014) finds that a key factor underlying growth in the number of doctorates in Colombia has been the availability of grants and loans from Colciencias (the main funder), followed by Colfuturo and the Colombian Institute for Education Loans and Technical Studies Abroad (ICETEX). It also recommends the expansion of grant and loan programs for university studies.

and differentiating the functions of policy design and strategy from policy execution.

Private sector financing: Increase access to credit **(**see CDC, paragraphs 3.8 to 3.12)

4.15 **Access to business credit remains limited**. Studies on financial depth and economic growth point to a positive correlation between these variables.[37] Financial depth, measured as the ratio of credit to GDP, is 40% in Colombia, compared with an average of 50% in the region and 112% in the OECD economies. While micro, small, and medium-sized enterprises in Colombia account for 99% of firms, 80% of private employment, and 35% of GDP, these companies receive only 14% of commercial loans. **Access to the banking system has improved in Colombia, although use of the system still needs to be extended and deepened**. Among the poorest 40% of the population, only 15% have a bank account, compared with 45% of the remaining 60%. **The cost of credit is high and access to business loans remains limited.** The interest rate spread in Colombia stands at around 7%, compared with 4.5% in Chile and 3% in EME-6.

4.16 **Proposals.** The following policy actions are suggested for this strategic objective: (i) **develop active policies that support improved access to financing**, with the development of mutual guarantee systems; (ii) **improve rules and regulations to reduce interest rate margins**, lower the cost of forced investments, improve competition, and develop secondary markets; and (iii) **improve credit access by stimulating supply and demand,** expanding second-tier financing to correct market failures, extending financing terms, promoting nonfinancial services to improve the entrepreneurial skills of underserved sectors, and promoting access to credit for women.[38]

Agricultural development: Boost productivity and expand the frontier (see CDC, paragraphs 3.13 to 3.18)

4.17 **The agricultural sector has stagnated, despite its potential.** Colombia's rural sector rests on 22 million hectares of arable land, of which only 5.3 million are being farmed. Currently 38.8 million hectares are used for pasture and extensive livestock farming, and only 477,575 hectares for commercial forestry.[39] Agriculture as a share of total GDP fell from 9% in 2000 to 6.2% in 2014. While the economy has grown by 4.4% per year on average over the last decade and a half, agricultural sector growth has been 2.5% per year. At the same time, a review of total factor productivity in agriculture compared with several countries in the region

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[36] Fedesarrollo (2014) has shown that the Colciencias' program of grants and loans for postgraduate studies has a high rate of economic return. Colciencias' grant and loan programs currently have a forgiveness mechanism that encourages postgraduates to live in Colombia and participate in science, technology, and innovation activities in the public and private sectors.

[37] IDB. Crespi et al. (2014) and Mhadhbi (2014).

[38] According to the World Bank's Financial Inclusion Index, in 2014, for the population aged 15 and older, 14% of women had taken out a loan with a financial institution, compared with 18% of men. However, this area of inquiry requires further research. It should also be noted that a key objective of the 2014 financial inclusion plan (Financial Superintendency of Colombia) is to increase access to financial services for the low-income population.

[39] Instituto Geográfico Agustín Codazzi [Agustín Codazzi Geographic Institute] (2012).

shows that Colombia had the worst performance.[40] Total factor productivity growth in agriculture in Chile and Peru improved over the 2006-2011 period compared with the 2001-2005 period and is six times higher in Chile than in Colombia, and seven times higher in Peru. **Sector budgets are dominated by subsidies rather than public goods.** Sector public expenditure is concentrated in subsidies (90% of the total) rather than sector public goods (which account for only 10% of the budget).[41] Other countries in the region invest an average of 50% in public goods that provide support for production. **Legal uncertainty with respect to property rights inhibits investment and technological change and reduces tax revenue**. In Colombia, illegal appropriation of large tracts of land and the existence of undocumented and informal rights create high levels of inefficiency and uncertainty in the sector. It is estimated that around 66% of properties in rural areas have no title, and 44% of rural areas are not included in the property register.[42] **Producer access to financial services remains very limited**. Only 38% of farmers have access to credit,[43] and the portfolio is just 32% of agricultural GDP.

4.18 **Proposals**. Increased productivity and competitiveness in agricultural sector production is an essential element in economic growth policies. The following policy actions are suggested: (i) **increase public investment in the sector and steer spending towards public goods**, prioritizing investment in irrigation districts and expanding the agricultural frontier, rural infrastructure, and public services, with a budget target of at least 50% in the form of public investment; (ii) **regularize property titles and boost the land market** by updating the rural property register, the land tax, and land use and planning; and (iii) **expand credit supply and private financing** by developing special production guarantee mechanisms, including strengthening of the Fondo Agropecuario de Garantía [Agricultural Guarantee Fund].

4.19 ***Achieve quality education and give priority to the most vulnerable sectors of the population*** (see CDC, paragraphs 3.19 to 3.25)

4.20 **Colombia has made significant efforts in recent decades to increase education levels in the population, though there are still significant gaps in the efficiency of expenditure and the quality of education**. Preschool attendance among 4- and 5-year olds is 80.5%. Coverage in the first six years of basic education is 96.7%, and average schooling rose from 6.7 years in 2000 to 7.4 years in 2012 (population between 25 and 64 years of age). Net secondary school coverage in urban areas rose from 82% to 84% from 2005 to 2013, and from 36% to 52% in rural areas. In urban areas, 76% of official enrollment is in schools with double-shift instruction, while in rural areas this percentage is 23%. **Colombia lags significantly behind in terms of the quantity and efficiency of education spending**. In relation to GDP, Colombia's effort is similar to that of the LAC-5, and is somewhat below 80% of OECD expenditure. However, spending efficiency is low, as suggested by the results of standardized tests under the

[40] International Food Policy Research Institute (2014).

[41] Public goods refer to rural infrastructure, animal and plant health services, technical assistance, etc.

[42] World Bank (2014b).

[43] Estrada (2014).

Program for International Student Assessment (PISA). The efficiency gap between the spending-to-GDP ratio and the PISA results is 23%, leaving Colombia in 63rd position out of the 65 countries that participate in the test. **Colombia faces major challenges with respect to the quality of education.** For example, 52% of children in third grade and 58% of those in fifth grade lack basic language skills according to national standardized tests (SABER).[44] In mathematics, the achievement gap between rural students and those in the highest quartile of the average national distribution was 18%—equivalent to almost two additional years of schooling. **Teacher quality is poor, and teacher assignments, in both social and territorial terms, are inequitable.** Only 18% of teacher training universities are accredited as providing high-quality instruction, and around 20% of students entering degree courses in the education sciences fall within the lowest 30% of the SABER 11 results distribution.[45] The compensation and incentives systems lack effective mechanisms for recognizing teacher performance, and they also fail to effectively identify the specific risks and conditions in which teachers work, such as rural isolation.

4.21 **Proposals**. The following policy actions are suggested in the education sector: (i) **increase investment in education and ensure the efficient and equitable use of these funds**, given that the additional funding necessary to achieve high-performance education is estimated to be of the order of 1.3% of GDP per year; (ii) **foster the development and assignment of effective teachers** through improved degree programs, grants for the best low-income students, progressive elimination of salary gaps to attract the best professionals, and a results-based teacher evaluation system; and (iii) **gradually introduce single-shift schooling**, focusing on the poorest sectors of the population and rural areas.

4.22 ***Raise the quality of infrastructure and urban development and reduce transaction costs in the economy*** (see CDC, paragraphs 3.26 to 3.37)

4.23 **Transportation costs constitute a major obstacle to productivity.** The average domestic cost per container is US$1,800, compared with US$700 for Latin America. The export cost is more than US$2,300, compared with US$1,300 for Latin America and US$1,080 for the OECD countries. The main causes of this situation are as follows: **The inadequate stock of infrastructure.** The density of the paved road network is low in Colombia, at 530 km per 1,000,000 inhabitants, less than in countries such as Brazil (1,066 km) and Mexico (1,188 km), and much less than in France (15,945 km).[46] **The low quality of transportation infrastructure affects productivity and competitiveness.** Colombia's road network is 213,000 km in length. Of these, only 25,000 km are paved. Colombia's score on the WEF index is 50% of the level for the OECD countries and Chile, and 25% below the average for Latin America. This indicator is especially important in the case of Colombia given that 72% of cargo is moved by road, compared with 50% in Brazil and just over 40% in Canada. **Investment in transportation infrastructure in Colombia has traditionally been low.** On average, the country invested less than 1% of GDP from 2002 to 2008, and between 1.5% and 2% from

44 SABER tests are administered by Instituto Colombiano para la Evaluación de la Educación [Colombian Education Evaluation Institute] (ICFES).

45 García et al. (2014).

46 Authors' calculations based on World Bank (2014a).

2009 to 2013, well below international comparators. Colombia invests around 0.4% of GDP in regional and rural roads, compared with 1% in other countries in the region such as Peru. **There are substantial inefficiencies in freight transport services.** In 2011, the distance traveled by trucks in the United States averaged approximately 106,000 km, compared with 56,000 km on average in Colombia.[47] **Climate change is affecting the country's infrastructure and reducing productivity.** Losses stemming from heavy rainfall caused by the La Niña phenomenon are estimated to have totaled 1.5% of GDP in the 2010-2011 period. **Economic productivity is adversely affected by poor connectivity between cities.** Half of the country's exports are concentrated in four departments with infrastructure deficiencies, and high transport costs have contributed to weak connectivity between regions and cities. **Mobility issues within cities impose high productivity costs.** The situation with respect to urban mobility in the main cities is complex, with travel times for distances of just a few kilometers occasionally exceeding more than two hours.[48]

4.24 **Proposals.** The following proposals have been prioritized within the strategic objective for transportation infrastructure and urban development: (i) **public investment in the transportation sector needs to rise to around 3.5% of GDP per year on average over the next two decades**, including paving of the entire primary and secondary network, fourth-generation concessions, expansion of the national primary road network and improvement of the entire tertiary network (80,000 km of new paved roads), and urban (Bogota metro), rail, air, and river transportation; (ii) **develop infrastructure in urban centers**, investing around 1% of GDP per year over 20 years in the 151 municipios in the Cities System; (iii) **implement regulatory reforms in the road freight transport sector**, including limiting the useful life of the vehicle fleet, formalizing enterprises, training small-scale freight agents, insuring goods, and liberalizing prices; and (iv) **develop resilient infrastructure** to reduce the impact and cost of climate change, with designs adapted to changing conditions on land, water, and climate.

4.25 This strategic area contributes to the implementation of the Update to the IDB Group's Institutional Strategy 2010-2020 with respect to the challenges of *low productivity and innovation* and *limited economic integration* and their objectives of: (i) including all segments of the population in financial markets; (ii) providing inclusive infrastructure and infrastructure services; (iii) developing quality human capital; (iv) providing adequate knowledge and innovation ecosystems; (v) providing urban planning and rural infrastructure; (vi) improving regional infrastructure; and (vii) addressing the economic and social impacts of climate change adaptation and mitigation.

4.26 Through a portfolio in execution totaling US$926 million,[49] the Bank will continue to support this strategic area: one program in innovation for US$25 million; two in

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[47] Federal Highway Administration (2012).

[48] The social value of time spent on transportation is estimated at 3% of GDP in Latin America and the Caribbean (Economic Commission for Latin America and the Caribbean, 2002). On average, people spend the equivalent of 10 working weeks per year in transportation (IDB, 2014b).

[49] Innovation, CO-L1092; financial markets, CO-L1124 and CO-L1132; education, CO-L1093; transportation infrastructure, CO-L1019, CO-L1109, CO-L1111, and CO-L1131; transportation and urban development, CO-L1091, CO-L1096, CO-L1125, and CO-L1133 (this operation has expenditure and fiscal revenue management and urban development components); and integration, CO-L1094.

financial markets for US$210 million; one in education for US$46 million; four in transportation infrastructure for US$103 million; four in transportation and urban development for US$530 million; and one in integration for US$12 million.

Public management effectiveness

4.27 This strategic area focuses on improving the effectiveness of public investment and public administrative management. The strategic objectives under this area are as follows: (i) establish a fiscal compact to improve State revenues; (ii) raise the quality of expenditure and public investment management capacity at all levels of government; and (iii) improve the quality of justice.

Establish a fiscal compact to improve State revenues*.* This strategic objective is focused on increasing general government tax revenue over a time horizon of around seven years, in order to achieve a public investment level of 7% of GDP per year from that point onwards. The significant efforts proposed in this country strategy to increase public revenue can be facilitated by the use of a progressive approach, based on a national vision and commitment to earmark this revenue for investments and productive spending to enable the country to become a developed economy within 20 years (see CDC, paragraphs 3.38 to 3.43).

4.28 **The low level of tax revenue limits the opportunities for expanding investment**. Colombia's tax system was modified more than 20 times from 1990 to 2012,[50] with the objective of increasing revenue, achieving greater economic stability, and making investments associated with government programs. Still, central and subnational government revenue levels have failed to rise above 18% of GDP. This tax ratio is low compared with the OECD average (26% of GDP) and with the ratio in a number of South American countries, such as Argentina (29%) and Brazil (26%). Limited tax receipts are mainly the result of three factors: (i) incentives and exemptions that erode the tax base; (ii) weak tax administration; and (iii) informality in the economy. **Exemptions are one of the main problems with the tax structure**. Tax expenditure is estimated at 4.5% of GDP in Colombia—2.4% in income tax and 2.1% in value-added tax (VAT)—owing to the more than 200 exemptions that represent around 30% of collections.[51] **Limited capacity at the Department of National Taxes and Customs (DIAN) prevents effective control of evasion**. The DIAN has a presence in just 43 of the country's 1,121 municipios; there is just one DIAN employee for every 10,000 residents, half the regional average; and only 0.1% of active taxpayers are audited, well below the regional average of 3.1%. While 8,676 audits were carried out in Colombia in 2010, there were 57,820 in Mexico in the same year, 74,500 in Argentina, 102,193 in Peru, and 565,373 in Chile.[52] **The high level of informality in the economy accentuates the level of tax evasion.** Evasion is estimated at 4% of GDP in the

[50] Acosta et al. (2012).

[51] Goods and services with exemptions or differential rates include beer, gambling, chocolate, cleaning services, security and temporary employment services, and tourism services provided to foreign residents.

[52] IDB (2012).

case of the income tax and the VAT, split evenly between the two taxes.[53] In 2010, the number of registered taxpayers was 17.3% of the population, lower than the average for Latin America (23%) and the OECD countries (59%).[54] **There is room to increase subnational tax revenue**. The departments and municipios currently collect approximately 3.1% of GDP, contributing 18% of the country's tax revenue. These levels are far below those in the OECD countries, where the average is 7.4% and 33%, respectively (OECD, 2014).[55] The level of collections is far below that of Brazil and less than in Argentina, both of them countries with a similar level of decentralization to Colombia and collect 9.8% and 5.9% of GDP, respectively. A recent IDB study indicates that properties are undervalued on average by 40% to 50% and that between 25% and 39% of the property register is not current.[56] Current effective tax rates stand at 0.5%, compared with a legal potential rate of 1.6%.

4.29 **Proposals.** To progressively raise tax revenue by at least 6% of GDP over a seven-year period, the following steps should be taken as part of a **national fiscal compact**: (i) **approve a comprehensive tax reform,** starting with an expansion of tax bases by cutting exemptions, reducing tax evasion, updating valuations, and, subsequently, adjusting tax rates. An analysis that compares Colombia's tax structure with international tax productivity (especially in Argentina, Brazil, Chile, and Uruguay), shows that potential additional revenue from the main national and subnational taxes in Colombia (VAT, income, property, and industry and commerce) could ascend to 13% of GDP; (ii) **expand the number of taxpayers** and avoid further pressure on those already paying. Increasing audit functions is a priority for reducing evasion. In the case of the personal income tax, the personal exemption should be reduced from 2.8 times per capita GDP to the Latin American average of 1.4 times GDP, applying a moderate tax rate and taxing dividends. Lastly, where the revenue intake rises beyond the target of an additional 6% of GDP, the corporate tax burden should be reduced by eliminating the wealth tax in particular, as well as the tax on financial transactions; (iii) **bring subnational revenue in line with the OECD countries**. In the case of the property tax, assessed values should come into line with market values, and rates should be set at around 1%. In the case of the industry and commerce tax (ICA), the number of registered taxpayers could be increased by improving tax supervision and collection systems. For an estimate of potential tax revenue from the proposed reform, see Table 2.

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53 According to the IDB (2012), a number of authors calculate VAT evasion at 36% of potential revenue, equivalent to approximately 3% of GDP. Steiner and Medellín (2014) estimate that if evasion were reduced to the levels seen in Uruguay and Chile, VAT collections could rise by 1.4% of GDP (maintaining the 16% VAT rate).

54 IDB, Inter-American Center of Tax Administrations (CIAT), Central America, Panama, Dominican Republic Regional Technical Assistance Center (CAPTAC-DR) (2013).

55 IDB. Corbacho et al. (2012).

56 IDB. España and Sanchez (2014).

Table 2: Comprehensive Tax Reform

Tax	Variable	Potential	Target range
Central government receipts			
VAT	Evasion	2	0.8 - 1.2
	Tax expenditure	2.5	1.3 - 1.7
	Change in rate (16% to 18%)	1	0.7 – 0.9
Income	Evasion	2	0.8 - 1.2
	Tax expenditure	2	0.8 - 1.2
Subtotal		*9.5*	*4.4 – 6.2*
Subnational receipts			
Property	Change in rate plus reassessment	1.6	0.8 - 1.2
ICA	Evasion	2	0.8 - 1.2
Subtotal		*3.6*	*1.6 – 2.4*
Total		**13.1**	**6.0 – 8.6**

Source: Authors' calculations based on IDB, Jorrat (2010); IDB, Corbacho et al. (2012); IDB, España et al. (2012); Steiner and Cañas (2013); and Steiner and Medellín (2014).

4.30 ***Raise the quality of expenditure and public investment management capacity at all levels of government*** (see CDC, paragraphs 3.44 to 3.48)

4.31 **Colombia's levels of efficiency in government and public investment management are low by international standards**. Public expenditure execution capacity is weak in Colombia, while the quality of public investment, public services, the civil service, and policy implementation is deficient. In the WEF government efficiency index, Colombia falls below the averages for the LAC-5, EME-6, and Chile.[57] The index of public investment efficiency calculated by the IMF places Colombia in the lower part of the international distribution with a score of 2.1, compared with 2.7 for Peru and 3.3 for Brazil and Thailand. The results of the efficiency analysis conducted by the IDB show that Colombia could increase the efficiency of infrastructure investment by 49% with the same level of investment.[58] **Institutional failures are the main obstacle to public investment execution.** According to the IDB study mentioned above,[59] during the period 1996-2011, more than 50% of inefficiency in the use of physical and human capital in public investment is explained by public management weaknesses,[60] including the application of rules and consultation mechanisms. **Colombia's civil service faces major challenges in terms of improving its effectiveness and efficiency**. The salary structure is rigid, there are no incentives to support a culture of results-based management,[61] and information and decision-making systems are inadequate for management purposes.[62] **Information mechanisms for State accountability and transparency are weak.** Colombia faces challenges in

57 WEF (2014). Government Efficiency Index.

58 IDB, authors' calculations.

59 IDB. Giménez et al. (2015).

60 As measured by the World Bank government effectiveness index (2014c).

61 Sanabria et al. (2015).

62 DNP (2014b).

relation to information management as a result of fragmented systems, a lack of standardization, and inaccessibility, as well as weak data integration and systematization and poor technological infrastructure to support the generation of information.

4.32 **Proposals.** Institutional obstacles to achieving good execution of expenditure must be overcome in parallel to the increase in investment funding proposed in this country strategy. To achieve this objective, this line of policy focuses on: (i) **lowering the transaction costs associated with rules, environmental permits, and public consultations,** ensuring that these regulations are applied in a balanced manner to ensure greater agility in issuing permits and conducting public consultations, as well as preventing abuses; (ii) **reshaping the civil service** through the decisive incorporation of a culture of results similar to that adopted in countries such as New Zealand and Australia; and (iii) **strengthening the role of central government institutions** with respect to five key functions: (i) strategic management; (b) public policy coordination; (c) performance monitoring and improvement; (d) public policy management; and (e) results reporting and accountability.

4.33 ***Improve the efficiency and quality of justice*** (see CDC, paragraphs 3.49 to 3.55)

4.34 **Public perceptions of the judicial system are negative**. According to a recent opinion survey,[63] 77% of the population disagrees with the way in which the judicial branch operates. The factors contributing to this perception include: (i) the low efficiency of the judicial branch; and (ii) corruption. **The duration and costs of court cases have improved, but weaknesses remain.** There were 748,049 incoming cases in the judicial branch in 1993, while in 2013 the number was 3,021,046, an increase of over 300%. The outgoing caseload also increased, from 566,827 in 1993 to 3,272,608 in 2013, a 477% increase over the period. This has been the result of plans to reduce the judicial backlog by hiring temporary judges, who represent 14.3% of the total number of judges. Despite this progress, the public has little confidence that cases will be resolved in an expeditious manner, owing to the poor performance of years past that has yet to be fully overcome.[64] **There are indications of corruption in the judicial system.** According to user surveys of justice systems in 95 countries, 19% of respondents in Colombia said they had paid a bribe, compared with 6% in Chile and 1% in Uruguay. The average for OECD countries is 5%, with some countries, such as Korea, Japan, and Finland, at 0%.[65] **The effectiveness of criminal investigations is low in Colombia.** The effectiveness index is 0.2 (out of 1.0) in Colombia; this is similar to the average for LAC-5, except for Chile's score of 0.42. In contrast, the high-income countries of the OECD score 0.62, with Austria, for example, at 0.84, Finland at 0.74, Canada at 0.73, and the United States at 0.65.[66] **There is a high level of impunity with respect to gender-based violence.** According to official figures for violence against women, in 2014 there were 37,881 reports of intimate

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[63] http://www.ipsos.com.co/?q=es/.

[64] Sanchez et al. (2013).

[65] Transparency International (2013).

[66] Data from the World Justice Project (2014) (Index: criminal investigation system is effective; values from 0 to 1).

partner violence, 41,944 reports of interpersonal violence, and 16,088 reports of sexual assault against women (13,606 of which involved girls under 18 years of age). A further 1,007 women were murdered, and there is evidence that many of them were victims of abuse by their partners. The level of impunity is estimated to be above 90%.[67]

4.35 **Proposals.**[68] To improve the performance of justice administration in Colombia, the following steps are proposed: (i) **consolidate policies to reduce judicial backlog,** incorporating the temporary judges through a competitive recruitment process; (ii) **modernize information technology and criminal investigation infrastructure,** implementing a technology platform to unify information from all of the justice services provided by the State; creating unique identification numbers for all cases resolved by authorities with a judicial role; and developing an efficient mechanism for monitoring compliance with judicial decisions; (iii) **foster public confidence in the judicial system,** increasing information and transparency and combating corruption; and (iv) **prioritize services to those in riskier and more vulnerable situations,** strengthening actions to prevent, address, sanction, and eradicate violence against women, and actions to balance work with family life; harmonizing the application of civil and criminal law, with attention to the classification of criminal offenses in the areas of sexual freedom, sexual and reproductive rights, integrity of the family, the free development of personality, life, and bodily integrity; and ensuring that women have de jure and de facto access to suitable and effective judicial resources.

4.36 This strategic area contributes to the implementation of the Update to the IDB Group's Institutional Strategy 2010-2020, with respect to the challenges of *social exclusion and inequality* and *low productivity and innovation* and their objectives of: (i) creating a more distributive fiscal policy; (ii) strengthening the capacity of the State; (iii) providing inclusive infrastructure and infrastructure services; (iv) establishing smart institutional frameworks; and (v) strengthening institutional capacity and the rule of law.

4.37 Through a portfolio in execution totaling US$581 million,[69] the Bank will continue to support this strategic area: three programs (including an undisbursed PBL) in the area of tax revenue for US$512 million; four in public institutions and public expenditure management for US$48 million; and one in justice for US$21 million.

Social mobility and consolidation of the middle class

4.38 This strategic area focuses on the elimination of extreme poverty and the expansion and strengthening of the middle class in a more formalized economy. The strategic objectives corresponding to this strategic area are as follows: (i) reduce poverty, with an emphasis on extreme poverty; (ii) reduce informality in

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[67] El Tiempo (2015): Based on estimates by the Instituto Nacional de Medicina Legal y Ciencas Forenses [National Institute of Legal Medicine and Forensic Sciences].

[68] The Bank has three operations under this strategic objective (CO-L1041, CO-L1097, and CO-L1098). It is also recognized that the Bank must coordinate its actions with other multilateral organizations and relevant entities to fully harness synergies and impact.

[69] Tax system, CO-L1133, CO-L1138, and CO-L1142 (PBL); quality of public institutions and public expenditure management, CO-L1097, CO-L1098, CO-L1102, and CO-L1125; and justice, CO-L1041.

the economy; (iii) consolidate a sustainable and inclusive pension and health system; and (iv) improve equitable access to quality basic services.

4.39 ***Continue to reduce poverty and eliminate extreme poverty*** (see CDC, paragraphs 3.57 to 3.62)

4.40 **Extreme poverty can be eliminated in Colombia.** In 2013, 9% of the population lived in extreme poverty, falling to 8% in 2014 as a result of economic growth and social programs. **Nonetheless, there is a high incidence of extreme poverty among the rural population**. Of those living in extreme poverty, 19% resided in the country's 13 major metropolitan areas, 32% lived in smaller cities and towns, and 49% were in rural areas. **There are problems in the targeting of social programs.** Although 49% of the extremely poor live in the countryside, they account for 44% of beneficiaries under the More Families in Action (MFA) program, 40% of those under Red Unidos [United Network], and 28% of Colombian Family Welfare Institute (ICBF) beneficiaries. It is estimated that only 68.6% of rural families with children living in extreme poverty are MFA beneficiaries. The percentage of children under 5 years of age that are living in poverty is 42.8%, with 12.5% in extreme poverty. Among rural children, 18% are extremely poor, in contrast to the figure of less than 8% for metropolitan areas.[70] Of the 1.9 million children covered by ICBF programs, only 28% are in rural areas, while 24% of the richest quintile also benefit.[71] **The income gap between moderate and extreme poverty is limited**. The gap between the income of the poorest households and the indigence line is approximately Col$100,000.[72] **Poverty rates are high in families in which the head of household belongs to an ethnic minority**. Of those households with a head of household that does not identify as belonging to an ethnic minority, it is estimated that one in ten are extremely poor and two in ten are moderately poor. These numbers are only slightly higher in the Afrodescendent, Palenquera, and Raizal communities. Among the indigenous population, however, the numbers rise to two in ten households in the case of extreme poverty, and three in ten in the case of moderate poverty.[73]

4.41 **Proposals.** The following proposals are aimed at achieving greater poverty reduction and eliminating extreme poverty in Colombia: (i) **expand coverage of transfer programs and improve targeting of distributive programs**, making proportional efforts in the various urban and rural areas to incorporate these families; (ii) **increase the MFA family subsidy to reduce extreme poverty and bring new families into the program**, with an increase in the amount of the Col$100,000 transfer to each family, which could reduce the rate of extreme rural poverty from 15.7% to 14.3%, or to less than 3% once economic growth is also taken into account;[74] (iii) **improve targeting and increase the coverage and quality** of Cero a Siempre [Zero to Always] programs and coordinate these with the MFA and the United Network; and (iv) **target ethnic minorities in particular,** making use of the Interior Ministry's indigenous population census to ensure total

[70] IDB. Authors' calculations based on DANE (2013b).

[71] Bernal (2014).

[72] IDB. Authors' calculations based on DANE (2013b).

[73] *Idem.*

[74] IDB (2014b).

coverage for these ethnic groups. Similar geographic targeting is recommended for Afrodescendent populations.

4.42 ***Reduce informality in the economy*** (see CDC, paragraphs 3.63 to 3.69)

4.43 **Labor informality is very high in Colombia, and it affects productivity and equity**. Only 35% of workers are formal sector employees, 18% are informal sector employees, and around 47% are self-employed. The informality rate for women between 2009 and 2012 was 65%, while for men it was 60%.[75] Formality rates are much lower for the Afrodescendent population (25.4%) and the indigenous population (11.5%) than for the country as a whole.[76] In 2010, 61% of firms lacked accounting records, and 43% were unregistered.[77] Total factor productivity in formal sector enterprises is 10% higher than in informal enterprises,[78] and two-thirds of investment and innovation takes place in formal businesses.[79] One-third of formal sector employees are engaged in temporary work, leading to high rotation between the different labor modalities.[80] In 2013, between 55% and 70% of hires (depending on the sector) were temporary. **Labor costs have fallen but remain high and affect formality in the labor market.** The minimum wage in Colombia is equivalent to 72% of the average wage, which is similar to countries such as Peru, Ecuador, the Dominican Republic, and Panama but compares unfavorably with economies such as Brazil, Chile, Mexico, and Uruguay, where the level ranges from 32% to 40% and the degree of formalization of the economy is higher. **One of the main reasons for the problems of labor market insertion and quality in Colombia is the weakness of the vocational education system.** Colombia allocates generous amounts of public funding to the vocational education system. Despite this, most companies use agencies other than the Servicio Nacional de Aprendizaje [National Training Agency] to train their employees (62% in industry, 76% in commerce, and 74% in services). Private training mechanisms are also weak. **High labor costs are an obstacle to job creation, affecting women in particular**. By law, social contributions must be paid in proportion to at least one minimum wage, and this increases the relative costs of part-time work, a modality used mainly by women. In all, 31% of employed women work part time, compared with 14% of employed men.[81] Women are thus especially affected, as their opportunities for part-time work (a modality preferred due to their domestic responsibilities) are limited.

4.44 **Proposals.** Proposals to address and reduce informality focus on actions to: (i) **accelerate economic growth**, following recent studies that show that informality declines as the rate of growth accelerates. In the case of Korea—a country in which per capita income grew by a factor of 2.5 from 1990 to 2012—formal employment grew from 60% to 72%, and informal employment fell from

[75] Alvarez Vos (not available).

[76] DANE (2007).

[77] Bustamente and Bayter (2013).

[78] Ydrovo (2010).

[79] Santa María and Rozo (2008).

[80] High rotation entails costs for labor productivity, owing both to lower human capital investments in temporary workers and weak job placement services (Carpio et al., 2011; Mazza, 2011).

[81] World Bank (2012).

40% to 28%;[82] (ii) **implement wage measures to stimulate employment in the formal economy**, linking minimum wage increases to average productivity increases across the economy; (iii) **reduce other obstacles to entering the formal labor market**, reducing severance payments and covering a portion of such payments with unemployment insurance; (iv) **align the content of vocational education with the skills demanded by firms**; and (v) **foster labor market insertion among women and support entrepreneurial opportunities for minorities**, through modification of the regulations governing social contributions for part-time work, the expansion of childcare and labor training, and support for entrepreneurial development among women and minorities.

4.45 ***Consolidate a sustainable and inclusive pension and health system***

Pension system (see CDC, paragraphs 3.70 to 3.74)

4.46 **Pension coverage is low and inequitable.** Thirty-two percent of workers are covered by contributory pension programs, a lower rate than in other Latin American countries such as Argentina (54%), Brazil (65%), and Chile (74%).[83] Projections for Colombia show that if current systems are maintained, between 50% and 80% of the population over 65 years of age may lack coverage in 2050. **The pension system is fragmented into various regimes with different rules and benefits**. Colombia's pension system is based on a mandatory contribution pillar, with two coexisting competing regimes: (i) a defined benefit regime (the Average Premium Regime, or RPM), which is administered by the State through Colpensiones; and (ii) a defined contribution regime (the Solidarity-Based Individual Savings Regime, or RAIS), which is managed by private pension fund administrators.[84] At the same time, there is a program of noncontributory monetary subsidies that are channeled to the vulnerable adult population through the Colombia Mayor [Senior Colombia] program. There is also an intermediate pillar known as Beneficios Económicos Periódicos [Periodic Economic Benefits] that is somewhere between contributory and noncontributory in nature. **The fiscal cost of Colombia's pension system is high in relation to its coverage.** Colombia allocates 3.8% of GDP to a public pension system (financed by the national budget) that covers one-third of the population of retirement age. Chile's system covers two-thirds of the population in this age bracket at the somewhat lower cost of 3.1% of GDP. **Management and administrative costs are high under the individual savings regime, and there are unquantified risks**. The arrangements adopted under the RAIS, together with the highly concentrated nature of the industry, have pushed up fees and the cost of pension plans. They also create inefficiencies in member transfers between the RAIS and the RPM**.** The annuities market cannot operate effectively under the current benefit regime, and the scheduled withdrawals regime does not work since pensions cannot be lowered either in nominal terms or below the minimum wage.

4.47 **Proposals.** Potential solutions to the challenges of Colombia's pension system include the following: (i) **initiate long-term systemic reform of the pension system**, improving the design of the institutional framework and expanding

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[82] La Porta and Shleifer (2014).

[83] OECD (2013).

[84] There are also special regimes for teachers and the armed forces.

coverage, in the latter case by means of a proposed "solidarity pillar" based on Colombia Mayor for workers without a contributory pension, as well as a transition towards a single contributory pillar that eliminates competition between the RAIS and RPM;[85] (ii) **facilitate and enforce contribution payments** by means of a State effort to help those workers belonging to the health subsidy regime pay into contributory regimes, and also by strengthening controls; (iii) **reform the RAIS**, separating out the fees of pension fund administrators from the cost of disability and survivors' insurance and the administration costs of individual savings accounts, setting a ceiling on administration costs, introducing a bidding process for the accounts of new members, encouraging the participation of other entities in fund management, and preventing transfers between the RPM and RAIS where these are suboptimal for the member concerned; and (iv) **ensure the sustainability of the pension system** by reconsidering a number of system parameters such as the replacement rate, the retirement age, and survivors' benefits.

Health system (see CDC, paragraphs 3.75 to 3.80)

4.48 **The financial sustainability of the health system is at risk.** Colombia's health system is based on an insurance model. Under this system, users are beneficiaries of health insurance that covers a mandatory benefit plan. There are two types of financing modalities for this insurance: (i) contributory, cofinanced by the employer and the employee or by self-employed workers; and (ii) State-subsidized, for unemployed citizens. Health sector spending in Colombia, including both the public and private sectors, stood at 7% of GDP in 2012—within the range for the LAC-5 and somewhat below that of the OECD countries. Positive aspects of the system include: (i) universal health insurance, covering 97% of the population; (ii) a substantial improvement in access to health services (e.g. 99% of births take place in health centers); and (iii) the highest level of health expenditure protection in the region, with out-of-pocket household spending of 1% of GDP. The new Health Statutory Law is estimated to have increased system costs by between 0.5% and 1% of GDP.[86] Insurers also have outstanding debts to service providers relating to medicines and health technologies that are not included in benefit plans. This situation is a result of judicial orders that protect the users that request them. As of July 2013, this debt was estimated at 1% of GDP. **The system has access and equity problems**. Metropolitan areas concentrate 90% of health service providers; 88% of doctors are available to serve 55% of the population. **There is a bias in favor of specialized care**. The utilization rate for highly complex services stands at over 90%, while in the case of basic services it is 60%.[87] **Lack of competition is a drag on system efficiency**. The system was designed to encourage insurers to compete based on the quality of their services. System incentives are not sufficiently effective given that all insurers are paid the same per capita amount. The incentive for attracting more members is also curtailed by the difficulties users experience in comparing quality.

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85 IDB. Bosch et al. (2015).

86 IDB. Cardona (2013) and Riascos (2013).

87 Ministry of Health (2014).

4.49 **Proposals**. The following policies can improve the sustainability and effectiveness of the health system: (i) **control health spending and increase system revenue** by regulating access and setting prices based on the contribution to health,[88, 89] providing incentives for efficiency and quality in primary health care, and discouraging the use of high-cost services;[90] (ii) **increase institutional capacity and investment to improve access and equity** by strengthening treatment capacity at the primary level with a model based on primary health care, infrastructure, and human talent;[91] strengthening the capacities of subnational entities to better manage the health of their populations; and expanding the supply of infrastructure, human resources, and equipment in rural and remote areas through public-private partnerships; and (iii) **improve quality incentives for insurers and providers** by developing a results-based payment mechanism.

4.50 ***Increase equitable access to quality basic services***. This strategic objective encompasses, in particular, an analysis of service coverage, quality challenges, subsidy mechanisms, and the structure of service delivery (see CDC, paragraphs 3.81 to 3.86).

4.51 **Electricity and water coverage is satisfactory, although there is room for improvement in some sectors**. Electricity is supplied to 96% of the population, including 99% in urban areas and 93% in rural areas. The remaining 3.9% of households lack service. The country's installed capacity is 147 GWh, and demand in 2013 stood at 68.9 GWh. There are inequalities in the distribution of water and sanitation services between urban and rural areas, as well as between regions, particularly in the Caribbean and Pacific zones. The coverage of water supply systems is 97% in urban areas and 73% in rural areas. Coverage in the Pacific region is on average 10% less than in the rest of the country; this is also the case with rural areas in the Caribbean region, where coverage is only 58%.[92] **The quality of electricity and water services can be improved**. The quality of electricity supply is mixed in terms of its continuity and voltage, while insufficient investment means that the quality of service delivery is inadequate, imposing costs

[88] The setting of drug prices based on health outcomes refers to the fact that if the therapeutic benefit of a new drug entering the market is no greater than that of an existing drug, the price of the first cannot be higher than the second. This applies generally to biotechnology medicines and high-cost drugs (cancer, HIV, hepatitis C).

[89] Claxton et al. (2008) show that the introduction of this mechanism improves the allocation of available public resources by evaluating not only the effectiveness and safety of drugs, but also their health outcomes. It is also a mechanism that fosters technological innovation in health, as better sales prices can be negotiated for technologies that bring new value.

[90] According to the World Health Organization (2008), the experience of developed countries demonstrates that a disproportionate focus on specialized tertiary care is not cost-effective, as unnecessary prescriptions of drugs and treatments lead to high costs. The measures adopted to support primary care in several of these countries in the 1980s and 1990s have struck a better balance between specialized curative care, primary care, and health promotion, helping to improve health results and generating cost savings for the sector.

[91] According to Caminal and Martin (2005), primary health care professionals make many critical decisions within a short space of time and are able to resolve over 90% of consultations. Accordingly, it can be assumed that more than 85% of problems can be resolved at the primary care level, with between 10% and 12% requiring some additional specialized consultations and care, and only 3% to 5% requiring primarily specialized care.

[92] National Social and Economic Policy Council (CONPES, 2014b).

on the productive sector and households. For example, electricity supply is available for between four and nine hours per day in rural areas served by the off-grid system serving 4% of the population.[93] In terms of the quality of water services, the average daily duration of supply rose by 2.5 hours over the 2008-2012 period, reaching a national average of 23.1 hours per day in the latter year. The quality risk index for rural water was 49.8%,[94] a level that falls within the high risk category. **Subsidy needs have grown substantially since 2008 relative to revenue**. The objective of the subsidized price system (electricity and gas, water, and telecommunications) is to keep prices low for the poorest households, yet it creates distortions. The redistributive impact of the subsidies is low, due to targeting problems[95] and the fact that the poorest households may not be connected to public services. The proportion of households paying higher rates is low and has fallen steadily, from 5.7% in 1997 to 3.5% in 2008, raising the share of subsidies paid by the government. In the case of the electricity sector, this share rose to 0.15% of GDP in 2011.[96] In the case of water and basic sanitation, the effective government subsidy stood at 0.05% of GDP.[97] **Water services are fragmented and offer low returns**. A total of 2,371 water and sewer service providers were registered in 2012, of which 90% served fewer than 2,500 customers. In the case of public sanitation services, 1,180 providers were registered, with 73% of these serving markets with less than 2,500 customers. The quality of these services in Colombia varies according to the size of municipio, the type of provider, and, above all, how rural an area is. **Climatic conditions affect service delivery.** Over the 1970-2012 period, more than 2,900 natural events were recorded that affected water and sanitation infrastructure, with 35% occurring from 2010 to 2012.

4.52 **Proposals**. The efficiency and sustainability of power, water, and sanitation services could be improved by means of the following policies. (i) **Improve the coverage and quality of electricity and water services**. Though electricity production is in surplus to 2015, demand is expected to rise considerably under the scenario of 6% economic growth proposed in this country strategy. Additional generation capacity is also required in the off-grid system if adequate coverage and quality standards are to be attained. Accordingly, the electricity sector will require annual public investment of 0.6% of GDP. In the water and sewer sector, estimated investment of 1.5% of GDP will be required to achieve universal coverage, based on the number of unserved households and the cost of connecting these to the systems. At the same time, water and basic sanitation firms invest an estimated 1.8% of GDP each year. (ii) **Reduce the fiscal burden of subsidies** by improving their targeting to those living below the poverty line, particularly to those living in extreme poverty. (iii) **Expand and improve water and sanitation service delivery in rural areas and small communities**. The following actions are proposed: create economies of scale by providing incentives for the consolidation of firms serving larger geographical areas; improve the

[93] Ministry of Mining and Energy.

[94] National Health Institute (2013).

[95] CAF (2008).

[96] Authors' calculations based on data from the Latin America Energy Organization (2013).

[97] Ministry of Housing, City, and Territory.

technical skills of the firms' human resources; and provide technical and financial support for the design, construction, and operation of the firms. (iv) **Strengthen the environmental sustainability of water and basic sanitation services**. This challenge requires the development of regulations to encourage investment in resilient infrastructure.

4.53 This strategic area contributes to the implementation of the Update to the IDB Group's Institutional Strategy 2010-2020 with respect to the challenges of *social exclusion and inequality* and *low productivity and innovation* and their objectives of: (i) eradicating extreme poverty; (ii) providing inclusive infrastructure and infrastructure services; (iii) developing quality human capital; and (iv) gender equality and diversity.

4.54 Through a portfolio in execution totaling US$583 million,[98] the Bank will continue to support this strategic area, in particular with three operations in the water and basic sanitation sector.

V. FINANCIAL SCENARIO

5.1 The financing framework in this country strategy is based on the central government revenue and expenditure projections contained in the Medium-term Fiscal Framework report prepared by the Ministry of Finance and Public Credit. Based on these projections, the fiscal balance is expected to deteriorate to 3.1% of GDP in 2017, with 2.7% of GDP forecast for 2018. Under these assumptions, the central government's gross medium-term financing requirement (fiscal deficit plus amortizations and treasury operations) would average US$22.9 billion per year over the 2015-2018 period. Based on these projections and programmed growth rates, it is estimated that the country's overall debt-to-GDP ratio will rise from 38.3% in 2014 to around 39.4% in 2019. Domestic sources will cover an average of 77.3% of total annual financing requirements, with external sources providing the rest. Based on this, the financing scenario assumes total disbursements of US$3.9 billion over the country strategy period—equivalent to average annual disbursements of US$1 billion from sovereign guaranteed operations. As a result, the Bank would account for 5.3% of total debt and 37% of multilateral debt in 2018 (see Annex III). Approvals totaling US$890 million are planned for 2015, and US$800 million annually for the period 2016-2018.

VI. STRATEGY IMPLEMENTATION

6.1 **The country strategy is an instrument for dialogue with the government regarding policy priorities for Colombia's medium-term development**. The new strategy focuses Bank actions on specific policy objectives to support strategic dialogue with the country, an area in which the Bank's influence is very significant. In this respect, the country strategy preparation process needs to be kept separate from the programming of operations. The country strategy is not a sector intervention plan but rather a comprehensive policy dialogue agenda for activities in both the public sector and the private sector. As a result, the Bank's operational program will not necessarily address all the different recommendations made in

[98] Water and basic sanitation: CO-L1028, CO-L1034, and CO-L1105.

this country strategy; rather, in each programming exercise, the government and the Bank will determine, in the framework of the country strategy, the Bank's intervention priorities. In this way, the Bank offers comprehensive support to the government and the country encompassing strategic conceptualization, technical expertise, and financial complementarity with national investment efforts.

6.2 **Lessons learned from implementation of the 2012-2014 country strategy**. The design of the 2012-2014 country strategy was oriented towards programming, with a profusion of sectors, which limited its usefulness as an instrument for policy dialogue with the authorities, the private sector, and organized civil society. The present country strategy seeks to: (i) introduce a more strategic, vision-driven approach; and (ii) enrich the analysis of the country development challenges as an instrument for policy dialogue. In terms of portfolio execution, during the 2012-2014 period, the following obstacles were identified: (i) lack of coordination between project planning and the country's budget processes; (ii) weak management capacity in executing agencies; and (iii) a lack of project ownership at some executing agencies. To overcome these portfolio execution challenges, the following actions are being taken: (i) biannual programming was introduced in 2015, with annual revisions,[99] in order to accommodate borrowing capacity at the agencies and ensure prompt start-up of projects; (ii) efforts to strengthen executing agencies have been intensified through periodic workshops with them; and (iii) the Bank has deepened its dialogue with the government to ensure project execution and continuity in each sector. At the same time, technical cooperation operations have proven to be a very valuable instrument for supporting dialogue with the country.

6.3 **Use of country systems**. In relation to the public procurement system, the Bank will continue to work with the Colombian government to improve procurement management by conducting an OECD/MAPS assessment aimed at evaluating and validating the Sistema Nacional de Compras y Contrataciones Públicas [National Public Procurement System]. The objective of this evaluation will to be gauge the opportunities for advanced use—or failing that, partial use—of the system in Bank programs, as well as the transfer of information regarding international best practices for Framework Agreements, with a view to implementation of the latter in major State buyers. With respect to public financial administration systems, use of the budget and treasury systems in Bank-financed projects will continue. Support for strengthening of the government control function (external and internal) will be maintained with a view to enhancing project monitoring. Private auditing firms will be used for this purpose, improving the quality, approach, and scope of audit services, including external audit reports, through the application of international standards. The Bank, together with the Office of the Comptroller General, recently completed a diagnostic assessment that uses the Supreme Audit Institution Performance Measurement Framework (SAI PMF) developed by INTOSAI[100] to evaluate the OCG's performance. The dialogue with the government will also be continued in relation to both improvements to the accounting and reporting system,

[99] This concept, which has been under consideration, consists in establishing a set program for the first year and an indicative program for the second year, to be confirmed during the Bank's regular programming exercise for the respective year.

[100] International Organization of Supreme Audit Institutions.

with a view to piloting its gradual use in Bank-financed operations, and convergence with International Public Sector Accounting Standards (IPSAS).

6.4 **Donor coordination**. The IDB maintains a high level of coordination with other multilateral and bilateral institutions. There is a donors committee in Colombia in which the IDB participates. It also has an ongoing technical and financial relationship with the World Bank and the CAF. In the technical sphere, the three institutions have established a dialogue regarding the long-term outlook in Colombia, and this is informing the three multilaterals' strategic vision for the country. There are examples of joint financing, such as the El Dorado airport, in which the IDB's private sector teamed up with the CAF and private banks to create the financing consortium for this key piece of infrastructure. Future plans for collaboration include construction of the Bogota metro. The IDB, together with the World Bank, will be providing technical and financial support for this project. Development of the Pacific region, with a focus on the city of Buenaventura, is another joint project in which the IDB, the CAF, the World Bank, and other donors have been collaborating. Lastly, the IDB is coordinating closely with the OECD on analytical work that will facilitate Colombia's accession to this organization. Recent OECD work on Colombia reveals a growing alignment between the country strategy and that institution's assessment and key recommendations.[101]

VII. STRATEGY RISKS

7.1 Country strategy risks refer to those events that could affect achievement of the vision, objective, and progress of the strategic areas. The most significant risks are as follows:

7.2 **Insufficient fiscal resources**. The investments required by the country could be affected by fiscal constraints, particularly under a legal framework for fiscal convergence that limits borrowing capacity, such as the fiscal rule. In compliance with the most recent tax reform law (December 2014), the government has created a high-level commission to propose a structural fiscal reform aimed at expanding budgetary resources over the medium and long terms, a requirement consistent with the country strategy. As mitigation measures: (i) in dialogue with the central government, the Bank is supporting a comprehensive fiscal reform to be approved in 2016; (ii) implementation of an electronic invoicing through operation CO-L1142); and (iii) through the CCLIP operation CO-L1133, the Bank is providing support to strengthen subnational public finances. The evolution of fiscal resources will be monitored periodically through Bank reports (e.g. the Research Department's Macroeconomic Report).

7.3 **Business cycle**. The decline in hydrocarbons prices since 2014 and the prospect of changes in international interest rates are affecting public finances, the external accounts, and capital flows. Given this new international context, the Colombian government is adopting prudent policy and financial measures to deal with a possible drop-off in international capital flows. This kind of external shock, as well as others of a domestic nature, may occur repeatedly for various reasons over the strategy period. The Colombian economy is in a position to partially absorb these fluctuations in the business cycle through automatic stabilizers such as the

[101] OECD (2013); OECD (2015).

exchange rate. The strengthening of tax revenue proposed by this country strategy would reduce the impact on the public finances of possible external and internal shocks. The Bank could mitigate the impact of the business cycle through dialogue and by means of knowledge and financial products: (i) supporting the strengthening of public finances, particularly expenditure and public debt management; and (ii) supporting operations in sectors with greatest impact on growth. Developments in the business cycle will be monitored periodically through Bank reports (e.g. the Research Department's Macroeconomic Report).

7.4 **Institutional challenges**. The capacity of State agencies to execute public investment is weak at all levels. This may have serious negative medium- and long-term implications for the country's development. Colombia has implemented State reform processes on several occasions. The country strategy proposals for strengthening public institutions and the investment management process systematically address a number of the reforms that are recommended for implementation over the medium and long term. To mitigate this risk: (i) the Bank is supporting the country in strengthening its institutional capacity, for example, through the project to support the Office of the Comptroller General, under which the control function will be simplified and implemented; and (ii) subnational public investment execution capacities will be improved under the CCLIP operation CO-L1133. Monitoring will be carried out using the indicator in the results matrix for this area (Annex I), and by using the portfolio in execution as a sample of and proxy for public investment execution. The portfolio in execution, in turn, will be monitored through portfolio reports and portfolio review workshops with the executing agencies.

RESULTS MATRIX AND COUNTRY SYSTEMS MATRIX
RESULTS MATRIX

Government (Strategies) Priorities*	Strategic Areas	Strategic Objective	Expected Results	Indicator	Baseline**	Source
Competitiveness and strategic infrastructure Rural transformation	**Increase economic productivity**	Spur innovation and development in business and agriculture	*Increase total investment (public and private) in R&D*	Total investment in R&D (% of GDP) Public investment in R&D (% of GDP) Private investment in R&D (% of GDP)	2014: 0.21% 0.15% 0.06%	DNP
			Expand private sector access to credit	Domestic credit to the private sector (% of GDP)	2013: 40%	DNP
			Increase agricultural productivity	Agriculture, value added (% of GDP)	2014: 6.1%	World Bank: World Development Indicators
		Improve the quality of education	*Improve learning among secondary students*	PISA scores in reading and writing, mathematics, and science	2012: 403/700 376/700 399/700	OECD
		Raise the quality of infrastructure and urban development and reduce transaction costs in the economy	*Strengthen/improve the quality of transportation infrastructure*	Paved road network in good or very good condition (% of total)***	2014: 55.8%	INVIAS
			Increase the use of urban transportation	Average number of passengers on integrated public transportation systems	2014: 4,006,000	DNP
Good government Building peace through security, justice, and democracy	**Improve public management effectiveness**	Support a fiscal compact to improve State revenues	*Increase State revenues*	Central and subnational tax revenue (% of GDP)	2012: 17.1% Central 14.3% Subnational 2.8%	DNP, MHCP
		Increase the quality of expenditure and public investment management capacity at all levels of government	*Increase public management effectiveness*	Government Effectiveness Index****	2014: 0.0	World Bank: Worldwide Governance Indicators
			Improve State accountability, transparency, and reporting mechanisms	Simple average of the indices for control of corruption, voice and accountability, and regulatory quality****	2013: -0.16’	World Bank: Worldwide Governance Indicators

Government (Strategies) Priorities*	Strategic Areas	Strategic Objective	Expected Results	Indicator	Baseline**	Source
		Increase the efficiency and quality of justice	*Improve the quality of justice*	Judicial Independence Index (1-7)****	2014: 2.8	WEF, Global Competitiveness Index database
Social mobility	**Increase social mobility and consolidate the middle class**	Continue to reduce poverty and eliminate extreme poverty	*Reduction in extreme poverty*	Extreme poverty, total rate Extreme poverty, rural rate Extreme poverty, urban rate	2014: 8.1% 19.1% 6.0%	DANE
		Reduce informality in the economy	*Reduce informal employment*	Share of the population working in the informal sector	2014: 48%	DANE, Comprehensive Household Survey (GEIH)
		Consolidate a sustainable and inclusive pension system	*Increase pension system coverage*	Percentage of the population of pensionable retirement age: National Management and Results Evaluation System (Sinergia), DNP	2014: 36.28%	DNP
			Increase health system coverage	% of the population with health insurance Total % insured under the contributory health system Total % insured under the subsidized health system	2014: 94.1% 47.9% 51.9%	DANE, Social Quality of Life Statistics (ECV)
		Increase equitable access to quality basic services	*Increase electricity coverage among rural households*	% of rural households in the country with electricity supply	2014: 93.4%	DANE ECV
			Increase water coverage among rural households	% of households without access to improved water supply (Multidimensional Poverty Index)	2014: 11.5%	DANE

Government (Strategies) Priorities*	Strategic Areas	Strategic Objective	Expected Results	Indicator	Baseline**	Source
	Crosscutting Sectors					
Social mobility	**Gender and diversity**	Reduce social gaps with respect to ethnic minorities	*Reduce extreme poverty among ethnic minorities*	Extreme poverty rate for ethnic minorities	2013 Indigenous: 18% Afrodescendents: 10%	DANE
Security, justice, and democracy for peace-building		Reduce gender-based violence	*Reduce gender-based violence*	Homicides: Interpersonal Intrafamily Sexual	2014: 192 57 131 4	National Institute of Legal Medicine and Forensic Sciences
Green growth	**Climate change**	Strengthen the resilience of infrastructure to climate change	*Incorporate climate change adaptation policies into sector plans*	Sector and/or regional plans with climate change adaptation policies included	2014: 8	DNP
Competitiveness and strategic infrastructure	**Integration**	Reduce barriers to integration	*Reduce export costs*	Average total export cost for a 20-foot container (US$)	2014: US$2,355	World Bank, Doing Business

*The National Development Plan (PND) has three major objectives that constitute the pillars of the development plan: (1) peace; (2) equity; and (3) education. To achieve these objectives, the plan identifies six crosscutting strategies and six regional strategies (one for each region defined in the plan). Each of the crosscutting and regional strategies has its own objectives and strategies. The six crosscutting strategies are as follows: (1) strategic infrastructure and competitiveness; (2) social mobility; (3) rural transformation; (4) security, justice, and democracy for peace-building; (5) good governance; and (6) green growth.

** Frequency of indicators is annual.

*** The surface condition of the paved network is determined by means of a visual survey of the road surface and classification into one of the categories envisioned for each group of paved roads. The surface condition of a road is determined as follows:

1) **Very good.** Roads classified as very good require no more than routine maintenance as they are in good condition or of recent construction.
2) **Good.** These roads require routine maintenance and probably some surface treatment or patching to cover cracked areas covering less than 15% of the total area.
3) **Fair.** These require routine maintenance and probably asphalt reinforcement of a thickness proportionate to the volume of traffic.
4) **Poor.** Roads in poor condition require substantial surface rehabilitation.
5) **Very poor.** Roads in very poor condition require significant reconstruction at a cost that is similar to construction.

Source: Guía Metodológica para el Diseño de Obras de Rehabilitación de Pavimentos Asfalticos de Carreteras [Methodological Guidelines for the Design of Asphalt Road Pavement Rehabilitation Works], 2008. INVIAS.

******** *Government Effectiveness* captures perceptions of the quality of public services; the quality of public administration and the degree of its independence from political pressures; the quality of policy design and implementation; and the credibility of the government's commitment to these policies.

Control of Corruption captures perceptions of the extent to which State power is used for private benefit, as well as State capture by elites and private interests.

Voice and accountability captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, association, and the media.

Regulatory quality captures perceptions of the government's capacity to design and implement sound policies and regulations that facilitate and foster private sector development.
The Judicial Independence Index captures perceptions of judicial independence from the influence of members of government, citizens, or companies.

COUNTRY SYSTEMS MATRIX

The Bank uses the following country systems for managing and supervising its operations: information (procurement), budget, and treasury. During the strategy period, the Bank will continue to provide support to the government to improve procurement management. This will be achieved through support for an OECD/MAPS (Methodology for Assessing Procurement Systems) assessment aimed at potentially validating the full or partial use of the country's procurement systems, as well as transferring knowledge and good international practices under framework agreements for implementation with large government buyers.
Support will also be provided to the government for strengthening the control function and accounting and reporting systems for potential use in Bank-financed operations. Technical and financial assistance will be provided to the Office of the Comptroller General to carry out a diagnostic assessment of its performance based on the Supreme Audit Institution Performance Measurement Framework (SAI PMF) developed by the International Organization of Supreme Audit Institutions (INTOSAI). Dialogue will also continue with the Contaduría General de la Nación [General Accounting Office] (CGN) to sustain the process of implementing International Public Sector Accounting Standards (IPSAS). The following table summarizes the use of country systems.

Government (Strategies) Priorities*	Bank Strategic Objective	Use of Country Systems	Baseline 2014	Estimated Use 2018	Actions planned under the country strategy
Good Governance	**Public management effectiveness**	Budget	100%	100%	Monitoring of Integrated Financial Information System (SIIF Nación 2) operations.
		Treasury	100%	100%	Monitoring of SIIF Nación 2 operations.
		Accounting and Reporting	0%	0%	1. Support for IPSAS implementation.
					2. Together with the government, review the opportunities for introducing required modifications to the SIIF Accounting and Reporting subsystem. Depending on the results, gradual use of this subsystem is expected to begin in Bank-financed operations, starting with pilot projects.
		Internal Audit	0%	0%	Support for strengthening the technical capacities of Internal Control Offices (OCIs). This exercise includes analyzing OCIs in a number of subnational public entities, as well as developing strengthening plans and implementation plans for improvements. It seeks to assist the offices to perform their work according to international standards.

Government (Strategies) Priorities*	Bank Strategic Objective	Use of Country Systems	Baseline 2014	Estimated Use 2018	Actions planned under the country strategy
		External Control	0%	5%	Support for the CGN in implementing international standards and modernizing audit techniques, with the aim of improving the efficiency, transparency, and quality of the control function. It is expected that progress will be made, to the extent possible, towards validating this system for use in Bank-financed operations.
		Information System	100%	100%	Analysis, evaluation, and potential approval of the public information system (Electronic Public Procurement System, SECOP-1) for use in the Bank's portfolio.
		Shopping	0%	20%	Achieving the targets for these indicators depends on updating the MAPS evaluation. The Bank could expand its use of country systems if the government accepts the validation proposal and roadmap.
		Individual Consultants	0%	20%	
		National Competitive Bidding – Partial	0%	20%	
		National Competitive Bidding – Advanced	0%	20%	

*The National Development Plan (PND) has three major objectives that constitute the pillars of the development plan: (1) peace; (2) equity; and (3) education. To achieve these objectives, the plan identifies six crosscutting strategies and six regional strategies (one for each region defined in the plan). Each of the crosscutting and regional strategies has its own objectives and strategies. The six crosscutting strategies are as follows: (1) strategic infrastructure and competitiveness; (2) social mobility; (3) rural transformation; (4) security, justice, and democracy for peace-building; (5) good governance; and (6) green growth.

SELECTED MACROECONOMIC AND SOCIAL INDICATORS

	2010	2011	2012	2013	2014	Source
Real economy						
Real annual GDP growth	4.0%	6.6%	4.0%	4.9%	4.6%	(i)
GDP per capita (PPP, 2011 constant U.S. dollars)	10,776.9	11,332.3	11,636.6	12,025.4	12,611.4	(vi)
Gross fixed capital formation (real annual growth)	4.9%	19.0%	4.7%	6.0%	10.9%	(i)
Household consumption (annual growth)	5.0%	6.0%	4.4%	3.8%	4.4%	(i)
Unemployment rate (annual average)	11.8%	10.8%	10.4%	9.6%	9.1%	(i)
Nonfinancial public sector (NFPS)						
Revenue (% of GDP)	27.0%	27.6%	29.2%	29.1%	29.2%	(ii)
of which: oil revenue (% of GDP)	2.7%	4.1%	4.0%	4.2%	3.8%	(iii)
Expenditure (% of GDP)	29.7%	28.3%	28.0%	29.8%	29.4%	(ii)
Overall balance (% GDP)	-2.7%	-0.7%	1.2%	-0.6%	-0.2%	(ii)
Primary balance (% GDP)	0.2%	2.1%	3.8%	1.8%	2.2%	(ii)
Gross debt stock (% of GDP)	35.6%	34.1%	32.5%	34.7%	34.0%	(ii)
Monetary and exchange rate						
Annual inflation (end-period)	3.2%	3.7%	2.4%	1.9%	3.7%	(i)
COP/US$ nominal exchange rate (period average)	1,899.0	1,848.0	1,798.0	1,868.9	2,001.1	(iv)
Real effective exchange rate (period average)	98.6	98.6	96.0	101.0	104.1	(iv)
Financial						
Credit to the private sector (% of GDP)	34.3%	36.8%	39.2%	41.5%	44.6%	(v)
Financial system assets (% of GDP)	55.9%	58.5%	62.2%	66.7%	70.1%	(v)
External sector						
Trade balance	-0.7%	0.3%	-0.2%	-0.7%	-3.0%	(iv)
Current account	-3.0%	-2.9%	-3.1%	-3.3%	-5.2%	(iv)
Foreign direct investment	2.2%	4.4%	4.1%	4.3%	4.2%	(iv)
Portfolio investment	1.1%	2.4%	2.0%	2.9%	4.9%	(iv)
Social						
Poverty	37.2%	34.1%	32.7%	30.6%	28.5%	(i)
Extreme poverty	12.3%	10.6%	10.4%	9.1%	8.1%	(i)
Gini coefficient	0.56	0.55	0.54	0.54	0.54	(i)

(i) DANE

(ii) MHCP (2014: figures to September, annualized)

(iii) Asociación Colombiana del Petróleo [Colombian Oil Association] (ACP)

(iv) Banco de la República

(v) Colombian Financial Superintendency

(vi) World Development Indicators, World Bank.

Note: 2014 estimate.

FINANCIAL SCENARIOS

Fiscal context. Over the last decade, Colombia's fiscal accounts have been in deficit. However, this deficit has been shrinking as a percentage of GDP. From 2010 to 2014, the central government deficit fell as a percentage of GDP from 3.9% to 2.4%. With the introduction of the fiscal sustainability principle as a constitutional criterion and the creation of a fiscal rule, a systematic reduction is projected in the deficit. Moreover, the fiscal rule enforces a downward trend in the overall deficit, with an intermediate target of 1.9% of GDP in 2018 and convergence to 1% of GDP in 2022. Net government debt declined from 37.2% of GDP in 2010 to 34.8% of GDP at the end of 2013.

Medium-term financing requirements. The central government financing requirement under the projected scenario would be covered as follows: 61.3% (US$56.1 billion) through domestic bond issues; 11.7% (US$10.7 billion) through international debt issues; and 10% (US$10 billion) through multilateral disbursements. Of the latter, the Bank could face demand of US$4 billion, equivalent to 4.3% of financing needs (Table 1).

Table 1: Central Government Financing Requirement (US$ billion)*

	2013	*2014*	*2015p***	*2016p***	*2017p*	*2018p*
USE	**21.5**	**27.6**	**20.9**	**22.9**	**22.9**	**24.8**
Primary deficit (a)	0.4	0.4	1.2	2.6	1.4	-0.8
Interest payments (b)	8.3	9.1	8.4	9.8	9.7	11.4
Amortizations (c)	12.9	11.5	9.4	8.1	6.7	8.8
Others (d)	-0.1	6.5	1.9	2.4	5.1	5.4
SOURCES	**21.5**	**27.6**	**20.9**	**22.9**	**22.9**	**24.8**
Multilateral disbursements (e)	1.4	2.5	3.1	2.2	2.2	2.4
IDB (f)	*0.7*	*0.6*	*1.1*	*1.1*	*0.9*	*0.8*
World Bank (g)	*0.7*	*1.9*	*2.0*	*1.1*	*1.3*	*1.6*
Domestic treasury bond issues (h)	16	17.9	12.3	14.2	14.2	15.4
International bond issues (i)	3.9	3.2	2.5	2.7	2.7	2.9
Others (j)	0.2	3.9	3.0	3.8	3.8	4.1
Financing requirement (% of GDP)	5.80%	6.90%	6.50%	6.70%	6.40%	6.30%
Primary deficit (% of GDP)	0.10%	0.10%	0.40%	0.80%	0.40%	-0.20%
IDB disbursements (% of GDP)	0.20%	0.10%	0.33%	0.33%	0.26%	0.20%

* Exchange rate: MHCP (2015, 2016) and LatinFocus (2017, 2018).

** MHCP projections were used for 2015 and 2015.

(a) and (b) Projections based on MHCP, authors' calculations.

(c) Source: MHCP. A maturity of over five years is assumed for new loans

(d) Includes accruals and treasury operations. 2016 and 2017 projections calculated as the average for 2011-2014.

(e), (h), and (i) 2017 and 2018 projections calculated as the average for 2014-2015.

(f) and (g) IDB projection

(j) Projections for 2017 and 2018 calculated as the gap between sources and uses of funds

IDB financing. Based on these projections and programmed growth rates, it is estimated at the country's overall debt-to-GDP ratio will rise from 38.3% in 2014 to around 39.4% in 2019. Domestic sources will cover an average of 77.3% of total annual financing requirements, with external sources providing the rest. Based on this, the financing scenario assumes total financing of US$4 billion over the strategy period, equivalent to average annual disbursements of US$1 billion from sovereign guaranteed operations. This means the Bank would represent 5.3% of total debt and 37% of multilateral debt in 2018 (Table 2).

Table 2. IDB Financing Scenario, 2015-2018*

US$ million	***2014***	***2015p***	***2016p***	***2017p***	***2018p***
Approvals	932	890	800	800	800
Disbursements	554	1,060	1,125	937	776
Amortizations	473	448	476	499	504
Net flow	81	612	649	438	272
IDB debt					
US$ million	6,250	6,862	7,511	7,949	8,221
% multilateral debt	39.6%	38.7%	39.2%	38.6%	37.0%
% external debt	16.7%	16.3%	16.3%	16.3%	15.3%
% public debt	4.3%	5.7%	5.6%	5.6%	5.3%
% GDP	1.7%	2.1%	2.3%	2.2%	2.1%

* Annual approval amounts are indicative and subject to the availability of Bank funds. Includes sovereign guaranteed operations only.

Sources: Projections based on IDB Finance Department and MHCP data.

DEVELOPMENT EFFECTIVENESS MATRIX (DEM)

COUNTRY STRATEGY: DEVELOPMENT EFFECTIVENESS MATRIX

In August 2008, the Board of Directors approved the Development Effectiveness Framework (GN-2489) to increase the evaluabiliy of all Bank development products.

The Development Effectiveness Matrix for Country Strategies (DEM-CS) is a checklist of the elements that are necessary to evaluate a country strategy. It is based on the evaluation criteria developed by the Evaluation Cooperation Group of the Multilateral Development Banks in the "Good Practice Standards for Country Strategy and Program Evaluation."

COUNTRY STRATEGY:

STRATEGIC ALIGNMENT
Refers to the degree to which the design and objectives of the CS are consistent with the country development challenges and with the government's development plans and priorities.

EFFECTIVENESS
This measures whether the country strategy is likely to achieve its intended objectives, through an examination of three dimensions: (i) the quality of the diagnostics on which Bank action is based in each area of work; (ii) the quality of the results matrix for the strategy; (iii) the use and build up of country systems.

Effectiveness dimensions	
I. Country Diagnosis - Country Development Challenges (CDC)	Yes/No
- The CDC is comprehensive / holistic / complete	Yes
- The CDC cleary identifies the main development challenges	Yes
- The CDC presents magnitudes of the main development challenges that are based on empirical evidence	Yes
II. Priority Areas Diagnostics	%
- That cleary identify and dimension, based on empirical evidence, the priority area's specific contrains and challenges	100%
- That cleary identify and dimension, based on empirical evidence, the main factors or causes contributing to the specific constrains and challenges	83%
- That provide policy related recommendations	83%
III. Results matrix*	%
- The expected outcomes are clearly defined	95%
- The strategic objectives that are directly related to the main constraints identified in the Diagnosis	100%
- The indicators are outcome indicators and are SMART	80%
- The indicators have baselines	100%
IV. Vertical logic	Yes/No
- The CS has vertical logic	Yes

* The Result Matrix is composed by indicators that are meaningful to, and capture progress towards, the expectd results. The expect results stem from the strategic objectives.

CS Diagnostic :
As part of the country strategy 2015-18 a country development challenges diagnostic was presented, under the title of Bases de la Estrategia de País 2015-2018 (Anexo 1). The CDC diagnostic is comprehensive and based on empirical evidence.The CDC diagnostic identifies 3 priority areas for the Bank's intervention productivity, quality of public institutions and social mobility

-The diagnostic cleary identifies and dimensions, based on empirical evidence, 100% priority area's specific contrains and challenges.
-The diagnostic cleary identifies and dimensions, based on .empirical evidence, the main factors or causes contributing to the specific constrains and challenges for 83% of the priority areas.
-The diagnostic provides policy recommendations for Bank actions, that are based in empirical evidence, for 83% of the priority areas.

Results matrix : The section of the results matrix corresponding to the new strategic area includes 14 strategic objectives for Bank action, 20 expected results and 20 indicators to measure progress.

- 95% of the strategic objectives clearly identify expected outcomes.
- 100% CS Objectives are directly related to the main constraints identified in the Diagnosis.
- 80% of the indicators used are SMART.
- 100% of the indicators have baselines.

Country Systems :se cuenta con diagnósticos para todos los sub-sistemas de gestión financiera. Se continuará con la utilización de los sub-sistemas de presupuesto y tesorería al 100%, de forma parcial el sub-sistema de contabilidad y reportes, el sub-sistema de control externo al menos un piloto (5%) de los proyectos de la cartera. En materia de adquisiciones, se cuenta con un diagnóstico del sistema de información; se prevé trabajar en el fortalecimiento de todos los sub-sistemas de adquisiciones.

Vertical logic. The CS has vertical logic.

RISKS. *This measures three dimensions: (i) identification of factors that actually do or might affect attainment of the proposed objectives; (ii) definition of mitigation measures; and (iii) monitoring mechanisms.*

The strategy identifies the main risk to the CS´s implementation: (i) lack of fiscal resources to implement the objectives proposed in the strategy; (ii) the international economic cycle as a factor that may affect public finances and public investment; (iii) the quality of public institutions may affect public investment. The CS identifies specific mitigation and monitoring measures for each risks.

RECOMMENDATIONS FROM THE COUNTRY PROGRAM EVALUATION – OVE

Recommendations from the Country Program Evaluation	Incorporation into the Country Strategy 2015-2018
Strengthen the design, monitoring, and completion of PBL series to avoid interruptions in the Bank's comprehensive support for priority sectors, and ensure that development objectives are met in a sustainable manner. When PBL series are interrupted, it is recommended that these be removed from the lending program, and a project completion report prepared for the truncated series.	The new project completion report (PCR) methodology approved by the Operations Policy Committee (OPC) on 5 August 2014 corrects the problem identified in relation to the "truncated series." The new strategy will implement this methodology, which recommends preparing a PCR for multiphase operations, even when the series is interrupted or the next operation in the series is indefinitely postponed. Consistent with the new methodology, if a multiphase operation is stopped (even before completion of an operation of the series), preparation of the PCR for all the operations of the series must start no later than 12 months after the last disbursement date of the most recent operation. The methodology likewise establishes that, if a multiphase operation schedule gets delayed, preparation of the PCR for all the completed operations of the series must start no later than six months after the expected approval date, according to the loan proposal, of the delayed operation in the series.
Strengthen risk analysis during project design and periodically reevaluate and reprioritize the lending program based on dialogue between the Bank and the Government of Colombia, with a view to lowering the cost of projects prepared but unapproved or canceled.	The Bank has strengthened its risk analysis instruments in Colombia since 2012, supplementing the institutional analysis (ICAS) with an analysis of central processes for the execution of operations. The operations to be approved under the new strategy will continue using these tools. The Bank is in ongoing and fluid dialogue with the government, which, as OVE noted, enabled it to maintain its relevance in the prior strategy cycle. As part of implementation of the new country strategy 2015-2018, and to keep preparation costs down, the Bank will continue planning regular meetings with the government during the preparation phases of operations, to ensure that they are still high priorities.
To lower the cost to the Bank of the program of technical cooperation operations, give priority to those linked to the Bank's strategy and lending program and increase the proportion of new technical cooperation operations executed by the client. In providing technical assistance, "fee-for-service" instruments may be useful for meeting client demands that cannot be met using nonreimbursable technical cooperation operations.	The Bank is currently working to create a monitoring system for technical cooperation operations. It is expected to launch during 2015 and provide clarification on this matter. The execution of technical cooperation operations by the client will continue to be emphasized during implementation of the new strategy, as it has been in the past. Colombia already makes use of fee-for-service instruments. The new strategy will seek to identify more opportunities for their increased use.
Strengthen country dialogue and continue exploring ways to become operationally involved with subnational entities, seeking innovative options that utilize sovereign guaranteed and non-sovereign guaranteed, technical cooperation, and fee-for-service instruments.	The Bank will continue supporting subnational entities in the 2015-2018 strategy period through the CCLIP for Fiscal and Public Investment Expenditure Strengthening in Subnational Entities (CO-X1018), approved in 2014. Under this operation, subnational entities are supported through a second-tier State-run bank, Financiera de Desarrollo Territorial S.A. (FINDETER). The Bank's work at the decentralized level will continue combining loan operations with other instruments such as technical cooperation operations and analytical studies. Ten cities in Colombia are beneficiaries of the Emerging and Sustainable Cities Initiative.
Consider expanding the Bank's involvement in rural development, given the persistence of regional disparities and the emergence of new work areas expected as a result of the peace process.	The programming dialogue with the government has emphasized the importance of Bank support in this area. The Bank is moving ahead on a rural development operation to strengthen the delivery of public goods by public institutions in the agricultural sector, focusing on the most vulnerable parts of the country. New opportunities for support in this area will be identified under the new strategy.

DONOR COORDINATION

The IDB maintains a high level of coordination with other multilateral and bilateral institutions. There is a donors committee in Colombia in which the IDB participates. It also has an ongoing technical and financial relationship with the World Bank and the CAF. In the technical realm, the three institutions have established a dialogue on the long-term outlook in Colombia, and this is informing the three multilaterals' strategic vision for the country.

There are examples of joint financing, such as the El Dorado airport, in which the IDB's private sector teamed up with the CAF and private banks to create the financing consortium for this key piece of infrastructure. Future plans for collaboration include construction of the Bogota metro. The IDB, together with the World Bank, will be providing technical and financial support for this project. Development of the Pacific region, with a focus on the city of Buenaventura, is another project in which the IDB, the CAF, the World Bank, and other donors have been collaborating, with IDB-World Bank cofinancing.

The IDB is coordinating closely with the OECD on analytical work that will facilitate Colombia's accession to this organization. Recent OECD work on Colombia reveals a growing alignment between the country strategy and that institution's assessment and key recommendations.[1] The IDB also maintains a fluid dialogue in the areas of transportation and urban development with bilateral agencies such as those of France, the Netherlands, China, and the United Kingdom. Through the Capital Markets and Financial Institutions Division, the IDB has also facilitated access to sources of international climate financing (the Clean Technology Fund) through Colombia's development bank, allowing the cofinancing of innovative programs aimed at leveraging private business investments in energy efficiency measures, sustainable transportation, and renewable energy generation.

Sector	World Bank	CAF	CTF	OECD	UNODC	Australia	China	Korea	Spain	France	The Netherlands	United Kingdom
Innovation	1											
Fiduciary	1,3											
Transportation	1,2,3	2					2	1		3	1	3
Urban Development										3	1	
Financial and Capital Markets			1									
Water and Sanitation	2							1			1	
MIF					3	3			3			
Institutional Capacity of the State								1				

1 OECD (2015a); OECD (2015b).

Sector	World Bank	CAF	CTF	OECD	UNODC	Australia	China	Korea	Spain	France	The Netherlands	United Kingdom
Fiscal Policy				1								
Pensions				1								
Health										2		
Energy	2											

Note: 1 = dialogue, 2 = loan, 3 = technical cooperation.

UNODC: United Nations Office on Drugs and Crime. CTF: Clean Technology Fund.