PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

June 21, 2017
Report No.: AB7913

Operation Name	Colombia Second Fiscal Sustainability and Competitiveness Development Policy Financing
Region	LATIN AMERICA AND CARIBBEAN
Country	Colombia
Sector	General public administration sector (50%); Public administration- industry and trade (50%)
Operation ID	P162858
Lending Instrument	Development Policy Financing
Borrower(s)	Republic of Colombia
Implementing Agency	Ministry of Finance and Public Credit, National Department of Planning
Date PID Prepared	June 21st, 2017
Estimated Date of Appraisal	November 06, 2017
Estimated Date of Board Approval	December 14, 2017
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Key development issues and rationale for Bank involvement

Robust macroeconomic policy framework, anchored by an inflation targeting regime, floating exchange rate, and fiscal rule, ensured orderly fiscal and external adjustments to the large terms of trade shock that affected the country since 2014. Far-reaching macroeconomic and structural reforms undertaken in recent years have allowed a build-up in the resilience of the economy with economic growth consistently outperforming the region's growth outturn. The country underwent a relatively rapid external adjustment and continued to comply with the fiscal rule. The key structural reforms aimed at improving the regulatory system and reducing rigidities in factor and product markets have also underpinned this resilience and started to lay the foundations for fostering the economic diversification. Meanwhile, poverty halted its downward trend in 2016. Official poverty rates show that the percentage of people in poverty slightly increased by 0.2 percentage points in 2016, rising to 28 percent from 27.8 percent in 2015. The mild increase is driven by urban areas where poverty incidence rose by 0.8 percentage points from 24.1 percent to 24.9 percent between 2015 and 2016. On the other hand, poverty in rural areas decreased significantly 1.7 percentage points from 40.3 percent to 38.6 percent. Similarly, extreme poverty grows 0.6 percent-age points in 2016 (from 7.9 percent to 8.5 percent) as a result of a significant increase in extreme poverty in urban areas. Meanwhile inequality of measured by the Gini coefficient declined to 51.7 in 2016 from 52.2 in 2015.

The proposed Fiscal Sustainability and Competitiveness Development Policy Financing series aims to support Colombia's efforts to enable fiscal sustainability and further strengthen the foundations for productivity growth in the context of the ongoing peace

process and under a less favorable external environment. The reversal in the external environment has highlighted the drawbacks associated with the country's increased reliance on extractive industries over the last decade. Domestically, Colombia is also at a historic juncture as the government has signed on November 24th 2016 a revised peace agreement with the rebel group of FARC to end more than 50 years of civil conflict . In addition, Colombia's National Development Plan 2014-2018 (NDP) has established Green Growth (GG) as an overarching strategy to reach both peace and sustainable development. The proposed DPF series recognizes and supports the Colombian authorities' reform efforts in the adjustment to this new environment. It supports critical revenue, expenditure and contingent liabilities reforms to help ensure fiscal sustainability; as well as structural reforms aimed at supporting productivity growth, particularly in the non-extractives sectors, as well as green growth.

II. Proposed Objective(s)

The Fiscal Sustainability and Competitiveness DPF series aims to support Colombia's efforts to maintain fiscal sustainability and enable the basis to accelerate productivity growth, particularly for the non-extractive sector, in the context of a less favorable external environment. The proposed DPF series recognizes and supports the Colombian authorities' reform efforts in the adjustment to this new environment and it is closely aligned with the priorities identified in the NDP. The series' Program Development Objectives (PDOs) are to: (i) help maintain fiscal sustainability through fiscal consolidation measures and improved contingent liabilities management; and (ii) foster productivity in non-extractives sectors by strengthening the policy framework for trade facilitation, investment, competition, business regulation, innovation. The reforms under these two objectives mutually reinforce each other. Both areas of reforms are likely to raise investor confidence, de-risk the economy, reduce costs for the private sector, make the country even more resilient to shocks, and foster growth over the medium term.

III. Preliminary Description

Fiscal consolidation remains a central priority for the government and is essential for maintaining fiscal sustainability, especially given additional spending needs required by the implementation of the peace process in the context of soft, albeit recovering oil prices. Central Government oil-related fiscal revenues declined by 3.1 percent of GDP between 2013 and 2016, and to contain the fiscal deficit the government has adopted a slightly contractionary fiscal stance. The implementation of the peace process will require additional public spending, especially for closing the development gap in states affected by conflict. At the same time the Fiscal Rules mandates a reduction in the central government deficit of 3 percentage points by 2022 (or going from 2.9 percent of GDP in 2016 to 1 percent of GDP by 2022 for the structural balance), highlighting the need for additional fiscal consolidation measures, in particular, on the expenditure side. In this context, the authorities remain strongly committed to stringent expenditure controls and measures, tax policy and administration reforms, and prudent management of fiscal risks stemming from contingent liabilities, particularly through the implementation of the reforms supported by this operation.

Reducing the country's vulnerability to price fluctuations in the extractives sector requires additional reforms to enable more diversified engines of growth. Colombia's economic growth since the 1960s was based heavily on factor accumulation, but in the current environment of low commodity prices this is increasingly unsustainable. In this new context, unleashing productivity becomes an even more urgent agenda. Measured by TFP growth, productivity has averaged a low 0.5 percent over the past 60 years in Colombia. Over the period 1991-2008, annual TFP growth was only 0.7 percent, compared to 1.7 percent in Chile and 4.8 percent in China. Sectoral productivity growth in Colombia has been largely driven by productivity gains within firms, but convergence to the productivity frontier has been hampered by limited innovation efforts. Weak productivity growth is also linked to low integration to international markets and limited competition in domestic markets. To this end, the Government is undertaking structural reforms to boost innovation; reduce the barriers to trade and investment, which disproportionally affect the non-extractives sectors; and improve the regulatory environment to enhance competition and spur economic dynamism. The proposed DPF series supports critical aspects of this reform program.

IV. Poverty and Social Impacts and Environment Aspects

The prior actions supported by this operation are not likely to have significant poverty, social or distributional effects. Some of the prior actions are likely to have a positive environmental effect. All prior actions have undergone an initial screening for such effects. While significant poverty, social and distributional effects are not likely for any of the prior actions, a poverty and social impact analysis will be conducted for the next stage of preparation to provide more conclusive evidence. The reforms related with green growth, by improving the efficiency of energy use by the private sector are likely to have a positive impact on the environment

V. Tentative financing

Source:		($m.)
Borrower		0.00
International Bank for Reconstruction and Development		500.00
	Total	500.00

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