Statement by Balmiki Prasad Singh
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Colombia: Country Assistance Strategy Progress Report

We welcome this discussion on the Country Assistance Strategy (CAS) Progress Report and the accompanying Financial Sector Adjustment Loan. Both the documents are very comprehensive and of an excellent quality. We commend the authors of the Report.

As is well known, the Colombian economy has deteriorated sharply in the last few years due to a variety of factors both external and internal. On the external front events emanating from the East Asian crisis have led to rising costs of borrowings, a position that was further complicated by the downgrading of the country’s investment-grade rating. At the same time the drop in oil and coffee prices led to trade shocks that put additional pressure on the economy. Domestically, fiscal imbalances, high interest rates, pressures on the exchange rate, the related problems in the financial sector, and the devastation from the earthquake have significantly exacerbated the economic and social problems of the country. As a result, the country faces the prospects of a negative growth rate this year, with a sharp downturn in economic and social indicators. The fiscal and current account deficits are high (although the latter is expected to fall, but only on account of lower imports), and
GDP has fallen by 6.7 percent in the first half of 1999. As a consequence of the crisis unemployment has risen to 20 percent (44.3 for those in the 15-19 age group). This in turn has led to deferred health care, with 7 million people unprotected against health risks, lower food consumption, higher school dropout rates (about 150,000 from public and private secondary schools), lower enrollment (a drop of 3.5 percent in secondary schools), and increase in child labor. The one silver lining that will help stem the crisis is that inflationary pressures have been contained.

Fortunately efforts are on a very challenging predicament. Primarily the issues of restoring fiscal balance, strengthening of the financial sector, extending the social safety net and ushering peace are the principal pillars on which the recovery effort will stand on. In this regard we acknowledge the strong commitment of the Administration to address the problems, as is testified by the legislative and administrative measures that have been initiated or are on the anvil. The government has launched an “ambitious” effort to tackle the complex local conflict. All efforts should be made to contain the role of the drug mafia and their cohorts. The National Development Plan along with the Plan Colombia seek to build social capital, aimed to resolve the ongoing social conflict. On the economic program the government has committed itself to reduce the fiscal deficit both by containing public expenditures as well as through revenue generation measures. A number of encouraging steps have been taken in this regard to initiate deep structural reforms. On the social side the government has been able to identify the population groups that have been hit the hardest by the crisis. To alleviate the distress faced by this segment the government’s program includes a wide array of measures which include job training, providing day care services, creating employment opportunities, expanding school lunch programs and enrolling 100,000 elderly in the health insurance system.

There is no doubt that the measures taken by the government are indeed very comprehensive. Overall it is a multi-pronged approach, which we believe to be essential. We also consider that the underlying strength of the program rests on the
highly participative nature of the program, both in conception and implementation. NGOs and civil society have been deeply involved in the process, as a result of which the ownership and implementation of the programs can be expected to be strong and efficient. In the context of the CAS, we note that despite the crisis the performance of the portfolio has been excellent with a disbursement ratio 29.5 percent. All projects are rated satisfactory with no projects at risk. These outcomes again testify to the strength of the partnership approach and the local implementation capacity. Given the needs of the government both to contain public expenditures while at the same time intervene to stem the crisis, we support management’s proposal to move the lending program to the high case scenario.

While the overall thrust of the CAS remains valid and is closely aligned with local programs, we would have liked to see a variation in IFC’s strategy in the country. Given the fact that poverty has increased relatively at a higher level in the rural areas perhaps IFC could have meaningfully intervened in that area by promoting agro-business projects. We would appreciate comments in this regard.

With respect to sources of funding we observe that FDI flows which averaged $3.7 billion per year in 1997-98 will decline to an average of $1.5 billion in 2001-02 after increasing in the interim on account of privatization. We would like to know why do the projections indicate such low levels?

In the CAS discussions in 1997 a number of Executive Directors had focused on the proposal for the Bank to engage itself in the area of violence. This was the first time that such a bold initiative was taken by the institution and was welcomed by many Chairs. We would very much welcome some further elaboration on this with some specific examples of the outcomes.

Colombia has achieved significant success in attracting private capital in the infrastructure sector. Moreover provisioning of urban services at the municipal level
has also been financed to a large extent by private sources. However as has often been discussed, private flows, particularly in infrastructure services which carry a high social element, as in water, need a strong independent regulatory framework, to lower the risks on investment. This is particularly so on the issue of setting tariffs, where non-economic considerations at the municipal level often distort prices. Given this what are the regulatory mechanisms that have been instituted to put in place an enabling environment which protects the interests of the consumers as well as the investors? Our policy dialogues with the government must help institutionalize the regulatory mechanisms and the imperatives of continuous vigil and economic prudence.

- **Financial Sector Adjustment Loan.**

Colombia's financial sector is large with assets equivalent to 50 percent of GDP of which 20 percent lies with State owned institutions. Given that the Colombian financial sector has developed along a specialized banking model, strengthening of the institutions will have to be based on a case by case approach for each segment. In face of the gravity of the challenge, we note the various measures that have been initiated to restructure, downsize, privatize and recapitalize institutions on the circumstances of each case. At the same time, relief measures are being taken to protect the most vulnerable groups affected by the crisis. We also note the various steps being taken to improve prudential norms and the regulatory framework. There is need to constantly monitor the economic situation.

While we support the adjustment loan as proposed by Management, we see that the main risk arises from the manner in which the macro-economic environment takes shape. The success of the effort is closely tied to the movement of interest rates, which in turn will be determined by government's fiscal management and structural reforms. On the other hand, any worsening of the external environment could also jeopardize the program. While these risks have been identified in the document, we
would like a further elaboration of this issue.

Overall, we strongly support the loan proposal and are encouraged by the action taken and commitment shown by the government to meet the challenges posed by the crisis.