Statement by Murilo Portugal  
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Colombia CAS Progress Report

Introduction

We welcome the discussion on Colombia's CAS Progress Report and commend Management and Staff for the high quality of the document. The report is timely due to the internal and external developments allowing the opportunity to integrate the priorities of President Pastrana's Government to the Bank's strategy.

The 1997 CAS identified as its main objectives poverty reduction, social development and sustainable growth which remain valid and are consistent with the constitutionally ordained four year National Development Plan (NDP) approved by Congress in May 1999. The pillars of the NDP are: i) obtaining peace and development; ii) achieving good governance; iii) building social capital; iv) reactivating macro-economic growth and employment. This strategy, among others, will delegate power to communities improving access to public goods, promoting universal access to education and health, ensuring gender equality, and achieving peace. The NDP acknowledges the serious consequences of corruption and outlines a strategy to attack structural weaknesses that create opportunity for corruption in both the public and private sector. The Presidential Program Against Corruption and the Specialized Anti-Corruption Unit of the Nation's General Attorney's Office are some of the initiatives that are currently being pursued. Colombia has also prepared a comprehensive strategy, Plan Colombia, to focus in the peace process, to control drug traffic and to reactivate the economy. The objectives identified in the 1997 CAS, that will be supported by the lending program proposed in the CAS Progress Report, are fully consistent with the Government's development priorities.

Economic Issues

Colombia experienced a consistent record of good performance and growth during the last five
decades with an average growth of 4.7% between 1965 and 1995, and 1.8% 1996-1998. Growth for 1999 will be negative with urban unemployment exceeding the historical average of 10% to an unheard 20% in June 1999.

On the other hand, inflation declined from the average 1974-1991 levels of 24.3% to the present level of 8.9%. The real lending interest rates have fluctuated from an average of 13.5% in the period 1986-1995 to a high of 27% in 1998. Since the end of 1998 interest have been declining and in September 1999, real lending interest rates were at 17%. The fiscal accounts of the non-financial public sector, that were balanced in the first half of the decade, showed a deficit of 3.7% of GDP in 1998 and a substantial deterioration in 1999. The external current account of the Balance of Payment showed a deficit of over 5% of GDP between 1995-1998 but will fall to 1.3% of GDP in 1999, due primarily to a deep recession and the consequent decline of imports.

The external environment deteriorated due mainly to the drop in two commodities coffee and oil. The crisis in the international credit markets increased the cost of borrowing and decreased the external finance for both the public and private sector. The large fiscal and external deficits resulted in pressure against the peso, capital outflow and losses of reserves. On the domestic front, the cause for the negative macro-economic results can be attributed to growing fiscal imbalances, political uncertainty and intensification of the armed internal conflict.

**Earthquake**

Colombia has undergone several natural disasters in most notably the earthquake in the central coffee region in early 1999 with human losses and extensive urban infrastructure damage in the amount of US$1.6 billion. The Bank and the IDB and a multi-sector Colombian Team (FOREC) responded immediately. At the request of the Government, the Bank has redirected four ongoing projects and is preparing an Emergency Recovery Loan to support the reconstruction effort with a clear impact in terms of employment generation and low-income housing reconstruction.

**Macro-economic Adjustment**

Since taking office in August 1998, President Pastrana's Government has taken strong measures to halt the economic decline. On the fiscal front, actions have targeted revenue enhancing and expenditure reduction. These include cutting operational costs of the central government, increase in the gasoline surcharge, widening of the VAT to 32 new goods and services and improving tax collection and anti-evasion initiatives. The Economic Emergency decrees of November 1998 created a tax on financial transactions mainly to fund relief programs to mortgage holders and strengthen banks and cooperatives.

After Colombia shifted the exchange rate band on two occasions during the past year, in September 25, 1999 the band regime was abandoned opting the country for a float of the peso. The exchange rate has remained stable below the ceiling of the previous band with no overshooting. A real depreciation of the peso of 24 percent year-on-year to August 1999 was recorded.
Congress has recently approved the Budget for Y00 with 0% wage increase for 70% of public sector employees and an increase of 9% for those with 2 minimum wages. Non-interest expenditures of the Central Government are projected to decrease from 16.7% of GDP in 1999 to 14.8% of GDP in 2000, and further 14.3% of GDP in 2002.

**Financial Sector Reform**

Congress, recognizing the gravity of the existing situation, has acted in a non-partisan responsible manner approving fundamental initiatives during the first half of 1999.

Congress passed the Financial Sector Reform Law (Law 510-1999) which raises banks' capital requirements and strengthens powers of the Banking Superintendency and FOGAFIN (Guarantee Fund). This Law leads the way to the financial reform program whose main objectives are: i) Support Financial Sector Legislation and Regulation strengthening bank supervision and deposit insurance as well as promote timely, fair and efficient resolution to banks facing financial solvency problems; ii) institutional strengthening of Bank Supervision Agency and FOGAFIN; iii) restructuring recapitalization, privatization and, if necessary, liquidation of state owned and banks currently under public sector management; iv) effectively implementing special, one-time measures to address the immediate impact on the financial system stemming from macro-economic, international market and related problems.

Within the Financial Sector Reform Law an inter-government task force was created to investigate and prosecute executives involved in corruption or mismanagement of public banks.

Proposals for the July-December 1999 legislative session include: i) A law to rationalize public finances and curb their deficit expansion; ii) To continue reform of Social Security; iii) To curtail current expenditures of local governments; iv) A Constitutional amendment to use part of the transfers to local government to finance local pension funds; v) A Constitutional amendment to freeze, in real terms, future transfers to local governments.

Colombia's financial program, oriented to achieve a sound and safer financial system, will be supported by the Financial Sector Adjustment Loan (FSAL). This operation, will be presented together with the CAS Progress Report and constitutes an integral part of the CAS's objective for achieving sustainable growth.

**IMF Program:**

To consolidate and expand the reforms and set the economy in a strong and sustainable path Colombia has put forward a comprehensive stabilization program supported by the IMF in a three-year Extended Fund Facility (EFF) amounting to US$2.7 billion. The program for 1999-2002 is centered on fiscal consolidation, financial sector restructuring and continued implementation of the government structural reform agenda.

**Macro-Economic Projections and Goals**

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Foreign direct investment due to privatization is projected to increase substantially as coal, electricity and telecommunications companies are privatized in 2000 and 2001. The expected revenues are US $2.7 billion and US$650 millions respectively.

**Social Impact**

Colombia will protect social expenditures and has allocated, within the IMF program, US$300 million (0.3% of GDP) per year in 2000-2002 for additional social expenditures above and beyond their level of 1999. Poverty had declined steadily since the 1960's from 50 percent to 20 percent in mid 1990's. Life expectancy rose to 70 years and infant mortality slashed to 24 per thousand live births as population growth dropped to 1.9 percent per year. In the past years conditions have deteriorated and incidence of poverty in rural areas has risen 7 percentage points between 1996 to 1998. In urban areas the extremely poor increased 2 percentage points between 1997 and 1998.

The economic crisis and the internal conflict have exacerbated unemployment figures. The poor and displaced have been strongly affected with reduced income preventing proper health coverage, adequate food consumption and leading to higher school dropouts. The government has identified the population hardest hit by the crisis who include children, the elderly, female heads of household, young entrants to the labor market and those displaced by internal conflict.

In association with the World Bank and the IDB the Government has designed a social safety net to be financed by 0.3% of GDP. The Bank has supported the government with analytic work and is preparing two operations; the first, to support the immediate strengthening and expansion of the social safety net framework and the second, to address structural reform in the social sector and to expand human capital through education and health.

**Peace Process**

Achieving peace is Colombia's unquestionable priority and commitment. Colombians understand that war is the worst enemy of development, as recently expressed by UN-Secretary Kofi Annan to the World Bank Staff. Colombians do not want war, as evidenced in last months unprecedented peace march during which 25 percent of the population demonstrated for peace.

The peace process, that Colombia has initiated, is based on territorial integrity, democracy and human rights which will strengthen the rule of law and the fight against narcotics trafficking.

At the request of the Government, the Bank has produced a report "Violence in Colombia:
Building Sustainable Peace and Social Capital" (Report No. 18652-CO) constituting the first time that violence has been the subject of sector analysis. The work has been published in Colombia with other international experiences in post-conflict reconstruction and President Pastrana has endorsed the publication by writing the prologue and will present the book in late November.

To attend the imminent concern of the 600,000 to 1,000,000 displaced people the Government and Bank are engaged in analytic work and the Social Reform Adjustment Loan to help address this problem. Other initiatives have been expressed in the National Development Plan and Plan Colombia. They imply investment to improve productivity, human capital and infrastructure. The rural and peasant communities, which are involved in illicit crops, will be supported to develop viable agribusiness ventures. A Productive Partnership for Peace project has been included in the lending program.

Colombia has moved from a primarily rural to an urban population of 70 percent. In order to reduce urban conflict, violence and poverty the Government has created preventive community based initiatives. Support for such initiatives derive from small projects with the Bank: Youth Development and Judicial Reform projects. The Bank and the city of Cali have started one of the first City Development Strategy (CDS) for the Latin American region.

As stated in the Plan Colombia- "Peace is not a matter of will: it has to be built". Colombia understands the open, transparent, participatory process within the spirit of the Comprehensive Development Framework and identifies with its principles of ownership, partnership, long term vision and structural and social concerns fundamental to enhance the peace process.

**Knowledge Bank**

As mentioned earlier, the Bank as a Knowledge institution has participated in important and fundamental work with respect to peace and violence and its impact on social capital. It has contributed the country's effort to address these issues. Studies in poverty, employment and social programs in partnership with the IDB and NGO's have been incorporated in the National Development Plan. The Bank's knowledge and experience in risk management and trade related issues have started to be part of the non-lending agenda. WBI and Universidad de Los Andes are creating an alliance in order for Colombia to become part of the Global Learning Network.

**IFC-MIGA**

The adverse macro-economic situation inhibited private investor activity to one of the lowest levels in the region. IFC's support is needed to boost investor confidence and to assist in the modernization of the private industry as Colombia searches to expand trade and to fight unemployment. IFC is currently assisting Colombia in housing finance, through advisory support for the development of a secondary mortgage market and the establishment of private equity funds. In Early 2000, IFC will make a presentation to the business community to enhance and
renew activities in the traditional financial, infrastructure, manufacturing and service sectors as well as in retailing, agribusiness, energy and communications.

MIGA's activities are expected to increase in the agriculture, financial, infrastructure, telecommunications, power, and oil sectors.

**Lending Scenario**

During the current decade Colombia has consistently had negative net disbursements from the Bank in excess of US$1.8 billion dollars. Today Colombia faces new global circumstances and internal challenges. The financial instability of the international markets; the need to cushion the adverse social impact of the economic recession; the commitment to implement structural reforms and the program to strengthen the banking system; the requirement to achieve the reconstruction of the coffee area devastated by the earthquake and the determination to support the peace process are some of the justifications to move to a high case lending scenario.

Colombia is confident of the support of the World Bank.