

Project Name	Colombia-Programmatic Fiscal and Institutional (@)... Adjustment Loan (FIAL)
Region	Latin America and the Caribbean Regional Office
Sector	Public Sector Group
Project ID	PO80831
Borrower (s)	Federal Government of Colombia
Amount:	For a Fixed-Spread Loan (FSL) US \$300 million
Implementing Agency	Ministry of Finance and Public Credit Address: Ministerio de Hacienda y Crédito Público Carrera 8 # 6 - 64 Bogotá D.C., Colombia Phone: (571)-2971310 Fax: (5-71)-2861400
	National Planning Department Address: Departamento Nacional de Planeación Calle 26 No. 13-19, Bogotá D.C., Colombia. Phone: (571) 596 03 00 / 5 66 36 66 Fax: 57(1) 5 99 95 50 Other head of sector agencies
Environment Category	Not rated
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#### I. Country and Sector Background

1. From the late 1950s onwards, Colombia's political system - a strongly presidential system of government fortified by a hegemonic two-party system of government - laid the basis for a period of authoritarian state-led development. The country experienced a period of determined construction of an effective, interventionist state apparatus (with comprehensive administrative reforms in the periods 1958-60 and 1968-70 being particularly important). But the growth of guerilla movements in the 1970s and drug trafficking in the 1980s as well as the growth in demand for political change progressively came to undermine the governance system.

2. The need for, and directions of change, became most evident in the late 1980s - for instance, decentralization reforms began seriously in 1986 - and the early 1990s. The 1991 Constitution best expresses the hoped-for direction of reform with its call for stronger citizen rights and participation, territorial decentralization, a slimmed-down state that should partner with the non-state sector, and more flexible forms of public administration and public expenditure. By and large, the hoped-for reforms have not materialized as planned. Decentralization has been dramatic, yet territorial transfers were the central element in Colombia's rapidly growing fiscal crisis of the 1990s, and decentralization has not generally improved accountability. A wave of central-government reforms - agency rationalization and regulatory reform in 1992-94, fiscal rationalization in 1999, further fiscal belt-tightening in 2000-01 - has failed to make the public sector more responsive, flexible, accountable, transparent, or efficient. Inefficiencies, misalignment of responsibilities, state capture by vested interests, and weak management and accountability still persist. A variety of reasons account for this failure: (a) some

reforms, especially those between 1998 and 1999, were frustrated because of legal or political obstacles; (b) another set of reforms produced only marginal effects on expenditure reduction; and (c) above all, recent reforms did not effectively tackle the inner roots of rigid growth in fiscal transfers or legal claims against the state. 3. From the point of view of reform management, the failure of administrative reform in Colombia can be largely explained by the lack of consensus, weak involvement of-- leading to lack of ownership by--potential beneficiaries, poor monitoring or evaluation disclosure and policy discontinuity between one government and the next. Therefore, those past experiences of public sector reforms call for a realistic strategy for implementation and sustainability--an approach that is built on stable political consensus, ownership at all levels of the administration and mobilization of civil society in support of the reforms.

4. The government inaugurated in August 2002 has put together an ambitious yet realistic program for fiscal and institutional reform that covers both the revenue and expenditure sides of the fiscal accounts.

5. The government has identified the need for shorter- and longer-term actions in a number of horizontal (i.e. systemic, cross-agency) areas and vertical areas (i.e. agency-by-agency reforms to redefine mission, increase efficiency, and improve coordination) of public administration.

6. The initial momentum to this process was the Presidential Directive number 10 (August 20, 2002), which establishes the guiding principles for the renovation of the public administration. Based upon this document, the government started a process of consultation with international financing organizations to receive financial and technical support for its implementation. The IBRD focused primarily on the horizontal aspects of the reform process, as well as some vertical elements that can lead to enhanced service delivery by the education sector or decentralized government agencies. The Inter-American Development Bank focused primarily on the vertical reforms and some cross-cutting issues such as information management, e-government and civil service reform. Other development entities (such as CAF and bilateral donors) are also involved in some specific areas of reform.

## II. Objectives

7. The government's final objective is to re-establish peace and security as essential components of a good investment climate. The primary objectives of the reform are: a) to increase revenues in order to ensure sustainability of public services, including security and anti-violence actions and b) make the state more efficient in order to liberate resources to finance peace and security, including poverty alleviation measures for those people that have been displaced by the conflict. 8. Reform of public administration is primarily targeted to efficiency gains and enhanced flexibility in public expenditures. 9. To reach these objectives, this operation will address (a) the fiscal framework and (b) the institutional framework. As past experience has demonstrated, reforming only the revenue side is insufficient to bring Colombian public sector finances back into balance. Rather, it is key that public expenditures are kept within the available resources. That is, the institutional reforms envisioned in this program are primarily geared to enabling the public administration to delivering better services within existing fiscal constraints. 10. The program to be supported by the structural Fiscal and Institutional Adjustment Loan (FIAL) is, nevertheless, not intended to deal exhaustively and conclusively with all areas where action could improve Colombia's fiscal outlook. Rather, it is conceived as a first-step package that focuses on a core set of critical policies of fiscal reform that can sufficiently strengthen and consolidate public finances. III. Financing and Implementation. 11. The timing of the first loan is calibrated to support the government in its efforts to deliver an immediate confidence-building signal to the markets through major reforms that have recently been

approved or implemented before the end of 2003. The first loan is expected to be presented to the Board of the World Bank in March 2003, the second loan in FY04, third in FY05 and fourth FY06. Commitments that serve as triggers to these loans will have to be implemented respectively, before the following loans are approved. 12. This operation will be implemented by the Ministry of Finance and the National Planning Department, as well as by the corresponding sector agencies committed in certain components. Overall reporting on the project implementation will be the responsibility of the Ministry of Finance. 13. This operation intends to ensure the feasibility and sustainability of this package of reforms by strengthening the fiscal capacity and the adequacy of government actions, while simultaneously minimizing risks in the government's comprehensive, multi-sector reforms. If this package is successfully implemented and maintained after the change of administration, Colombia should have a public sector that is more responsive, accountable, and participatory. 14. Cooperation with IMF and IDB. Within its macroeconomic framework, the government will sign a new Stand-By Agreement with the IMF in the amount of SDR1.5 billion for the next two years. Achieving the structural benchmarks of the agreement will constitute an overarching policy condition for the FIAL. Some of the targets of the IMF-backed program for 2003 are a consolidated non-financial public sector deficit of 2.5 percent of GDP, a current account deficit of 0.8 percent of GDP and an inflation rate between 5 percent and 6 percent. The IDB will provide support to the government of Colombia in certain of the reforms termed as "vertical," that is, aimed at sector reforms such as downsizing (including personnel cuts) and adjustments of the government structure. The IDB will also provide support for the expansion of e-government in Colombia. The World Bank program, and that of the IMF and IDB, are intended to lessen this risk by demonstrating active, visible support of the government's proposed fiscal and public sector adjustments. IV. Benefits and Risks 15. Benefits. The reform program supported by the FIAL would put the NFPS accounts on a more sustainable path. Each of its proposed measures carries fiscal implications. The reforms are projected to improve the overall balance of the non-financial public sector by 0.8 percent of GDP in 2003, relative to the alternative without reforms. Continued pursuit of the reforms, which the proposed programmatic operation will support, is projected to have a fiscal benefit of over two percent of GDP by 2006. 16. The measures supported by the FIAL would prevent--and reverse--an otherwise unsustainable debt and debt-service accumulation, while also protecting social sector expenditures and vulnerable groups. To achieve these targets, the combination of policies will enhance revenues and rationalize spending. Those policies include, among others, budget reforms that will produce efficiency gains that will allow the government to finance additional programs and reduce the fiscal pressure. The non-financial public sector deficit of 4 percent of GDP would be virtually eliminated by the year 2006. 17. The proposed FIAL will contribute to poverty reduction at all levels. It will help protect the macroeconomic framework of the country by reducing the likelihood of widespread government fiscal crises. The various proposed sectoral reforms which FIAL would support should sustain economic recovery, consolidate economic growth in the medium and long term, and reduce poverty. Additionally, the FIAL will also ensure that through the fiscal strengthening program, in particular the tax reforms, more resources will become available to help ensure the allocation of adequate public resources to social programs and reduce the insecurity that affects particularly those that lack the resources to protect themselves. This is especially pertinent for education and health, facilitating the provision of public services for the poor. Finally, the FIAL supports measures to improve the efficiency and coverage of these services, benefiting the poor directly. This is to be achieved through better budgeting, the results agreements and their evaluation, and more transparent procurement. These should ensure that essential public services are more efficiently available to those who could not otherwise procure them on their own. 18. Risks. With regard to internal risks, the first is that the overall political context, including the conflict and violence associated with illegal drug activity, could escalate, which would negatively impact the implementation of the Bank's program. Although Colombia is

deeply committed to ending the violence that has plagued the country for decades, and has obtained the pledge of the international community to fully support this endeavor, the conflict could still intensify during the next few years. This FIAL supports reforms that will help liberate resources to take care of the country's priorities during transition from the conflict to the post-conflict era. This FIAL will also support introduction and institutionalization that help consolidate peace and stability during the post-conflict era. 19. The program supported by the proposed loan promotes the joint effort of all branches of the Colombian state, private capital and civil society through built in participatory, consultation and other consensus building mechanisms. Consensus building instruments have been incorporated in each one of the proposed components and in the overall management of the reform process. If successfully applied, consultation and evaluation should be sufficient to mobilize government and non-government institutions in support of the reforms and overcome resistance from particular interests that have previously captured the state. 20. The Referendum approved by Congress on December 2002 that contains most of these reforms will be placed before the people in March 2003. In this connection, and in order to avoid delays in advancing the government's program, most of those reforms that require Congressional approval were included up front -and have been largely approved by congress-- during the first year in the program. The government is already planning on substitute measures in case the Referendum is not approved by the people. Those substitute measures would include: i) gradual elimination of some special pension regimes through legal reform and collective bargaining; ii) law reform proposals and administrative measures would be introduced to ensure expenditure cuts and additional tax revenues with a fiscal effect that is at least equivalent to the expected impact of current expenditure freeze, and iii) the government would put pressure on subnational governments that currently receive royalty transfers to concentrate their project proposals in the education sector. 21. On balance consequently, the FIAL is judged to be a "high-risk, high-return" operation. Therefore, it will be essential to maintain a close working relationship with the client, and to provide ample, ongoing dialogue and assistance during the implementation period. To this end, the parallel TAL will provide an important opportunity for the Bank to closely accompany the program. In addition, the supervision activities of MAFPII will be a fundamental vehicle to maintain frequent coordination with the Government counterparts. All these reflect the belief that, as this operation would form the core of the Bank's interventions in Colombia, its successful implementation will be critical. V. Environment Aspects 22. Being a structural adjustment operation, this program does not trigger OD 8.60 on Environmental Assessment, and, as a consequence does not require an environmental rating. VI. Contact Point

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Note: This is information on an evolving project. Certain components may not be necessarily included in the final project.

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