PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE

July 11, 2016
Report No.: AB7853

Operation Name	Colombia First 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	P158739
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	July 11, 2016
Estimated Date of Appraisal	October 12, 2016
Estimated Date of Board Approval	December 1, 2016
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

Sound macroeconomic policies and structural reforms, coupled with favorable external conditions, enabled a strong broad-based growth and poverty reduction. Between 2004 and 2014, average annual growth reached 4.8 percent, making Colombia one of the strongest performers in Latin America. Colombia's sound macroeconomic management, based on a combination of its inflation targeting regime, floating exchange rate, and strong track record of fiscal discipline, helped the country weather the global financial crisis 2008-9, and together with strong oil prices, enabled a remarkable bounce back between 2009 and 2013. A favorable external environment in that period also helped to boost foreign direct investment (FDI), exports and Government revenues. Extreme poverty fell from 17.7 percent in 2002 to 8.1 percent in 2014, while total poverty fell from 49.7 percent in 2002 to 29.5 percent in 2014. Labor income growth has been the main driver of poverty reduction (explaining 84 percent of the reduction in total poverty between 2002 and 2013), rather than redistribution policies.

The proposed Fiscal Sustainability and Competitiveness Development Policy Financing series aims to support Colombia's efforts to enable fiscal sustainability and the basis for a more diversified growth 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 an end to Latin America's longest-running civil conflict is in sight. 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.

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 and innovation. The reforms under these two objectives mutually reinforce each other. Both areas of reform are likely to raise investor confidence, reduce costs for the private sector, make the country even more resilient to shocks, and foster stability and growth over the medium term.

III. Preliminary Description

Fiscal reforms continue to be a central priority to ensure sustainability. Oil-related fiscal revenues for the Central Government fell by 2.1 percent of GDP between 2013 and 2015. While the authorities have taken a number of measures and reforms to contain the deficit so far, additional expenditure pressures are coming to the fore. Interest payments on debt increased from 2.2 percent of GDP in 2013 to 2.6 percent in 2015. At the same time, there is not much space for drastic reductions in investments over the medium term without harming growth prospects. The conclusion of the Peace Agreement will also imply additional public spending, including on rural development. Thus, while the fiscal consolidation path mandated by the Fiscal Rule requires a deficit reduction of 2.6 percent of GDP between 2016 and 2022 (or going from 2.2 percent of GDP in 2015 to 1 percent by 2022 in structural terms), the extra pressures require the creation of even more fiscal space. In order to achieve this, the authorities are committed to strong expenditure controls, tax policy and administration reforms, and the prudent management of fiscal risks stemming from contingent liabilities, particularly through 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, distributional or environmental effects. 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. As for environmental effects, any such effects related to the prior actions would be of an indirect nature, and are not likely to be significant.

V. Tentative financing

Source:		($m.)
Borrower		0.00
International Bank for Reconstruction and Development		600.00
	Total	600.00

VI. Contact point

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