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Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 02-May-2023 | Report No: PIDA35816

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Colombia	P180566	Equitable and Green Path Development Policy Financing (P180566)	
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
LATIN AMERICA AND CARIBBEAN	13-Jun-2023	Poverty and Equity	Development Policy Financing
Borrower(s)	Implementing Agency		
Republic of Colombia	National Planning Department (DNP)		

Proposed Development Objective(s)

The development objective of the proposed operation is to support measures that promote (i) more equitable and green fiscal policies, (ii) productive and social inclusion for vulnerable groups, and (iii) inclusive and green private sector development.

Financing (in US$, Millions)

SUMMARY

Total Financing	750.00

DETAILS

Total World Bank Group Financing	750.00
World Bank Lending	750.00

Decision
The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

1. **Income inequality in Colombia is one of the highest in the world**. It is the highest among Organization for

Economic Cooperation and Development (OECD) countries and the second highest among 18 Latin America and Caribbean (LAC) countries. Inequality increased with the COVID-19 shock, with the Gini coefficient increasing from 51.7 to 54.4 between 2018 and 2020. While the economic recovery in 2021 reversed income inequality, this remains very high (52.3). Moreover, the recovery did not reach all groups: while the national poverty rate dropped to 39.3 percent in 2021, down from 42.5 in 2020, rural poverty increased, the poverty rate only declined marginally for Venezuelan migrants and stayed the same for Afro-Colombians and indigenous people, groups with significantly higher poverty rates pre-pandemic. Large disparities also limit social mobility for these groups: for instance, learning-adjusted years of education – a component of the Human Capital index - are significantly lower for ethnic groups and children living in certain regions (World Bank 2021). Finally, the increasing frequency and intensity of climate-related shocks exacerbate inequalities as they impact disproportionally less well-off groups (women, informal, and rural workers) (forthcoming, World Bank Country Climate and Development Report). Tackling inequities can increase the country's growth potential through a more skilled and productive labor force and tighter social cohesion.[1]

2. **Colombia's economy has been growing robustly since 2021, and the macroeconomic policy institutional framework remains strong, but policy action is needed to foster inclusive growth.** In Q4 of 2022, real GDP was 10.4 percent, above its pre-pandemic level (Q4 of 2019), after annual average growth of 3.4 percent between Q4 of 2019 and Q3 of 2022. Macroeconomic policies continue to be guided by a credible inflation-targeting regime, a flexible exchange rate, and rule-based fiscal policies, which are solid foundations for macroeconomic stability. At the same time, the economy has overheated, the current account deficit remains high, and a sustainable reduction of the general government's debt-to-GDP ratio requires prudent fiscal policy management. As the economy is headed towards a needed cooling down, prospects for growth-driven poverty reduction are narrowing. Moreover, growth alone is unlikely to reduce poverty for all groups, with complementary actions needed to promote productive and social inclusion. Finally, climate change poses longer-term challenges to Colombia's development by increasing the risk of damages to physical capital, disruption of electricity generation, reduced labor productivity, human capital erosion, and agricultural losses.

Relationship to CPF

3. **The proposed operation is aligned with the Country Partnership Framework (CPF) for Colombia (FY16-21), and its most recent Performance and Learning Review (FY16-21), and the twin goals are at the core of all measures supported by this DPF.** Beyond the alignment with the corporate goals and the Green, Resilient, and Inclusive Development (GRID) approach, the DPF supports all three Pillars of the CPF: (i) Fostering Balanced Territorial Development, (ii) Enhancing Social Inclusion and Mobility through Improved Service Delivery, both in line with actions in Pillar II and III of this DPF; and (iii) Supporting Fiscal Sustainability and Productivity, in line with measures supported in Pillar I and III of this DPF. The operation also addresses equity and climate, two of the four main development challenges identified in the Colombia Systematic Country Diagnostic (2021), which will inform the upcoming CPF.

C. Proposed Development Objective(s)

4. The development objective of the proposed operation is to support measures that promote (i) more equitable and green fiscal policies, (ii) productive and social inclusion for vulnerable groups, and (iii) inclusive and green private sector development. The DPF supports reforms structured around three pillars:

Pillar I focuses on fiscal policy measures that increase the progressivity of income taxation and expand and introduce taxes that promote decarbonization and healthier lifestyles; these measures allow for increased tax revenues to, in the

[1] For example, closing gender gaps in labor force participation and education would increase Colombia's GDP per capita by an estimated 14 percent by 2050 (Devadas and Kim 2020).

second phase of the program, strengthen and expand the social protection system.

Pillar II promotes productive and social inclusion of vulnerable groups – women, migrants, Indigenous and Afro Colombian populations. The aim is to reduce gaps in access to opportunities by promoting their access to assets (for example, education and land) and services (care services, services for women victims of gender-based violence).

Pillar III promotes inclusive and green private sector development by increasing opportunities for financial access to women, lower-income households, and currently excluded groups and by better aligning the private sector to climate objectives.

Key Results

5. The overall result will be to promote inclusive and green growth, specifically by supporting measures that foster (i) more equitable and green fiscal policies, (ii) productive and social inclusion for vulnerable groups and (iii) inclusive and green fiscal policies. Key results under Pillar 1 aim to support fiscal measures that, in the first phase of the program, increase revenue and, at the same time, increase the progressivity of income taxation while expanding and introducing taxes that promote decarbonization and healthier lifestyles. Pillar 2 targets results that aim to narrow gaps in access to opportunities by promoting their access to productive assets and basic services, including care and support for victims of GBV. Finally, key results under Pillar 3 are a more inclusive and greener private sector that will open opportunities for underserved groups and that will enhance its contribution towards climate objectives.

D. Project Description

6. The proposed Equitable and Green Path Development Policy Financing (P180566) (DPF) in the amount of US$750 million for the Republic of Colombia, is the first in a series of two and supports the Government of Colombia (GoC)'s policies to promote inclusive and green growth. The development objective of the proposed operation is to support measures that promote (i) more equitable and green fiscal policies, (ii) productive and social inclusion for vulnerable groups, and (iii) inclusive and green private sector development. The program supports reforms towards a more progressive fiscal tax system through changes to the personal income tax, and one that is better aligned with the objective of sustainability and better health through the introduction of health taxes and carbon taxes. It also recognizes that not all groups in society have the same opportunities and that targeted actions are needed to close the barriers they face. As such, the program supports measures that aim at narrowing inequalities in the productive capacity of the less well-off in society, with groups defined by gender, ethnicity, location and migratory status. It supports actions to narrow gender inequalities in access to economic opportunities and agency, that increase opportunities and access to services for migrants, and that promote a more participatory approach for land management for ethnic communities. Finally, the program promotes financial inclusion through increased access to credit and a more competitive sector, and a private sector and financial sector better aligned with climate objectives. This proposed program directly supports the Government's objectives and its content is fully complementary to and consistent with the policy plan envisaged for the coming years.

7. The proposed indicative triggers for the operation show a sustained public commitment to continued advancement on the inclusive and green growth agenda. Indicative triggers 1 and 2 in Pillar 1 aim at strengthening and expanding the social protection system using tax revenues from the first phase, including the creation of a new system of adaptive social transfers and an income registry as a mechanism to reduce asymmetries of information between those who declare income and those who do not. Indicative Trigger 3 supports efforts to lower emissions by reducing subsidies on gasoline and diesel, including mechanisms to compensate the poor for the resulting increase in prices. In Pillar 2, Indicative Trigger

4 supports regulations for the functioning of the National Care System included in phase one of the program, while the proposed Indicative Trigger 5 supports the modification of the Law that promotes women's economic empowerment in rural areas through initiatives to title women's land and improved access to economic opportunities. Indicative Trigger 6 supports regulations that adopt the guidelines for carrying out the cadaster in collective territories of ethnic communities and Indicative Trigger 7 supports regulations on the socio-economic integration of migrants. In Pillar 3, Indicative Trigger 8 introduces a segmented regulatory framework for CACs with regulatory requirements and permissible activities proportional to the risks and capabilities of the institutions, incentivizing sector growth and consolidation while proposed Indicative Trigger 9 captures the development of governance arrangements and standards for open finance. Indicative Trigger 10 covers the creation of Colombia's emissions trading system (ETS) and Indicative Trigger 11 focuses on gas flaring efficiency, supporting efforts on decarbonization. Finally, Indicative Trigger 12 captures the regulation of other thematic financial instruments, namely thematic collective investment funds, as per its Roadmap for Greening of the Financial Sector.

8. The operation is being prepared in coordination with the International Finance Corporation (IFC), particularly on private sector development and financial sector measures. Moreover, it is being very closely coordinated with CAF Development Bank (including joint discussions with the Government counterparts), who are leading a parallel and complementary operation on promoting equity and gender equality, and with the Inter-American Development Bank (IADB) and KFW Development Bank who will be advancing complementary subsequent operations on the equity agenda.

E. Implementation

Institutional and Implementation Arrangements

9. The Ministry of Finance and Public Credit and the National Planning Department are responsible for collecting and monitoring information related to program implementation and progress toward the achievement of results for this DPL. They are further responsible for coordinating with the agencies involved in the reform program supported by this DPL. The Ministry of Finance and Public Credit and the National Planning Department have long-standing experience collecting and monitoring information in the context of DPLs. Monitoring and evaluation of the operation will also be carried out through ongoing policy dialogue and technical assistance programs.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

10. **With reducing inequalities at the core of this operation, the supported prior actions are expected to have significant positive effects on distributional outcomes over the short to long term**. All Pillars are expected to have positive distributional impacts in the short and long term. With the strong analytical foundations, including an ongoing and updated model on the distributional impact of fiscal policies, the Colombia Equity Flagship and the upcoming CCDR.

11. **Pillar I advances the agenda of a more progressive fiscal system**. Microsimulations show an increased progressivity of the PIT from the reform and a reduction in income inequality. For example, the Kakwani progressivity index is estimated to increase from 0.435 to 0.445, and the Gini at the disposable income to decrease by 0.34 percent linked to this reform (World Bank, forthcoming). It also promotes the goals of sustainability and better living standards in the design of the fiscal system through increases in carbon taxation[2] and the introduction of healthy taxes, which tend to

[2] The gasoline carbon tax, assuming full pass-through to consumers, would be progressive in absolute terms (share of the tax paid increases with income). It would increase the share that the tax represents of the income of the poorest (first decile), although remains very low (from 0.28% of their income to 0.37%).

benefit the poorer, given their consumption patterns.[3] While these two actions may have short-term mild negative effects on the poor, their expected medium- to long-term effects are estimated to outweigh short-term effects.

12. **Pillar II aims to promote productive and social inclusion of vulnerable groups, with positive poverty and distributional effects expected.** It opens opportunities for groups defined by gender, ethnicity, migratory status, and location, by addressing barriers for a more productive participation in society.

13. **Pillar III increases access to financial assets for the excluded groups, including women and low-income households, through a more inclusive and greener private sector, including strengthening synergies to tackle climate change**. Measures to promote financial inclusion are expected to have positive effects in poverty by boosting access to credit for excluded groups, fostering income generation and incentivizing formality, with positive impacts on job creation and quality. Similarly, measures under this Pillar aimed at reducing carbon emissions and promoting a productive transformation of the economy are expected to have positive social and distributional effects in the medium to long run.

Environmental, Forests, and Other Natural Resource Aspects

14. **Prior Actions 3, 5, 8 and 9 are expected to significantly and positively affect the environment support the country's actions toward its NDC commitment**. These Prior Actions promote and incentivize investments to reduce greenhouse gas (GHG) emissions contributing to climate change mitigation by embedding planning approaches that reduce carbon pollutants, improve energy efficiency, and reduce fossil fuel consumption. Positive environmental and health benefits, as well as positive climate co-benefits, will be achieved through the reduction of GHG, including the reduction of black carbon and other particulate matter, such as nitrogen and sulfur oxides, among other primary and secondary pollutants. Policy measures to improve inclusiveness in cadaster and land administration supported in Prior Action 5 under Pillar 2 are expected to affect the environment positively. The participatory cadaster supported under this Prior Action will enable ethnic and peasant communities to secure land rights, which can reduce land use conflict and environmental degradation. No significant negative impacts to Colombia's environment, forests or other natural resources are expected to arise from the policies supported under this operation. Any potential negative effects on the environment resulting from these PAs will be managed through the nation's environmental framework.

15. **Colombia has a comprehensive environmental regulatory and planning framework for environmental management.** The Ministry of Environment and Sustainable Development (MADS) is the national regulatory entity in charge of formulating, implementing, and enforcing environmental policies and regulations to ensure environmental protection and sustainable development. Through the Decree 1076 of 2015, the MADS sets out the activities subject to environmental licensing. Together with the National Environmental Licensing Authority (ANLA by the acronyms in Spanish) and the Regional Autonomous Corporations (CARs by the acronyms in Spanish), they are responsible for the environmental licensing and permitting process for projects/investments at the national and regional level. The MADS, ANLA and CARs have the adequate institutional capacity to manage environmental management and related licensing/permitting processes.

G. Risks and Mitigation

16. **The overall risk level for this DPF is assessed as Moderate.** This is based on a Moderate rating for most risks,

[3] Health-related taxes cannot be assessed in monetary terms only, as they are expected to have positive health effects. Nevertheless, assuming consumption patterns remain, it is slightly regressive and the share of the tax over the incomes of the poorest is 0.79%. A brief of international experiences and evidence on sugary drinks taxes can be found here: https://openknowledge.worldbank.org/bitstream/handle/10986/35186/Taxes-on-Sugar-Sweetened-Beverages-International-Evidence-and-Experiences.pdf?sequence=1&isAllowed=y

excluding those related to fiduciary and environmental and social risks which are rated as Low. Although macroeconomic risks have intensified in a context of a more difficult international economic environment and the need to reduce inflation, the current account, and the fiscal deficits, if policies continue to support macroeconomic stability, the probability that the government's budget were to become insufficient to support the objectives of this operation is high only for triggers related to Pillar one, and moderate for all other prior actions and triggers. The mandate to issue a medium-term fiscal framework annually and the fiscal rule constitute strong mitigation measures against fiscal risks.

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APPROVAL

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