INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A PROPOSED

LOAN

IN THE AMOUNT OF EUR $624.2 MILLION TO
(Equivalent to US$700 MILLION at an exchange rate of 0.8917)

THE REPUBLIC OF COLOMBIA

FOR THE

SECOND PROGRAMMATIC SUSTAINED GROWTH AND INCOME CONVERGENCE
DEVELOPMENT POLICY LOAN

November 5, 2015

Macroeconomics and Fiscal Management Global Practice
Finance and Markets Global Practice
Colombia and Mexico Country Management Unit
Latin America and the Caribbean Region

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COLOMBIA - GOVERNMENT FISCAL YEAR
January 1 – December 31

CURRENCY EQUIVALENTS
(Exchange Rate Effective October 23, 2015)

CURRENCY EQUIVALENTS
COP 2,925.36 = US$1.00

ABBREVIATIONS AND ACRONYMS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AEO</td>
<td>Authorized Economic Operators</td>
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<tr>
<td>AFP</td>
<td>Pension Fund Administrator (Administradora de Fondos de Pension)</td>
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<tr>
<td>ARTNet</td>
<td>Asia-Pacific Research and Training Network</td>
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<tr>
<td>CCE</td>
<td>Colombia Buys Efficiently (Colombia Compra Eficiente)</td>
</tr>
<tr>
<td>CE</td>
<td>External Circulars (Circulares Externas)</td>
</tr>
<tr>
<td>COLCIENCIAS</td>
<td>Administrative Department of Science, Technology and Innovation (Departamento Administrativo de Ciencia, Tecnología e Innovación)</td>
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<tr>
<td>CONPES</td>
<td>National Council for Economic and Social Policy (El Consejo Nacional de Política Económica y Social)</td>
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<tr>
<td>CPS</td>
<td>Country Partnership Strategy</td>
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<tr>
<td>DANE</td>
<td>National Administrative Department of Statistics (Departamento Administrativo Nacional de Estadística)</td>
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<td>DIAN</td>
<td>Tax and Customs Revenue Authority (Dirección de Impuestos y Aduanas Nacionales)</td>
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<tr>
<td>DPL</td>
<td>Development Policy Loan</td>
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<tr>
<td>FARC</td>
<td>Revolutionary Armed Forces of Colombia (Fuerzas Armadas Revolucionarias de Colombia)</td>
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<tr>
<td>FCL</td>
<td>Flexible Credit Line</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GoC</td>
<td>Government of Colombia</td>
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<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>MHCP</td>
<td>Ministry of Finance and Public Credit (Ministerio de Hacienda y Crédito Público)</td>
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<tr>
<td>MTFF</td>
<td>Medium-term Fiscal Framework</td>
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<td>NDP</td>
<td>National Development Plan</td>
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<td>NQF</td>
<td>National Qualification Framework</td>
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<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<td>PA</td>
<td>Programmatic Approach</td>
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<td>PDO</td>
<td>Program Development Objective</td>
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<td>PER</td>
<td>Public Expenditure Review</td>
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<td>PES</td>
<td>Public Employment Service</td>
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<td>PFM</td>
<td>Public Financial Management</td>
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<td>PSIA</td>
<td>Poverty and Social Impact Assessment</td>
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<td>RAS</td>
<td>Reimbursable Advisory Services</td>
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<tr>
<td>R&amp;D</td>
<td>Research and Development</td>
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<tr>
<td>SENA</td>
<td>National Service of Learning (Servicio Nacional de Aprendizaje)</td>
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<tr>
<td>SFC</td>
<td>Securities and Futures Commission</td>
</tr>
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<td>SGP</td>
<td>General Participation System (Sistema General de Participaciones)</td>
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<td>SIIF</td>
<td>Financial and Administration System (Sistema Integrado de Información Financiera)</td>
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<tr>
<td>Acronym</td>
<td>Description</td>
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<tr>
<td>SME</td>
<td>Small and Medium Enterprises</td>
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<tr>
<td>TIM</td>
<td>Andean International Transit of Goods (Tránsito Aduanero Internacional</td>
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<tr>
<td></td>
<td>Multimodal)</td>
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<tr>
<td>UAESPE</td>
<td>Special Administrative Unit for the Public Employment Service (Unidad</td>
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<tr>
<td></td>
<td>Administrativa Especial del Servicio Público de Empleo)</td>
</tr>
<tr>
<td>URF</td>
<td>Financial Regulation Unit (Unidad de Regulación Financiera)</td>
</tr>
<tr>
<td>UVAE</td>
<td>Firms’ Vocational and Learning Units (Unidades Vocacionales de Aprendizaje</td>
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<td></td>
<td>Empresarial)</td>
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</table>

- Regional Vice President: Jorge Familiar
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- Country Director: Gerardo Corrochano
- Global Practice Directors: John Panzer (Acting)
  - Gloria M. Grandolini
- Practice Managers: Pablo Saavedra
  - Alfonso Garcia Mora
- Task Team Leaders: Bábara Cunha
  - Patricia Caraballo
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The Second Programmatic Sustained Growth and Income Convergence Development Policy Loan was prepared by an IBRD team consisting of Bárbara Cunha (Co-Task Team Leader, GMFDR), Patricia Caraballo (Co-Task Team Leader, GFMDR), Marcelo Becerra (GEDDR), Jeannette Estupinan (GGODR), Victor Ordoñez (CTRLN), Enrique Fanta (GGODR), Jimena Garrote (LEGLE), Leonardo Iacovone (GTCDR), Irina Luca (GGODR), Ana Maria Oviedo (GSPDR), Victor Ordonez (WFALN), Carlos Rodriguez Castelan (GPVDR), Eduardo Malasquez (GPVDR), and Ana Luisa Gómez (GENDR). The team is grateful for overall guidance provided by Pablo Saavedra (GMFDR), Alfonso Garcia Mora (GFMDR), Samuel Freije-Rodriguez (GPVDR), Eva Gutierrez (LCC1C), Wendy Cunningham (LCC1C), and Alma Kanani (LCROS). The Bank gratefully acknowledges the excellent collaboration of the Colombian authorities, as well as the support and guidance of peer reviewers David Rosenblatt and Catiana García Kilroy.
**SUMMARY OF PROPOSED LOAN AND PROGRAM**  
**COLOMBIA**  
**SECOND PROGRAMMATIC SUSTAINED GROWTH AND INCOME CONVERGENCE**  
**DEVELOPMENT POLICY LOAN**

<table>
<thead>
<tr>
<th>Borrower</th>
<th>Republic of Colombia</th>
</tr>
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<tbody>
<tr>
<td>Implementation Agency</td>
<td>Ministry of Finance and Public Credit and the National Planning Department</td>
</tr>
<tr>
<td>Financing Data</td>
<td>EUR 624.2 million; IBRD Flexible Loan Market-based variable reference rate plus a fix spread</td>
</tr>
<tr>
<td>Operation Type</td>
<td>Second loan in a programmatic series of Development Policy Financing - Single tranche</td>
</tr>
<tr>
<td><strong>Pillars of the Operation and Program Development Objective (PDO)</strong></td>
<td>The Programmatic Sustained Growth and Income Convergence Development Policy Series supports the implementation of policy reforms in three main areas: (1) fostering solutions to develop infrastructure financing and increasing access to finance for firms; (2) building productive skills and improving their allocation; and (3) strengthening regulations that affect innovation and business efficiency.</td>
</tr>
</tbody>
</table>
| **Pillar 1: Fostering solutions to develop infrastructure financing and increasing access to finance for firms** | (i) Amount of financing allocated to the 4G concessions program by type of institution (increase from a baseline of 0 in 2013 to COP$6.5 billion from Banks, COP$ 2 billion from FDN, and COP$ 1.5 billion from AFPs in 2016)  
(ii) Number of registrations in the collateral registry (increase from a baseline of 0 transactions in 2013 to 1 million transactions in 2016)  
(iii) Number of new issuers that entered the market through the hybrid regime (increase from a baseline of 0 issuers in 2013 to 10 issuers in 2016); and number of investors in mutual funds (increase from a baseline of 1.34 million in 2013 to 1.5 million in 2016) |
| **Pillar 2: Building productive skills and improving their allocation** | (i) Number of job placements achieved through the new system (increase from 166,000 in 2013 to 315,000 in 2016) and number of persons occupationally oriented and referred to management and placement services (increase from a baseline of 386,910 in 2013 to 1,120,000 in 2016)  
(ii) Number of firms providing professional training (increase from a baseline of 0 UVAEs in 2013 to 40 in 2016) and number of qualification matrixes (defining the skills, knowledge, and aptitudes expected for each education levels) prepared (increase from 0 in 2013 to 4 in 2016)  
(iii) Number of communities certified and able to directly manage resources from the SGP, including earmarked transfers for education (increase from 0 in 2013 to 4 in 2016) |
| **Pillar 3: Strengthening regulations that affect innovation and business efficiency** | (i) Number of projects evaluated in the new methodology for formulation, selection and approval of innovation projects financed with royalties’ resources (increase from 0 in 2013 to 20 in 2016)  
(ii) Share of budgeted tax benefits for science, technology and innovation effectively used by firms (increased from 69% of budget resources in 2013 to 100% of budget resources by 2016)  
(iii) Number of instruments, i.e. projects and programs, designed and implemented in a coordinated manner by institutions under the new unified Governance system (increased from 0 in 2013 to 30% of instruments designed and implemented in 2016)  
(iv) Number of pilots implementing the new regulatory evaluation process (increased from 0 regulations in 2013 to 5 regulations 2016)  
(v) Number of Authorized Economic Operators (increased from 0 in 2013 to 30 in 2016) |
| **Overall risk rating** | Moderate |
| **Operation ID** | P154821 |
1. INTRODUCTION AND COUNTRY CONTEXT

1. This proposed Second Programmatic Sustained Growth and Income Convergence Development Policy Loan (DPL) continues to support the Colombian Government’s efforts to sustain economic growth and increase productivity. This DPL for EUR 624.2 million (equivalent to US$700 million) is the last in a series of two single tranche operations. It comes in the context of lower export demand for commodities, worsening terms of trade, and the prospects of higher borrowing costs that are affecting a large number of emerging economies. The DPL series seeks to address selected bottlenecks to spur productivity across sectors, which will be critical for growth amid the less favorable external environment. Reforms supported include those geared to improve access to financing for investment in infrastructure and physical capital for firms; measures to strengthen labor force skills and reduce labor supply-demand skill mismatches; and measures to reduce barriers to innovation and trade costs in the private sector. The supported program is fully consistent with the FY12–FY16 Colombia Country Partnership Strategy (CPS), discussed by the Board of Executive Directors June 12, 2016, particularly with the pillar on inclusive growth with enhanced productivity; and with the Government’s National Development Plan (NDP) for 2014–2018, in its strategic area of infrastructure and competitiveness and the pillar of education. The first DPL for US$700 million was approved by the Board of Executive Directors on December 12, 2014. This operation is part of the country’s pre-financing planning for 2016.

2. In the last decade, Colombia consolidated its position among the top economic performers in Latin America, helped by internal and external factors. 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 and sustain relatively high growth rates. Colombia’s performance also benefited from a favorable external environment. High commodity prices contributed to an expansion of extractive industries’ production and exports, which in turn supported fiscal revenues and growth. The country also received large capital inflows, taking advantage of abundant international liquidity. Colombia had an average growth rate of 5.4 percent before the global crisis (2004–08) and 4.8 percent after it (2010–14), helping close the country’s per capita income gap with top economies of Latin America and high-income countries of the Organization for Economic Cooperation and Development (OECD). However, growth has been slowing in the context of a less favorable external environment.

3. Colombia’s strong economic performance has contributed to poverty reduction and shared prosperity. According to Colombia’s official poverty line, poverty rates decreased significantly in the last decade (from 49.7 percent to 29.5 percent, between 2002 and 2014). Poverty reduction has been accompanied by progress in shared prosperity, with the income growth of the bottom 40 percent of the population reaching 6.3 percent over the period 2008–2014 compared to 4.2 percent for the total population. These trends are mostly explained by sustained economic

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1 Which is nearly four times the Bank’s benchmark poverty line of US$1.25/day.
4. **Colombia is currently facing headwinds and growth will have to come from unlocking existing structural bottlenecks.** External conditions have deteriorated significantly over the last 12 months. International oil prices have declined sharply (56 percent since mid-2014), leading to a deterioration in the terms of trade (25 percent since mid-2014). Expectations about monetary policy changes in the United States have been leading to lower and more volatile capital flows. In this context, sustaining economic growth will depend even more on Colombian firms’ ability to efficiently produce and sell goods and services. Therefore, addressing structural bottlenecks can yield important growth dividends. In particular, closing Colombia’s gap with top performers in Latin America and OECD with respect to physical capital, labor, and human capital quality, as well as productivity, particularly through innovation and a regulatory environment for businesses, will be critical.

5. **While Colombia has been making efforts to address its structural bottlenecks, it still lags behind in a number of areas that are relevant for long-term growth.** The proposed operation builds on the efforts of the first DPL in the series and supports a second round of reforms focusing on: (i) fostering solutions to develop infrastructure financing and increasing access to finance for firms; (ii) building productive skills and improving their allocation; and (iii) strengthening regulations that affect innovation and business efficiency. Access to finance is relatively narrow and costly, and approximately 41 percent of Colombian firms identify access to financing as a major constraint to business (while the average for Latin America is 15 percent). Lack of adequate financing also contributed to Colombia’s large infrastructure gap (the country ranks 117 out of 148 countries in terms of infrastructure quality). While Colombia has made progress in educational attainment and achievement, the country is still among the lowest ranking countries in the Program for International Student Assessment student achievement test of 2013. Labor regulations are also frequently mentioned as a restrictive factor, although recent reforms have helped reduce labor costs. Innovation remains restrained by inefficiencies in the innovation framework of the country, limiting learning and productivity growth. Despite its impressive integration efforts, Colombia’s trade integration is still limited when compared to regional peers, in part due to high trade costs (both tariff and non-tariff related).

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2 Enterprise surveys 2010. According to the 2013 *Gran Encuesta PYME*, this number increases to 50 percent for small and medium enterprises (SMEs).
3 Infrastructure Quality Index--World Economic Forum 2013.
4 The 2012 reform on non-wage labor costs was supported by the Enhancing Fiscal Capacity for Shared Prosperity DPL, approved in September 2013.
2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

6. In the last decade, Colombia has implemented important macroeconomic, structural, and social reforms. They included the Fiscal Responsibility Law, the Fiscal Rule, and important Tax Reforms to address loopholes, reduce distortions, and encourage formal job creation. These reforms have strengthened the country’s policy management tools and promoted sustainability, increasing buffers against shocks. In parallel to these reforms, the Government has proceeded with peace negotiations with the guerrilla group Fuerzas Armadas Revolucionarias de Colombia (FARC), which is critical to stability, reaching agreements on four out of five topics (illegal drugs, rural development, political participation and transitional justice). The last pending topic is the end of the conflict that includes the disarmament and the demobilization of the guerrilla fighters. Over more than five decades, the conflict has imposed severe economic and social costs and the dividends from reaching peace are expected to be significant.

7. Colombia’s sound economic management and favorable external environment helped consolidate the country’s position among the strongest performers in Latin America. As a result of an enhanced macroeconomic policy framework, a commodity price boom, and better security conditions, Colombia’s economy has grown strongly since the early 2000s. The country weathered the financial crisis robustly, sustaining high average growth rates (close to 5 percent) before and after the crisis. This performance helped Colombia close its per capita income gap with top Latin America economies and high income (OECD) countries. In recognition of the important achievements of the last decade, Colombia was invited to start its accession process to OECD membership (October 2013) and had its sovereign rating upgraded above investment grade by all major rating agencies. Government actions to support economic activity, helped sustain high growth rates in 2014 (4.6 percent), despite unfavorable changes in the external environment. Growth slowed down to 2.9 percent in the half quarter of 2015, driven by low international oil prices.

8. Growth over the last 18 months has been led by domestic demand, fueled by a mildly supportive macroeconomic policy that helped smooth the severe oil price shock. From a sectorial point of view, growth has been led by the construction sector (mainly due to infrastructure projects and housing construction driven by mortgage subsidy programs), social services (mostly public administration), and the financial sector. In contrast, extractive activities remain stagnant following a sharp drop in international prices (more than 40 percent) and interruptions in

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5 The first agreement on rural development aims to transform the living conditions in rural areas, reversing the negative effects of violence. The second agreement reached established the basis for the eventual participation of the FARC in Colombian politics. It included rights and guarantees for new political parties that may emerge after a final peace deal, mechanisms of citizen participation, and measures to promote engagement in politics. Also, the FARC agreed through the third point of the agenda to break any relationship with the illegal drugs business, while the GoC compromised to continue fighting illegal drugs and give greater priority to crop substitution and drug treatment programs. Finally, the fourth agreement completed in September 2015 is related to political participation and transitional justice – restorative and reparative.

6 Moody’s upgraded Colombia’s debt rating in July 2014 (to Baa1 local currency, Baa2 foreign currency); Fitch upgraded in December 2013 (to BBB+ and BBB, respectively), while Standard & Poor’s upgraded in April 2013 (also to BBB+ and BBB, respectively).
production. From the demand point of view, gross capital formation (backed by the Government’s large infrastructure investment program) and household and Government consumption were the main drivers of growth, compensating for the widening trade deficit. Growth has been accompanied by improvements in labor market outcomes. Unemployment has dropped consistently, reaching a record low of 9.1 percent in 2014, the lowest annual figure in this century. Despite the recent slowdown in economic activity, the unemployment rate continues to fall in 2015.

9. **Worsened terms of trade contributed to a larger current account deficit, which remains financed by foreign direct investment (FDI) and portfolio inflows.** The current account deficit widened to 5.2 percent of GDP in December 2014 (from 3.3 percent in 2013), led by a combination of growth in imports (8 percent) from strong economic activity and a contraction in exports (5.5 percent) stemming from low oil prices and a temporary shutdown in the Cartagena Refinery. The deficit was comfortably financed by large portfolio inflows (net 3.1 percent of GDP) and FDI (net 3.2 percent of GDP). The foreign exchange reserves stood at US$46 billion, or 8.7 months of goods and services imports at the end of 2014. Colombia’s external debt remains relatively low (31.8 percent of GDP), balanced between public (18.8 percent of GDP) and private (13 percent of GDP) sectors, and mostly long term (27.3 percent of GDP). Finally, Colombia has recently renewed its precautionary Flexible Credit Line (FCL) arrangement with the International Monetary Fund (IMF) for US$5.45 billion.

10. **Monetary policies have been consistent with the country’s stability objectives.** The Central Bank has appropriately managed monetary policy tools, in response to fluctuations in economic activity, while maintaining inflation within the target range. Inflation recovered ground after reaching a 50-year record low in 2013 (prices increased 1.9 percent year-on-year), reaching a rate of 3.7 percent end of year for 2014. As the economy approached the full use of production capacity in 2014 and prices rapidly converged to the midpoint of the target range (2 percent to 4 percent), the Central Bank initiated a process of monetary tightening that lasted five months, with the policy rate reaching 4.5 percent. Despite the recent deceleration in economic activity, the Central Bank has recently increased the policy rate to 4.75 percent to contain a temporary increase in inflation since the beginning of 2015 (that reached 5.3 percent in September), driven by the pass-through effect of the currency depreciation.

11. **Colombia’s flexible exchange regime has provided a first line of defense to external shocks.** During the last decade, Colombia experienced a long currency appreciation cycle, which raised concerns about potential Dutch disease effects. This cycle was interrupted in mid-2013, following changes in the external environment. The U.S. dollar continued to lose ground in 2014, averaging COP 2,000 per U.S. dollar above the 2013 and 2012 rates of COP 1,869 and COP 1,797, respectively. As of August 2015, the U.S. dollar averaged COP 2,975. The real exchange rate (RER) has depreciated approximately 35 percent since 2012, slightly below the values predicted by the country’s fundamentals. This result was mostly driven by less favorable external conditions.

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7 Triggered by an increase in Colombia’s weight in the J.P. Morgan Emerging Market Bond index.
8 Term longer than one year.
9 Ojeda and Trejos (2012) find that the RER has fluctuated above its ideal levels because the observed current account has been better than what was predicted by the fundamentals of the economy.
Overall, Colombia’s exchange rate fluctuation has been an effective shock absorber, helping to smooth the impacts of changes in the external environment.

12. **Colombia has a sophisticated financial sector, dominated by banks which report healthy financial indicators despite economic deceleration.** Colombia has a sophisticated financial system, with banking and insurance sector intermediation comparable to countries of similar per capita GDP, size, and demographics—although capital market intermediation to the private sector remains below potential. Credit growth to the private sector increased at an annualized rate of around 14 percent in 2014. The financial soundness indicators remain robust. The capital adequacy ratio (at 17 percent) is well above regulatory limits. In terms of asset quality, the ratio of non-performing loans to total loans in the banking system was relatively stable in 2014, ending the year at 2.9 percent\(^\text{10}\). Banks' return on equity and return on assets stood at 19.8 percent and 2.9 percent, respectively, in December 2014, compared with 19.5 percent and 2.8 percent a year earlier. Colombia has introduced capital and liquidity regulations that are aligned with international standards albeit the key issue of supervision of conglomerate holdings remains to be addressed.

13. **Colombia has enjoyed a sound fiscal position, but fiscal space for further maneuvering is narrowing down.** The Government remains strongly committed to its medium-term consolidation goals. The country’s fiscal rule and medium-term fiscal framework (MTFF), adopted in 2011, target a gradual consolidation of the central Government’s deficit to reach 1 percent in 2022 (in structural terms). Colombia has met the fiscal targets during the first three years of its new fiscal rule. Central Government results in 2014 remained broadly unchanged with respect to 2013 (with a structural deficit of 2.3 percent of GDP). However, subnational governments posted strong expenditure growth following the elections, which contributed to an increase in the consolidated public sector deficit (1.6 percent of GDP in 2014). This, combined with the effects of the exchange rate depreciation, contributed to an increase in the overall public debt (44.3 percent of GDP). While the impacts of lower oil prices on revenues were small in 2014, larger impacts are expected in 2015 and 2016 as dividends from ECOPETROL and royalties from oil productions are expected to decrease. For this reason, the Government introduced a tax reform which is expected to partly compensate for the revenue drop driven by the slowdown of the economy, lower oil prices and expiring temporary taxes. The reform expects to raise US$12.5 billion in 2015 and further increase revenue during 2016–2018.

14. **Despite solid fundamentals, Colombia’s economy still faces various challenges to achieve sustainable, inclusive, and higher potential growth.** During most of the 2000s, Colombia benefited from growing external demand, high commodity prices, and abundant FDI. These ‘tail winds’ have started to stall and, progressively, economic growth is likely to be driven by structural factors. Additional growth dividends from macro stability reforms are limited. However, the country faces considerable challenges to boost and sustain growth: (a) access to finance for firms and infrastructure investment is low and narrow compared to regional peers, limiting effective capital accumulation and infrastructure provision; (b) lack of adequate education and professional skills and skill matching mechanisms contribute to low levels of labor productivity and weak labor market outcomes; (c) the country lacks a coherent and integrated innovation financing system that will encourage productivity gains and sophistication of firms over time; and (d) regulations and

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\(^{10}\) Colombia’s Financial Superintendence (Superintendencia Financiera de Colombia)
procedures increase business costs, limit competitions and trade activities. Box 1 discusses in more detail key structural challenges for sustaining growth and income convergence in Colombia.

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**Box 1. Challenges for Sustained Growth and Income Convergence in Colombia**

**Colombia sustained historically high growth rates in the last decade, which contributed to a convergence in income levels with top economies of Latin America and the OECD.** The Colombian economy sustained an average GDP growth of 4.8 percent in the last decade, more than 1 percentage point above the average for the previous three decades (3.5 percent). In per capita terms, growth was around 2.9 percent, contributing significantly to poverty reduction and shared prosperity (compared to 1.7 percent in the previous decades). In 2000, the per capita income of Latin America was 1.8 times Colombia’s, while the OECD countries had an average per capita income that was 10.9 times Colombia’s level. However, by 2013 these differences had diminished to 1.6 and 8.5 times, respectively.

**Following historical patterns, growth was heavily based on factor accumulation; productivity gains were relatively modest.** Physical capital accumulation contributed 1.5 percentage points to growth and the combined effect of employment growth and human capital accumulation contributed another 2.4 percentage points. A slowdown in population growth (-1.5 percentage points) also contributed to higher per capita income. Finally, total factor productivity growth only contributed 0.3 percentage points to the total. This contribution is higher than in the previous decade but well below the average for Latin America (0.6 percentage points) and fast-growing Asian economies (1.62 percentage points).

**Despite the importance of factor accumulation to growth, Colombia still lags behind with respect to physical capital, particularly infrastructure.** Colombia has a large infrastructure gap. The country ranks 117th out of 148 countries in terms of infrastructure quality, more than 1 point below the world average. This gap is the largest in the transport sector, where Colombia is ranked well below Latin American peers and other emerging economies. Both the quality (that is, paved roads out of total roads) and quantity (that is, length of roads per km²) of roads are low; road length scaled by land area is less than a tenth of the OECD average. As a result, the country’s costs of internal freight transport are one of the highest in the world increasing export costs. Investing in physical capital can also be a challenge for Colombian firms, particularly SMEs. Domestic credit to the private sector more than doubled in the last decade but remains well below the level in the OECD and other emerging economies. Access to financing and high financing costs currently represent major constraints to investment, as cited by firms. High intermediation margins can also constrain entry of new businesses in the real sector and undermine productivity. High levels of informality and lack of collateral add additional challenges to financing of SMEs.

**Colombia also lags behind with respect to human capital, education, and labor market outcomes.** Colombia’s performance in the last decade was largely driven by growth in the employed population and gains in primary and secondary education attainment. However, Colombia’s skill formation and labor market outcomes still lag behind regional peers. Colombia continues to be among the lowest ranking countries in the Program for International Student Assessment 2012, underscoring the country’s underperformance relative to its middle-income status. Enrolment rates in preschool and tertiary education are also low when compared to some regional peers such as Argentina and Chile. The post-secondary school National Training Service (Servicio Nacional de Aprendizaje [SENA]) attempts to fill the general education and technical training gaps, but studies find that the SENA curriculum is not aligned with employer skill demands and the quality of training is mixed, at best. Lack of adequate skill affects employment prospects and income generation opportunities. According to the World Bank Enterprise Survey, 44.5 percent of Colombian employers identify an inadequately educated labor force as a constraint to growth, as compared to 36 percent of Latin American firms and 25.8 percent of global firms. One in three firms surveyed reports vacancies are not filled because of a lack of the needed skills. Lack of adequate skills is aggravated by lack of efficient matching mechanisms. Nearly 70 percent of workers rely on informal job search mechanisms, finding their jobs through the help of family and friends. Only 3 percent used labor intermediation systems, which are mostly small and local private labor services. These intermediation services operate independently. As a result, Colombia’s informality and

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11 Colombia Growth and Structural Changes Policy Note, 2014.
12 Infrastructure Quality Index, World Economic Forum 2013.
13 OECD 2013.
14 Enterprise Surveys 2010.
unemployment rates are among the highest in the region. Under-educated individuals and ethnic minorities are disproportionately more likely to be unemployed, work informally, or remain out of the labor force.

Many factors have contributed to Colombia’s historically slow productivity growth. First, in addition to its direct effects on growth, Colombia’s low human capital has implications for productivity. Quality education helps develop advanced skills that are crucial for an economy to assimilate new technologies and consistently innovate. In fact, innovation rates are low and Colombia’s management practices are among the worst in the region. Total national research and development (R&D) expenditures are 0.18 percent (2011) of GDP, roughly half of that expected for a country at this level of development. According to the National Innovation Survey IV (2007–2008), only 11.8 percent of Colombian firms with over 10 workers innovate in product or process compared to 30 percent on average for countries at the same level of development. Second, despite its trade integration efforts, Colombia has remained relatively closed (relatively low levels of trade to GDP ratio, for the region). Economic literature has identified positive productivity spillovers from competing with, buying from, selling to, and receiving investment from foreign firms. By facing high costs for trade and investment for decades, partially due to burdensome regulations and procedures, Colombia’s low levels of international integration have limited opportunities for technology adoption. In fact, Colombia’s small improvements in total factor productivity growth in the last decade coincide with a continued effort to open the economy.

Addressing these gaps is a key requirement for sustaining high long-run growth rates and speeding up the income convergence process with high-income economies. A simple growth decomposition exercise can provide some understanding of the requirements to sustain GDP per capita growth rates of around 3.2 percent (equivalent to baseline GDP growth rate of 4.5 percent over the next 10 years). The employment growth required to implement such rates is consistent with an increase of 1.8 percent of the economically active population combined to a reduction in unemployment rate to 7 percent (from 9.1 percent in 2014). In terms of capital accumulation, the country is expected to sustain investment rates above 30 percent (close to the maximum historical levels), to maintain the levels of productivity gains of the last decade (also close to the historical maximum). Closing gaps in each of the areas described above can help implement this scenario. While labor market performance is directly mentioned in the exercise, other elements have implications on capital accumulation and productivity and are only indirectly linked to the estimate. In an attempt to measure their individual contributions to income convergence and growth, a second counterfactual exercise can be presented based on growth regression models. The exercise suggests that closing Colombia’s gap in financial development (proxied by the credit-to-GDP ratio) with the top 10 percentile performers in Latin America, that is, double the level of credit to GDP, would lead to an increase of 11.5 percent in Colombia’s per capita GDP in five years—on average 2.2 percent a year. Closing Colombia’s gap in trade openness (equivalent to level of trade to GDP ratio that is three times larger), would lead to an increase of 8.6 percent in the per capita GDP in five years—on average 1.6 percent a year. Closing Colombia’s infrastructure gap with the top 10 percentile performers in Latin America (that is, significantly improve nine positions on an infrastructure index combining roads and telecommunications), will lead to an increase of 4.3 percent in Colombia’s per capita GDP in five years—on average 0.84 percent a year. Finally, closing Colombia’s gap in education (increase secondary school enrolment rate from 78 percent to 100 percent), would lead to an increase of almost 2 percent in Colombia’s per capita GDP in five years—on average 0.39 percent a year.

The Sustained Growth and Income Convergence DPL series has been supporting a program of reforms aimed at addressing the structural bottlenecks mentioned above and providing concrete initial steps toward closing Colombia’s performance gap. For example, reforms supported under Pillar I of the operation address some of the existing bottlenecks and market failures on private financing of infrastructure projects, contributing to improvements in Colombia infrastructure in the medium term. This pillar also supports access to finance for firms by facilitating the use of collateral and broadening the reach of capital markets. Reforms on Pillar II support skill formation and a better matching of skills and jobs, with direct and indirect dividends for growth. Pillar III combines reforms that are expected to contribute to innovation financing, access to more efficient operational and managerial practices, and help increase productivity gains and reforms that reduce the cost of trading internationally, improve access to markets and goods.

16 The economic literature has mixed. While Hanushek and Woessmann, 2011 find very large effects, Caselli and Ciccone, 2011 find positive but modest impacts.
17 Colombia Policy Notes, The Urgent Innovation Agenda—Governance, Knowledge, and Firms, 2014.
18 Tendencia Economica 144, Jun 2014.
19 Brueckner (2014).
2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

15. **Colombia is expected to continue outperforming its regional peers, but strong headwinds will slow down economic growth in the near term.** A strong oil price shock has materialized, affecting most extractive commodity exporters in Latin America. While there is significant uncertainty about future oil prices, they are likely to remain low over the medium term (following weaker demand from China and supply expansion in the United States and Saudi Arabia). In addition, expectations about monetary policy normalization in the United States have increased capital markets volatility. An actual increase in the U.S. interest rate could trigger capital outflows and increase the cost of financing for governments in the region. In this context, short to medium term growth is expected to be driven by domestic demand, particularly private consumption and new infrastructure investments, which will help attenuate the impact of external shocks.

16. **Colombia has a robust macroeconomic framework that can help withstand the adverse external environment.** The macroeconomic policy framework rests on three mutually reinforcing pillars: (a) a responsible fiscal policy based on a credible MTFF, supported by a fiscal rule; (b) a monetary policy based on an inflation-targeting regime and a floating exchange rate with moderate interventions; and (c) sound macro and micro prudential policies combined with a robust financial system. This framework provides a solid basis for the country’s economic prospects and macroeconomic response to shocks.

17. **Owing to strong fundamentals and some, though limited, degree of policy space, Colombia is expected to experience a gradual recovery starting in 2017.** While the economic outlook is subject to the downside risks associated with larger than expected deterioration in the external environment, the most likely scenario for Colombia is described as follows:

- **Growth and inflation.** Lower oil prices and production disruptions are expected to affect the GDP negatively through lower exports and private investment, particularly in the oil sector. These impacts should be partially offset by investments under the Government’s fourth generation of road infrastructure program (4G) in 2015 and 2016 and by the Government’s efforts to stimulate the economy, such as the structural reforms supported by this operation. Growth is expected to decelerate to 2.9 percent in 2015 and gradually recover to 3.0 percent in 2016 and 3.6 in 2017, still below its 4.5 percent long-term potential. Investment (3.5 percent) and private consumption (3.3 percent) are expected to sustain domestic demand growth, led by supportive policies in 2015. Inflation will stay above target, at 4.8 percent in 2015. The large depreciation of the Colombian peso in the first half of the year has temporarily pushed prices up, but inflation is expected to gradually slow down towards the end of 2015. Over the rest of the projection period, price variation should stay within the Central Bank target range, kept in check by timely interventions.

- **Fiscal accounts.** Despite the recent oil shock, Colombia still enjoys a relatively strong fiscal position. By targeting the structural deficit, the fiscal rule accommodates a gradual adjustment in expenditures/taxes in response to lower oil revenues and a smooth transition to a lower equilibrium price. The central Government deficit is expected to reach 3.6 percent of GDP in 2016 while the overall public debt is expected to reach 46 percent of GDP. Both figures are expected to decrease thereafter as the Government implements the structural fiscal consolidation path set by the MTFF. While the path assumes a mild annual adjustment on the fiscal balance, under unchanged tax policy and declining structural oil revenues, the
path would imply expenditure cuts\(^{20}\) and leave limited room to accommodate social and infrastructure expenditure requirements. To keep the Government’s solid track record of fiscal management, authorities are expected to take corrective policy measures needed to meet the fiscal deficit target and have announced the intention to increase gross tax revenues with more efficient collection in the short term and a structural reform in the medium term.\(^{21}\)

- **External accounts.** The current account deficit is projected to deteriorate in the medium term as earnings from traditional extractive exports decrease, particularly oil and coal. In 2014 the current account deficit reached 5.2 percent of GDP. It is expected to widen to around 6 percent of GDP in the near term, as the country’s export composition adjusts with lower participation of extractive intensive industries and larger participation of manufacturing and agriculture which benefit from a weaker Colombian peso. Import growth should moderate as the floating exchange rate acts like a shock absorber. The current account deficit is expected to continue to be primarily financed by inflows of net FDI, and portfolio inflows. In addition, Colombia has been and is expected to maintain adequate reserve buffers. The reserve adequacy metric is considered adequate for precautionary purposes (IMF 2015). In addition, reserves are expected to cover at least 7.7 months of imports and 3 times the external short-term debt during the forecasting period.

18. **The debt sustainability analysis indicates that public debt is expected to follow a declining path in the baseline case and in the alternative scenarios.** This analysis is consistent with the macroeconomic assumptions outlined in Annex 1. In the baseline scenario, the combined public debt-to-GDP ratio is projected to increase initially to accommodate the oil price shock, then decline continuously, going from 44.3 percent of the gross combined public sector debt in 2014 to 38.5 percent in 2020 (Annex 4). This scenario is largely based on the Government’s consolidation plans supported by the MTFF. Because a large share of the central Government’s debt is in local currency and on fixed terms, shocks to the interest (one standard deviation shock) and exchange rates (20 percent devaluation) have only a modest impact on the debt trajectory. At the same time, the debt outlook is not severely affected by shocks to economic growth (one standard deviation shock) or if the primary balance is left unchanged. Contingent fiscal liabilities represent a potential risk to fiscal accounts, but after a simulated increase of 10 percent in debt creating flows, the public debt continues to follow a declining trend. Even when historical figures are taken into account, the debt path is still declining. These results suggest that public debt sustainability is not a major concern in the medium term.

19. **On the whole, and notwithstanding the economic risks to the near-term outlook, Colombia’s macroeconomic policy framework is deemed adequate, including for development policy lending.** Medium-term fiscal policy remains prudent, with proposed fiscal adjustments already well underway. Monetary and exchange rate policies are also supportive of macroeconomic and financial stability, though downside risks remain significant. Primarily, a sharper-than-expected decline in commodity prices would tighten the fiscal position and a large income shock could reverse social gains and erode efforts to reduce poverty. However, Colombia’s economy is well positioned to weather these shocks. In addition, the country could benefit from

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\(^{20}\) Most of the adjustment will come from capital spending. This reduction is partially compensated by larger private investment through PPPs, but in the absence of additional tax revenues, total investment could suffer.

\(^{21}\) A pragmatic first step is to reform the system for nonprofit organizations. Other options under consideration include strengthening the income tax system, VAT rates and the tax base (IMF 2015).
positive shocks that are not accounted for in the baseline scenario, including a faster-than-expected implementation of the peace agreement or acceleration of the infrastructure investment program.

### Table 1. Key Economic Indicators

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP growth (%)</td>
<td>4.0</td>
<td>4.9</td>
<td>4.6</td>
<td>2.9</td>
<td>3.0</td>
<td>3.6</td>
</tr>
<tr>
<td>GDP deflator (average %)</td>
<td>2.9</td>
<td>1.9</td>
<td>1.7</td>
<td>2.7</td>
<td>3.5</td>
<td>3.5</td>
</tr>
<tr>
<td>CPI (eop)</td>
<td>2.4</td>
<td>1.9</td>
<td>3.7</td>
<td>4.8</td>
<td>3.4</td>
<td>3.0</td>
</tr>
<tr>
<td>Oil price, Colombian mix (US$/bbl)</td>
<td>104.2</td>
<td>104.1</td>
<td>96.2</td>
<td>55.2</td>
<td>61.2</td>
<td>63.7</td>
</tr>
<tr>
<td>Gross national savings</td>
<td>20.8</td>
<td>20.9</td>
<td>20.8</td>
<td>18.3</td>
<td>18.4</td>
<td>19.0</td>
</tr>
<tr>
<td>Gross domestic investment</td>
<td>24.0</td>
<td>24.6</td>
<td>26.0</td>
<td>24.0</td>
<td>23.5</td>
<td>23.4</td>
</tr>
<tr>
<td>Export growth (FOB, %)</td>
<td>6.1</td>
<td>-1.5</td>
<td>-0.1</td>
<td>-18.7</td>
<td>7.3</td>
<td>9.3</td>
</tr>
<tr>
<td>- Oil exports growth (%)</td>
<td>10.8</td>
<td>2.9</td>
<td>-11</td>
<td>-19.2</td>
<td>6.7</td>
<td>6.6</td>
</tr>
<tr>
<td>Import growth (FOB, %)</td>
<td>9.6</td>
<td>3.1</td>
<td>1.8</td>
<td>-10.4</td>
<td>8.7</td>
<td>9.4</td>
</tr>
<tr>
<td>Current account balance</td>
<td>-3.0</td>
<td>-3.3</td>
<td>-5.2</td>
<td>-5.9</td>
<td>-5.4</td>
<td>-4.8</td>
</tr>
<tr>
<td>FDI (net)</td>
<td>4.2</td>
<td>2.2</td>
<td>3.2</td>
<td>2.5</td>
<td>2.8</td>
<td>3.0</td>
</tr>
<tr>
<td>Gross reserves (months of G&amp;S)</td>
<td>6.5</td>
<td>7.5</td>
<td>8.7</td>
<td>8.1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Gross reserves (share of short-term external debt)</td>
<td>358.0</td>
<td>358.4</td>
<td>327.2</td>
<td>324.6</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Total external debt +</td>
<td>21.3</td>
<td>24.2</td>
<td>26.8</td>
<td>32.8</td>
<td>31.5</td>
<td>29.9</td>
</tr>
<tr>
<td>Total revenue</td>
<td>16.1</td>
<td>16.9</td>
<td>16.7</td>
<td>16.2</td>
<td>15.2</td>
<td>15.4</td>
</tr>
<tr>
<td>Tax revenue</td>
<td>14.3</td>
<td>14.3</td>
<td>14.2</td>
<td>14.2</td>
<td>14.2</td>
<td>14.4</td>
</tr>
<tr>
<td>Non-tax</td>
<td>1.8</td>
<td>2.7</td>
<td>2.5</td>
<td>2.0</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Total expenditures</td>
<td>18.4</td>
<td>19.3</td>
<td>19.1</td>
<td>19.2</td>
<td>18.7</td>
<td>18.5</td>
</tr>
<tr>
<td>Current expenditures</td>
<td>14.2</td>
<td>14.6</td>
<td>15.3</td>
<td>15.8</td>
<td>16.5</td>
<td>16.4</td>
</tr>
<tr>
<td>- Wages and salaries</td>
<td>2.1</td>
<td>2.2</td>
<td>2.2</td>
<td>2.4</td>
<td>2.4</td>
<td>2.3</td>
</tr>
<tr>
<td>- G&amp;S</td>
<td>0.8</td>
<td>0.9</td>
<td>1.0</td>
<td>0.8</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td>- Interest</td>
<td>2.6</td>
<td>2.3</td>
<td>2.3</td>
<td>2.6</td>
<td>2.8</td>
<td>2.8</td>
</tr>
<tr>
<td>- Transfers</td>
<td>8.7</td>
<td>9.3</td>
<td>10.1</td>
<td>10.0</td>
<td>10.6</td>
<td>10.6</td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>4.2</td>
<td>4.6</td>
<td>3.8</td>
<td>3.4</td>
<td>2.2</td>
<td>2.1</td>
</tr>
<tr>
<td>CG, overall balance</td>
<td>-2.3</td>
<td>-2.4</td>
<td>-2.4</td>
<td>-3.1</td>
<td>-3.6</td>
<td>-3.1</td>
</tr>
<tr>
<td>Primary balance</td>
<td>0.2</td>
<td>0.0</td>
<td>0.0</td>
<td>-0.5</td>
<td>-0.6</td>
<td>-0.3</td>
</tr>
<tr>
<td>Total revenues</td>
<td>28.3</td>
<td>28.3</td>
<td>28.2</td>
<td>26.5</td>
<td>26.3</td>
<td>26.4</td>
</tr>
<tr>
<td>Total expenditures</td>
<td>28.3</td>
<td>29.2</td>
<td>29.6</td>
<td>29.5</td>
<td>28.8</td>
<td>28.5</td>
</tr>
<tr>
<td>NFPS, overall balance</td>
<td>0.1</td>
<td>-0.9</td>
<td>-2.3</td>
<td>-2.4</td>
<td>-2.4</td>
<td>-2.0</td>
</tr>
<tr>
<td>CPS, overall balance</td>
<td>0.1</td>
<td>-0.9</td>
<td>-2.4</td>
<td>-2.5</td>
<td>-2.5</td>
<td>-2.1</td>
</tr>
<tr>
<td>Public debt</td>
<td>5.45</td>
<td>37.8</td>
<td>44.3</td>
<td>45.1</td>
<td>46.0</td>
<td>46.3</td>
</tr>
<tr>
<td>Of which foreign currency</td>
<td>12.1</td>
<td>13.8</td>
<td>18.5</td>
<td>19.0</td>
<td>18.0</td>
<td>17.2</td>
</tr>
<tr>
<td>Base money</td>
<td>10.0</td>
<td>15.3</td>
<td>7.0</td>
<td>10.0</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Credit to private sector</td>
<td>16.3</td>
<td>12.1</td>
<td>14.7</td>
<td>11.9</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Interest (key policy interest rate)</td>
<td>4.25</td>
<td>3.25</td>
<td>4.5</td>
<td>4.5</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>GDP (US$, billions)</td>
<td>369.8</td>
<td>378.4</td>
<td>384.9</td>
<td>332.4</td>
<td>360.3</td>
<td>390.2</td>
</tr>
</tbody>
</table>

Source: National Administrative Department of Statistics (Departamento Administrativo Nacional de Estadística [DANE]), Banco de la República, MHCP, the IMF, and World Bank staff projections. Note that figures presented in this table may differ from official figures owing to differences in methodology and definitions. Note: CPI = Consumer Price Index; FOB = Free on board; G&S = Goods and services; CG = Central Government; NFPS = Nonfinancial public sector; CPS = Combined Public Sector. Public and private external debt.
2.3 IMF RELATIONS

20. In June 2015, the IMF Board approved a two-year renewal of the precautionary Flexible Credit Line (FCL) for Colombia. This is a successor arrangement of the FCL that Colombia has had with the IMF since 2009 and has renewed every 2 years. The IMF Board’s review concluded that Colombia has maintained robust economic performance in recent years due in large part to its very strong policy framework. Well-anchored inflationary expectations, a flexible exchange rate, a structural fiscal balance rule, and effective financial supervision and regulation have contributed to the resilience of the Colombian economy in the face of global uncertainty. The FCL, approved on June 17, 2015, is a two-year arrangement in an amount equivalent to SDR 3.87 billion (about US$5.45 billion), and is treated by the authorities only as a precautionary measure. The IMF and Word Bank teams maintain close collaboration on the monitoring of the macroeconomic framework and support to structural reforms to sustain growth.

3. THE GOVERNMENT’S PROGRAM

21. The National Development Plan (NDP) 2014–2018, “All for a New Country”, recognizes the importance of growth as a means to shared prosperity. The NDP proposed a framework based on three pillars: Peace, Equality, and Education—and six cross-cutting strategic areas relevant to all pillars: (a) competitiveness and strategic infrastructure, (b) social mobility, (c) rural transformation, (d) security, justice and democracy to build peace, (d) good governance, and (e) green growth.

22. The NDP’s competitiveness and strategic infrastructure area consolidates several objectives supported by this operation. The first objective considered under this area is to increase the productivity of Colombian firms by investing in sophistication and diversification of production. The second objective is to contribute to productive and social development through science, technology, and innovation. The third objective is to promote technology as a platform for equity, education, and competitiveness. Finally, the fourth objective considers the provision of infrastructure and transport to integrate the Colombian territory. This operation is also related to the cross-cutting area of ‘social mobility’, which has a key objective of closing the gaps in access to and quality of education to build human capital and improve social mobility.

23. The core sectors covered in the DPL series are well-aligned with the areas targeted by the Colombia NDP 2014–2018. The objectives supported by the plan are critical to address Colombia’s structural bottlenecks for growth. In particular, objectives related to competitiveness and strategic infrastructure underscore the importance of firms’ access to finance, innovation and efficiency policies, infrastructure investment and financing, and skills formation, which are closely associated with the policy areas and actions supported by this operation.
4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

24. The PDO and pillars supported by this DPL series are closely linked with the strategic priorities set by the NDP 2014–2018, which reflects critical needs for promoting growth.\footnote{Participation of the private sector in financing and development of public, economic, and social infrastructure is still scarce within Colombia. This is due to (a) the deficient structuring of projects, (b) weakness in the legislative framework regulating projects, (c) institutional weakness within different sectors, and (d) the lack of adequate incentives that allow linking long-term investors offering quality services.} The objectives of the proposed operation are: (i) fostering solutions to develop infrastructure financing and increasing access to finance for firms; (ii) building productive skills and improving their allocation; and (iii) strengthening regulations that affect innovation and business efficiency. Table 2 presents a mapping between the Government’s goals and strategic areas and the pillars supported by this operation. The Government goal of sustainable growth and competitiveness is directly linked to the PDO and some of the strategic policy areas supported by this goal are perfectly in line with the three pillars of the operations.

Table 2. Links between the DPL Series and NDP 2014–2018

<table>
<thead>
<tr>
<th>Cross-cutting Areas</th>
<th>Selected Objectives</th>
<th>Associated Pillar of the DPL series</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitiveness and strategic infrastructure</td>
<td>Objective 1: Increase firms’ productivity</td>
<td>i. Pillars I and III</td>
</tr>
<tr>
<td></td>
<td>Objective 2: Promote science, technology, and innovation</td>
<td>ii. Pillar III</td>
</tr>
<tr>
<td></td>
<td>Objective 3: Provide infrastructure and transport</td>
<td>iii. Pillar I</td>
</tr>
<tr>
<td>Social mobility</td>
<td>Objective 4: Close education gaps</td>
<td>Pillar II</td>
</tr>
<tr>
<td>Rural transformation</td>
<td>n.a.</td>
<td>None directly</td>
</tr>
<tr>
<td>Good governance</td>
<td>n.a.</td>
<td>Pillar III</td>
</tr>
<tr>
<td>Security and justice</td>
<td>n.a.</td>
<td>None directly</td>
</tr>
</tbody>
</table>

25. The design and preparation of this DPL series take into account lessons learned over several years of engagement through DPLs in Colombia. A key lesson is that DPLs should be seen as one strategic tool of engagement for policy dialogue with a sophisticated client, within a broader program of technical and analytical support that responds to the country’s needs and demands. Consultations between the Bank and the GoC during preparation and implementation of the program have helped expand the policy dialogue. These consultations also create opportunities to build on ongoing engagement and develop new areas for technical support.

4.2 PRIOR ACTIONS, RESULTS, AND ANALYTICAL UNDERPINNINGS

26. The Programmatic Sustained Growth and Income Convergence Development Policy Series contributes to Colombia’s growth and convergence agenda by supporting the implementation of policy reforms. The First Income Convergence and Sustained Growth DPL (P149609) for US$700 million was approved in December 2014 and fully disbursed by February 2015. For the proposed second DPL, 7 of the 10 actions proposed as indicative triggers in the first DPL have been met (Table 3). While most of them have been upgraded to prior actions, new actions have been introduced to fully reflect progress made in the areas supported by the first
operation. In addition, new results indicators have been added to strengthen the monitoring and evaluation framework and better track the results. Each policy area and the proposed prior action and results indicators are described below (and summarized in the policy matrix in annex 1).

Table 3. Mapping of Indicative Triggers (DPL1) and Prior Actions (DPL2)

<table>
<thead>
<tr>
<th>Indicative Triggers (DPL1)</th>
<th>Prior Actions (DPL2)</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>#1 The GoC reviews the definition and simplifies the framework for the issuance of credit guarantees in order to further support 4G projects investments.</td>
<td>#1 In order to promote the financing of projects under the 4G Concession Program, the Government has: (i) reduced restrictions for pension funds to invest in private capital infrastructure funds; and (ii) eased the requirements for funding operations in international markets.</td>
<td>The GoC decided to move forward with reforms on the funding side for 4G financing and to delay the reform on guarantees under the concern that the latter would increase investor’s uncertainties during the first round of issuances of 4G projects.</td>
</tr>
<tr>
<td>#2 Additional regulations to coordinate the exchange of information between the collateral registry and the registry of vehicles at the Ministry of Commerce/Ministry of Transport.</td>
<td>#2 In order to improve and promote firms’ access to credit, the Government has: (i) further strengthened the collateral registry by regulating the mechanisms for the execution of guarantees, and electronically linking the collateral registry with the existing vehicle registry; and (ii) created a central registry for electronic invoices (Registro de Facturas Electrónicas) which, among other things, facilitates the use of invoices as collateral.</td>
<td>Met</td>
</tr>
<tr>
<td>#3 Detailed regulations issued to implement and operationalize mutual funds and Segundo Mercado decrees.</td>
<td>#3 In order to continue fostering capital markets development, the Government has: (i) established new governing rules for the management of mutual funds (Fondos de Inversion Colectiva); and (ii) set internal policies, procedures and operating systems for the custody of securities.</td>
<td>Met. The Segundo Mercado started operating without requiring the additional regulations that were contemplated. For this reason the action focused on operationalizing the reforms of mutual funds.</td>
</tr>
<tr>
<td>#4 Approval of the regulatory framework defining the institutional arrangement and responsibility for processing the registry of information and managing the system; approval of the regulatory framework of information flow and basic public employment service (PES) indicators.</td>
<td>#4 In order to strengthen the Public Employment Service (PES), the Government has defined the institutional arrangements, responsibilities and information requirements for the implementation of the PES management and job placement tools,.</td>
<td>Met</td>
</tr>
<tr>
<td>#5 Approval of a decree regulating the operation of UVAEs that includes general guidelines of a national learning service (nonformal training) and approval of a basic and socioemotional skills curriculum in the SENA training program.</td>
<td>#5 In order to improve the formation of professional skills, the Government has: (i) created the national framework of professional qualifications and competencies, (ii) established a system of transfers and credits connecting the different</td>
<td>Expected to be met, but it was substituted here by a stronger actionable policy.</td>
</tr>
</tbody>
</table>

13
<table>
<thead>
<tr>
<th>Indicative Triggers (DPL1)</th>
<th>Prior Actions (DPL2)</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>branches of tertiary education, and (iii) defined the Ministry of Education as responsible for implementing this system.</td>
<td>#6 Enactment of the decree/law regulating the transfer of Sistema General de Participaciones (SGP) resources for, among other things, education and human capital formation for indigenous communities.</td>
<td>Met. The special regime create allow indigenous communities to direct access and manage resources from the SGP</td>
</tr>
<tr>
<td>#6 In order to improve inclusive skills and income generation opportunities, the Government has established a special regime for the administration of the educational system for Indigenous Communities, including tertiary education.</td>
<td>#7 Approval of a regulation clearly defining rules for execution of royalty (regalia) resources dedicated to science, technology, and innovation; approval of a regulation clearly defining the procedures for monitoring and evaluation of the use of these resources.</td>
<td>Met</td>
</tr>
<tr>
<td>In order to improve the effectiveness of public investment in innovation, the Government has: (i) defined the criteria for formulation, selection and approval of innovation projects financed with Royalties’ Resources, and (ii) created an information platform to monitor projects financed by royalties (MAPAREGALIAS).</td>
<td>#8 Creation of a Committee for Improving the Production of Regulations.</td>
<td>Partially met. Although the committee is working on issues related to the content of reforms, the regulation that formally implements it has not been approved. The regulation was delayed because the Government decided to amplify the scope of the committee to oversee issues related to legal coherence and consultations. The action has been substituted by a decree defining improved procedures for issuing new regulations prevent barriers to competition.</td>
</tr>
<tr>
<td>#10 In order to prevent new regulations from interfering with competitive practices, and in line with best practices from the Organization for Economic Co-operation and Development (OECD), the Government has established procedures that require all agencies drafting new regulations that could impact competitive practices to first consult with the Government’s Superintendence of Industry and Commerce.</td>
<td>#9 The GoC reorganizes the National Tax and Customs Administration (Dirección de Impuestos y Aduanas Nacionales [DIAN]), with the purpose of streamlining processes and improving efficiency and effectiveness.</td>
<td>The reorganization was reconsidered due to its negative fiscal/budgetary implications in a context of lower revenues. Instead, the Government advanced other areas of trade facilitation that are more actionable, as supported as a prior action.</td>
</tr>
<tr>
<td>Partially met. Although progress has been made, the simultaneous inspections for imports are not yet operational.</td>
<td>#11 11. In order to facilitate international trade, the Government has: (i) streamlined the procedures for issuing authorizations to Authorized Economic Operators (AEO), and allowed AEO to be considered for streamlined procedures to clear customs; and (ii) implemented an integrated transit of goods with the Republic of Ecuador.</td>
<td></td>
</tr>
<tr>
<td>#10 The GoC further strengthens the Single Window for International Trade by extending simultaneous inspection methods to imports.</td>
<td>#11 11. In order to facilitate international trade, the Government has: (i) streamlined the procedures for issuing authorizations to Authorized Economic Operators (AEO), and allowed AEO to be considered for streamlined procedures to clear customs; and (ii) implemented an integrated transit of goods with the Republic of Ecuador.</td>
<td>The reorganization was reconsidered due to its negative fiscal/budgetary implications in a context of lower revenues. Instead, the Government advanced other areas of trade facilitation that are more actionable, as supported as a prior action.</td>
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<tr>
<td></td>
<td></td>
<td>Although progress has been made, the simultaneous inspections for imports are not yet operational.</td>
</tr>
</tbody>
</table>
27. The Colombian Government is aware of the important structural bottlenecks to sustained economic growth faced by the country and the strategic value of addressing those issues in an unfavorable external environment. For this reason the Government has defined a comprehensive program of policy reforms with implications for growth. The proposed DPL is designed as part of a programmatic series, focusing on the areas that have been identified as critical under the CPS and NDP and which are implementable in the foreseen time frame.

Pillar 1: Fostering solutions to develop infrastructure financing and increasing access to finance for firms

Fostering the financing of key infrastructure projects

28. The availability of adequate financing mechanisms for 4G infrastructure projects is key for sustained growth. The first DPL of the series supported actions directed toward the improvement of financing mechanisms for the 4G program. The GoC has continued working on additional reforms and regulations that will complement the changes introduced in the first operation, increasing their effectiveness. With technical assistance from the Bank, the GoC is working on a decree regulating the usage of guarantees as credit enhancements in project finance structures (Trigger #1 of DPL1), but it decided to delay the approval of the decree and it is now expected to be issued by the end of 2015. Nevertheless, the GoC remains committed to the implementation of the program and has issued additional complementary reforms.

DPL2 Prior Action #1: In order to promote the financing of projects under the 4G Concession Program, the Government has: (i) reduced restrictions for pension funds to invest in private capital infrastructure funds; and (ii) eased the requirements for funding operations in international markets.

29. The GoC has advanced on a decree that modifies the regulations of private infrastructure capital funds and supports the financing mechanisms of projects under the 4G program. In particular, the decree allows pension funds to invest in those private capital funds that could potentially invest in projects operated by firms that belong to the same conglomerate, as long as the private capital fund is externally managed and has at least 50 percent of capital from other investors. It is important to note that of the total assets administered by the private capital funds (COP 7.1 billion) resources used for infrastructure projects only account for 5.6 percent (as of June 2014). In Colombia there are two large Pension Fund Administrators (Administradora de Fondo de Pensiones – AFPs) that are the main domestic investor and belong to large real-financial conglomerates. These reforms lift key constraints for project financing in AFPs and aim at contributing significantly to the financing of the 4G infrastructure program.

30. Additionally, aiming to expand the availability of resources for long-term financing, the GoC facilitates commercial banks’ access to funding in international capital markets. Resolution No. 4 of April 24, 2015, from the Central Bank of Colombia relaxes the constraints for banks to issue debt in international capital markets to obtain resources for investing in local markets. The new regulation allows banks to borrow in foreign currency and lend in local currency.

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23 The technical assistance support from the Bank includes an assessment of the relevant regulatory framework in Colombia, applicable to banks and institutional investors in the provision of limited-recourse and non-recourse project financing and issuance of guarantees.
as long as the foreign operation is backed by a currency hedge. The regulations help increase and diversify the funding sources available for financing the 4G infrastructure program, including the local and foreign financial system, debt in Colombian pesos and dollars, and resources from the National Development Bank (Financiera de Desarrollo Nacional).

31. **Expected results.** These actions, combined with the reforms supported by DPL1, are expected to increase the amount of financing allocated to the 4G concessions program by type of institution from a baseline of 0 in 2013 to COP$6.5 billion from banks, COP$ 2 billion from FDN, and COP$ 1.5 billion from AFPs in 2016.

**Improved access to credit by firms**

32. **Credit for investment remains limited among Colombian firms, particularly SMEs.** Smaller firms lack long-term finance to modernize their operations. They have lower access to bank financing and have fewer non-bank financing sources. Thus, the GoC has been recently supporting reforms to improve access to credit and foster the capital markets as an additional source of finance. Initiatives to deepen capital markets would grant long-term access to finance to a more diversified pool of borrowers, especially supporting more access for small- and medium-sized firms.

33. **Progress on reforms to promote access to credit by firms exceeded expectations.** The indicative Trigger #2 considered under this policy area in DPL1 was met and expanded to reflect additional reforms to support a more comprehensive access to credit reform for SMEs. In particular, since October 2014, the Government has implemented reforms to (a) support the implementation of the law that authorized the use of movable assets as collateral in financial operations and (b) increase access to credit for micro, small, and medium enterprises through factoring.

**DPL2 Prior Action #2:** In order to improve and promote firms’ access to credit, the Government has: (i) further strengthened the collateral registry by regulating the mechanisms for the execution of guarantees, and electronically linking the collateral registry with the existing vehicle registry; and (ii) created a central registry for electronic invoices (Registro de Facturas Electrónicas) which, among other things, facilitates the use of invoices as collateral.

34. **The GoC has continued the implementation of the secured transactions regime approved in 2014.** Greater access to credit has been fueled by strengthening the Law on Secured Transactions.24 The law facilitates the use of movable assets as collateral, which helps cover the risk inherent in financial transactions and mitigates problems of asymmetric information between the grantor of credit and the recipient. The Government has made significant progress implementing additional regulations to the law. In particular, the decree of execution of guarantees (Decree 1835) regulates and implements extrajudicial execution mechanisms, which are expected to improve collection mechanisms and reduce the time to execute guarantees from 1,500 to 90 days without the need to go to court. In addition, the decree integrates the law and the insolvency proceedings. It also implements mechanisms for the sale of repossessed assets. This, together with

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24 The Law on Secured Transactions (Law 1676) expanded the universe of securities that are available for contracting credit obligations, created an electronic collateral registry for movable assets, and established a centralized and more efficient registration and consultation scheme.
the methodologies recently developed by the Securities and Futures Commission (SFC) for facilitating collateral appraisal, will help increase banks’ acceptance of a wider range of assets as collateral for lending. These actions are expected to promote the inclusion of new borrowers, including enterprises with a collateral value that did not appeal to formal creditors until now.

35. **Decree 1835 also covers the regulation to coordinate the exchange of information between the collateral registry and the registry of vehicles at the Ministry of Commerce/Ministry of Transport (indicative Trigger #2 of DPL1).** The decree amends the way guarantees on vehicles are registered, given that the current regulations denote a double record. The Registry of Security and the Ministry of Transport will coordinate the registration of security interests in motor vehicles, allowing intercommunication between both registries to avoid double entries and to reduce transaction costs. The Registry of Security will notify, electronically and in real time, the registration of a vehicle to the Ministry of Transport through the Single National Registry of Traffic.

36. **Colombian SMEs also face limited access to financing, particularly for working capital.** For SMEs, the deadlines to pay bills within 120 days put additional financial pressures since these resources are often essential to continue running their business units. Law 1231 of 2008 legally created the activity of factoring for the purchase of bills. However, thus far it has not been effective. According to the *Gran Encuesta PyMES* of 2014, on average only 3 percent of the universe of micro, small, and medium enterprises used factoring as an alternative source of funding to maintain the dynamics of their business. One of the key requirements for the proper functioning of factoring is the regulation of the electronic invoice as underlying security and the existence of a system of information on the operations, containing the traceability of the titles and reducing the risk of fraud. The lack of a single registry for electronic invoices which stores and monitors the use of invoices as collateral has been an important bottleneck for the expansion of factoring. The use of electronic invoices as collateral, has the potential to improve access to working capital financing and therefore boost company growth and job creation while reducing financial inefficiencies.

37. **To boost factoring activities, the GoC created the Central Registry of Electronic Invoices (Article 9 of the NDP 2014–2018, May 2015).** As a first step, Article 9 of the NDP created the Central Registry of Electronic Invoices. Subsequently, the GoC will regulate the legal, operational, and technical aspects needed to allow the deployment and transfer of electronic invoicing as a title. In addition to facilitating access to working capital financing, the centralized registry of electronic invoices contributes to greater transparency of the business operation, especially in the SME sector. Electronic invoicing also helps facilitate the interaction between domestic and foreign clients and it is an important milestone to encourage the formalization of SMEs.

**Expected results.** The Government strategy is expected to improve access to credit in the medium run. With this new legal and regulatory framework, an increase in the number of registrations in the collateral registry is expected (increase from a baseline of 0 transactions in 2013 to 1 million transactions in 2016).

**DPL2 Prior Action #3:** In order to continue fostering capital markets development, the Government has: (i) established new governing rules for the management of mutual funds (Fondos de Inversion Colectiva); and (ii) set internal policies, procedures and operating systems for the custody of securities.
38. The GoC remains committed to continue fostering capital market development and facilitate access to bond financing for a larger and more diversified group of companies, including SMEs. Supported by DPL1, an alternative securities issuance scheme (*Segundo Mercado* or second market) for institutional investors was created as a hybrid regime between public offering and private placements. The reform entailed more flexible requirements, lower costs of issuance, and faster approval times than in standard public offerings. Low origination of securities and high credit quality requirements for the public offering regime for corporate bond markets in Colombia were some of the main motivations to propose reforms in the new hybrid issuance regime. Thus far, no additional regulatory requirements have been necessary for the implementation of this *Segundo Mercado* reform.

39. In particular, reforms within this programmatic series of DPLs seek greater efficiency for the industry of mutual funds so that it will stimulate and further channel savings and financing of new businesses. The GoC has supported the diversification of the institutional investor base by reforming the administration and management of mutual funds. The reform included measures to allow independent or smaller portfolio managers to enter the mutual fund industry and to create stronger custodial arrangements. To continue the implementation of these reforms, additional regulations have been issued by the SFC, to implement the provisions of the decrees (Circular Externa No. 26 September 15, 2014). These reforms include allowing agents to strategize and design the portfolio composition of the funds in line with international practices and benchmarks and standardizing the mechanisms of information disclosure to investors, including consolidated financial information. In conjunction, this new framework will improve the protection of investors and give greater transparency to the market. Finally, SFC issued new procedures (Circular Externa No. 15, June 13, 2014, and Circular Externa No. 31, November 21, 2014) regulating the activities of the Custody of Securities, an entity created by Decree 1243. The procedures adjust policies, procedures, and operational systems to ensure the proper conduct of business. Additionally, to mitigate operational and market risks, it is necessary that the participants in the new scheme conduct a gradual migration of portfolios to trust companies authorized to provide the custody of securities service.

40. Expected results. The number of new issuers that entered the market through the hybrid regime, *Segundo Mercado*, is expected to increase from a baseline of 0 issuers in 2013 to 10 issuers in 2016; and number of investors in mutual funds (*Fondos de Inversion Colectiva*) is expected to increase from a baseline of 1.34 million in 2013 to 1.5 million in 2016.

**Pillar 2: Building productive skills and improving their allocation**

41. Colombia’s inadequate supply of skills has limited labor productivity and growth. Although education attainment among Colombians is higher than ever, Colombia’s labor market outcomes compare poorly with the average for Latin America and the Caribbean and the OECD member countries. Education quality is also lagging relative to Colombia’s level of development. Lack of adequate skill affects employment prospects and income generation opportunities. This problem is aggravated by skills mismatches in the labor market. As a result, Colombia’s informality and unemployment rates are among the highest in the region (9.1 percent

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25 A new issuer is considered an issuer for the first time or an issuer that has not accessed the market in the past five years.
unemployment rate and 75 percent informality rates in 2014) (see Annex 5 para. 14). In response to these challenges, the GoC has been implementing an employment strategy aimed at improving skills and employment opportunities. Actions supported under this operation are part of strengthening the employment prospects strategy, in particular, in the areas of job training and labor intermediation.

**Improving the matching between jobs and skills**

**DPL2 Prior Action #4:** In order to strengthen the Public Employment Service (PES), the Government has defined the institutional arrangements, responsibilities and information requirements for the implementation of the PES management and job placement tools.

42. In 2013, the Ministry of Labor created a national employment system, **Sistema de Gestión de Empleo para la Productividad**, with the purpose of articulating and coordinating labor market instruments aimed at improving employment prospects. The system (created through Law 1636, 2013 and regulated through Decree 2852, 2013 supported by the first DPL) includes the PES, a labor intermediation network comprising public and private operators and coordinated by the Ministry of Labor to serve a broader clientele of job seekers and employers. The PES is the instrument of the *Sistema de Gestión de Empleo para la Productividad* responsible for improving the labor market structure and organization and helping workers to find good jobs and employers to contract appropriate workers who meet their firm’s needs. The system includes a number of actors, namely the SENA which offers job placement services to its graduates, the municipal offices of the PES, and private operators, mostly *Cajas de Compensacion*.

43. The Ministry of Labor has been proactive in gradually improving the implementation of the PES. In the past year, the GoC has made progress in implementing the trigger of DPL1 for the approval of the regulatory framework for the implementation of the PES. In particular, several aspects of Decree 2852 have been regulated, such as protocols to post and manage vacancy information and mechanisms to improve the management of the information to the *Unidad Administrativa Especial del Servicio Público de Empleo* (UAESPE) (Resolution 2605, June 2014 and Resolution 129, March 2015). In addition, the GoC has regulated the registry of operators of the PES and has defined UAESPE’s responsibilities in managing the registry (Resolution 1397, April 2015). Finally, the UAESPE was granted authority and resources to implement actions that could improve vacancy management and that would help increase placement rates (Resolution 3418 of August 2014).

44. **Further strengthening of the PES would be necessary as the system evolves.** In particular, the institutional links between the UAESPE and the Ministry remain weak, and this creates a vacuum in setting up guidelines for operations for the network as a whole. Some of the issues contemplated in Decree 2852, such as the obligation to provide services of quality, are still being regulated and the integrated information technology system is not fully able to handle and effectively manage the vast load of vacancies that it needs to administer (almost 1.1 million as of September 2014). The system has also—unintentionally—created an uneven competition between operators with very heterogeneous clients and resources, effectively penalizing public (municipal) operators who tend to cater to clients with lower employment prospects and thus have lower vacancy filling rates.
45. **Expected results.** The number of job placements achieved through the new system is expected to reach 315,000 in 2016 (from a baseline of 166,000 in 2013). The job placement rate reached 180,000 in 2014 and is expected to continue increasing. However, the Government revised its projection for 2016 downwards (from the 342,000 in 2016 as contemplated in the first DPL) in line with the more realistic projections prepared under the NDP, which take into account a lower international oil price. The number of persons occupationally oriented and referred to management and placement services is also expected to increase from a baseline of 386,910 in 2013 to 1,120,000 in 2016. By July 2015, 655,188 were already oriented and referred.

**Building professional skills**

**DPL2 Prior Action #5:** In order to improve the formation of professional skills, the Government has: (i) created the national framework of professional qualifications and competencies, (ii) established a system of transfers and credits connecting the different branches of tertiary education, and (iii) defined the Ministry of Education as responsible for implementing this system.

46. **The Government has taken significant steps to improve the quality and access to professional training.** Since the tax reform of 2012 (Law 1607) and the creation of the income tax for equity contribution (*Impuesto sobre la Renta para la Equidad*) that in part replaces payroll taxes and finances SENA’s operation, SENA can only use these resources for social projects via the *Programa de Reentrenamiento y Formación a lo Largo de la Vida* (Retraining and Life-long Learning Program) (through Decree 681/2014, supported by the first DPL). The program provides counterpart funding to nongovernmental organizations, employer associations, and UVAEs. Since the approval of the first DPL, the GoC has taken additional steps to strengthen the program. In October 2014, SENA issued Resolutions 2021 and 2320 to further define the guidelines for the implementation of the Retraining and Life-long Learning Program, including detailed procedures for the execution of the program. The GoC is also finalizing the regulatory framework for the creation and operation of UVAEs. This decree was contemplated as a trigger for DPL2 and is expected to be approved by November 2015. It includes general guidelines for the national learning service (non-formal training) and approval of a basic and socioemotional skills curriculum in SENA training programs. All together, these additional regulations are expected to complement Decree 681 and support the appropriate implementation of the program.

47. **Expected results.** The number of firms providing professional training has increased from a baseline of 0 UVAEs in 2013 to 40 in 2016. By the end of 2014, 30 UVAEs have been created.

48. **Diagnostics from the OECD and the Bank have highlighted the need for a National Qualification Framework (NQF) in Colombia.** Policymakers in Colombia have generally recognized the potential benefits of a well-organized and widely accepted qualifications framework, including (a) a clear description of the rules and skills for each level of education and training system; (b) comparability of qualifications, either at the level of certificate diploma or degree; (c) recognition of prior learning; (d) removal of the courses ‘end’ and its replacement by a system of credits that allows individuals to continue their studies at higher levels; and (e) access and return of adult learners, strengthening the system of continuing education.

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26 Through this mechanism, SENA brings employers and training programs closer together, with an emphasis on job competences and on-the-job training while encouraging firms to become trainers of their own workforce.
49. As part of the NDP, the Government has reformed the tertiary education system to facilitate the pursuing of higher educational levels and aligned skill formation with market demands. Article 58 of the NDP Law creates the NQF and a system of transfers and credits for tertiary education. The NQF is a tool for classifying and structuring the knowledge, skills, and competences for different professions and areas of expertise at different education levels. It facilitates human resource management through a model that maps required labor skills in the productive sector to relevant training provided for the accumulation of such skills. This framework aims to improve communication between the labor market and education systems, as well as support those looking for jobs and training. A well-organized and well-understood NQF provides a common language for the education system and the employers. This framework also facilitates mobility of students in the education system, promotes lifelong learning, and increases the employment prospects for those looking for work at different levels. Under the previous system an individual who wanted to advance one education level (for example, advance from a technological to university degree under the same area of expertise) had to start from zero. Under the new system, the individual will have current competences and skills recognized and will complement them with those required for an advanced level. The existence of the NQF makes qualifications more transparent for students and employers and allows students to move freely between institutions and levels, knowing that they will receive the credit for previous study. This reform is critical for the alignment of skill formation with market demands, and replaces the indicative trigger regulating the operation of UVAEs.

50. The full implementation of the new tertiary system will require additional regulatory and operational efforts led by the Ministry of Education. The initial step for the design and operationalization of the new tertiary education system is the creation of qualification matrices that define knowledge, skills, and competences at different educational and professional levels. This matrices are currently being developed in consultation with key stakeholders (including education institutions, private sectors and central and local Government institutions). The second step, expected to start in 2016 is the adoption of this framework by education institutions. Four pilots are expected to be completed by 2016 and are considered as result indicators for the operation.

51. Expected results. Qualification matrices including knowledge, skills, and competences at eight different education levels, have been developed for four pilot sectors (Information Technology, Finance, Construction, and Agriculture) by the end of 2016 (from a baseline of 0 in 2013 and 2014).

*DPL2 Prior Action #6: In order to improve inclusive skills and income generation opportunities, the Government has established a special regime for the administration of the educational system for Indigenous Communities, including tertiary education.*

52. There are large education gaps among the ethnic groups in Colombia, which reflect in limited income generation and low participation on formal productive activities by these groups. Data from the 2005 population census shows that 30 percent of those of indigenous ethnicity have received no schooling as compared to 10 percent of the general population, and only 2.7 percent have reached higher education versus 37.2 percent of all Colombians.
53. **As part of the Government efforts to improve skills and income generation opportunities to vulnerable groups, the Government issued a decree in October 2014 regulating skills formation for indigenous populations.** The decree establishes the indigenous self-education system, which entails a collective and comprehensive training process to rescue and strengthen cultural identity, territory, and autonomy of indigenous peoples who will attend the training of their communities from early childhood to higher education. The cycles or levels of the indigenous education system will have correspondence with the educational standards laid down in the Colombian constitution. More specifically, the main objectives of the indigenous self-education system are (a) to promote and consolidate the processes of self-education in accordance with the particularities of each people and strengthen areas of knowledge of indigenous peoples’ own culture; (b) to strengthen the construction of a multiethnic and multicultural state; (c) to preserve and strengthen the ethnic and cultural identities of indigenous peoples, as well as preserve, revitalize, and recover native languages; (d) to generate relevant skills and establish the dialogue about knowledge while recognizing and protecting ethnic and cultural diversity; (e) to promote multilingualism as a strategy to build knowledge; and (f) to contribute to the strengthening of autonomy and self-government structures of indigenous peoples.

54. **The indigenous education system is supported by the creation of the autonomous indigenous politico/administrative entities, which receive specific funding for this purpose.** For instance, the decree established the transfer of Sistema General de Participaciones (SGP) resources for, among other things, education and human capital formation for indigenous communities.

55. **Moreover, recognizing the need to boost the skills and employability of workers from indigenous territories, the reform also allows indigenous groups to create indigenous higher education institutions.** The indigenous higher education institutions will be public entities with their own special characteristics, whose main objectives are comprehensive training and research under the indigenous education system itself and contribute to the recognition of ethnic and cultural diversity of the Colombian nation. The decree defines the procedures and requirements, as well as the monitoring procedures of tertiary education for indigenous communities.

56. **Ultimately, this reform intends to increase access to general education and productive skills while preserving cultural traces and norms.** The decree is expected to have important shared prosperity implications as indigenous households have relatively high rates of multidimensional poverty (58 percent in 2010), partially driven by low access to education and relatively low per capita income (less than 59 percent of the income of different ethnic groups), both resulting in part from limited income generation opportunities.

57. **Expected results.** Number of communities certified and able to directly manage resources of the SGP, including earmarked transfers for education (increase from 0 in 2013 to 4 in 2016). By September 2015, 3 had already been certified.
Pillar 3: Strengthening regulations that affect innovation and business efficiency

Promoting innovation and technological progress

58. As discussed in box 1, Colombia’s low levels of investments in Research and Development (R&D) and innovation limit productivity gains and sustained growth. Only 11.7 percent of Colombian firms\(^27\) innovate in products or processes compared to 30 percent on average for countries at a similar level of development. The poor quality of firm management generates low technological ‘absorptive capacity’ and is associated with low efficiency. A recent LSE-World Management Survey indicates that Colombian firms have among the worst management quality measured in all Latin American countries surveyed.\(^28\) Finally, the total national R&D expenditures as a share of GDP at 0.19 percent\(^29\) are roughly half of what would be expected for a country at this level of development.\(^30\) Low levels of R&D in Colombia have been linked to low competition and incentives, as well as lack of adequate financing for these activities.

59. While Colombia has a few innovation financing mechanisms, regulatory ambiguities, inadequate institutional arrangements, and difficulties in execution, have led to low uptake and ineffective use of resources. Currently, Colombia possesses two main instruments to finance R&D: (a) the system of tax incentives for firms’ investment in science, technology, and innovation which supports private investments and (b) the science, technology, and innovation fund financed with oil and mining royalties’ resources which supports public investments. In both cases, resources have been underutilized due to regulatory gaps related to granting the benefit and ambiguities in the definition of eligible expenditures, particularly regarding firms’ innovation spending and seed capital. In the case of tax incentives, uptake has been less than half of the amount budgeted. Some of the reasons for low uptake are the vague definitions of eligible expenditures and complexities of the applications and selection process. In the case of royalties’ fund,\(^31\) in addition to execution rates continuing to be very low, questions have been raised regarding the nature and relevance of projects selected. Both financing mechanisms have favored the financing of science and technology more from an academic point of view than from the perspective of increasing firms’ productivity and commercial innovation. This is partially due to a separation in institutional arrangements between science and technology versus competitiveness in addition to shortcomings and overlaps between the two areas.\(^32\)

60. The GoC has been taking important steps to address these issues, which are being supported by this DPL series.

**DPL2 Prior Action #7:** In order to improve the effectiveness of public investment in innovation, the Government has: (i) defined the criteria for formulation, selection and approval of innovation projects financed with Royalties’ Resources, and (ii) created an information platform to monitor projects financed by royalties (MAPAREGALIAS.

\(^{27}\) Based on a firm survey (EDIT 2011-12) including only firms with 10 or more employees.

\(^{28}\) Countries surveyed include Chile, Mexico, Brazil, and Argentina.

\(^{29}\) Observatorio Colombiano de Ciencia y Tecnología, 2014

\(^{30}\) Colombia Policy Notes, The Urgent Innovation Agenda—Governance, Knowledge, and Firms, 2014.

\(^{31}\) Since the royalty’s reform in 2012, 10 percent of royalty annual receipts are earmarked to finance science, technology, and innovation projects.

\(^{32}\) Colombia Policy Notes, The Urgent Innovation Agenda—Governance, Knowledge, and Firms, 2014.
61. **Aware of the challenges to the allocation of public resources to science, technology, and innovation financing, the GoC is seeking to improve the efficiency and effectiveness of publicly funded innovation.** The prior action supports the Government’s efforts to improve the efficient allocation of public resources invested in science, technology, and innovation projects as well as transparency in the use of these resources consistently with the indicative trigger proposed in DPL1. The GoC has narrowed the scope of projects financed by royalty (Article 07 of NDP Law 2015) by mandating that science, technology, and innovation projects funded by royalties’ resources be adjusted according to priority areas defined by strategic agreements between the Departamento Administrativo de Ciencia, Tecnología e Innovación (COLCIENCIAS); the DNP; and regional governments. In addition, the Government has defined clear criteria for the formulation (design, feasibility analysis, and presentation); selection; and approval of these projects (Agreement 0027, April 15, 2015). Finally, the GoC improved the transparency and monitoring of such projects through the MAPAREGALIAS (Agreement 0023, June 26, 2014), an information platform which includes all projects presented, selected, and approved to be financed with resources from royalties, their precise location, total amount, other financing sources, status of execution, and result indicators.

62. **Expected results.** The number of innovation projects financed with royalties resources evaluated under the new methodology is expected to increase from 0 in 2013 to 20 in 2016. By 2015, already 11 projects had used this new framework.

**DPL2 Prior Action #8:** In order to strengthen the system of tax benefits for innovation, the Government has defined the specific eligible expenses that could be granted as fiscal benefits, including firm-led innovation.

63. **The Government has also taken concrete steps to stimulate private innovation investments by reforming the system of fiscal benefits for innovation.** The reform, implemented through CONPES 3834, July 2015 complements the action supported by DPL1. It defines specific expenses that are eligible for fiscal benefits and extends the benefits to innovation projects led by firms. The reforms also facilitate SMEs’ access to these benefits.33

64. **Expected results.** These actions are expected to lead to a more effective mobilization of private resources to promote innovation in the medium term. During the timeframe of this operation, the share of budgeted tax benefits for science, technology, and innovation is expected to increase from 69 percent of budget resources in 2013/2014 to 100 percent of budget resources by 2016.

**DPL2 Prior Action #9:** In order to improve the coordination and allocation of resources for productive development, the Government has unified its Governance System of Competitiveness and Innovation with its Governance System for Science Technology and Innovation at national and regional levels.

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33 Previously only science, technology, and innovation projects led by research and academic institutions were eligible.
65. **Finally, the Government has taken the initial steps to improve the governance of Colombia’s National Innovation System.** The governance system supporting innovation in Colombia has been characterized by fragmentation, duplication, and lack of specialization among the different institutional stakeholders. Effectively supporting innovation involves an extensive process of raising the capacity of existing firms; promoting the entry of new ones; and cultivating, over time, their ability to absorb technologies. Colombia has lacked a coherent integrated system of support that encourages increasing productivity and sophistication of firms over time. There are many different elements composing the current innovation support system that are now scattered across different entities linked to the Governance System of Competitiveness and Innovation and/or the Governance System for Science Technology and Innovation, with substantial overlap and duplication of programs. The NDP Law starts to address these issues by unifying the System of Competitiveness and Innovation with the System for Science, Technology, and Innovation as a means to simplify administration of policy guidelines and improve the coordination and allocation of resources for productive development and innovation programs. Given that a large share of investment programs, funded through royalties, is planned and implemented at local level, it is especially important that this integration of the two systems of governance is mandated not only at the national level but also at the local level where the Regional Commission for Competitiveness becomes the only local actor coordinating local programs to support innovation and interacting with the national institutions. At the national level, additional regulations under preparation are required to define institutional arrangements under the unified system.

66. **Expected results.** The number of instruments, i.e. projects and programs, designed and implemented in a coordinated manner by institutions under the new unified Governance system increased from 0 in 2013 and 2014 to 30% of the instruments designed and implemented in 2016.

67. **Improving regulatory efficiency**

68. **As previously discussed, the country’s regulatory and business environment can generate inefficiencies and distortions that hinder productivity gains.** According to the ‘Doing Business’ indicators, Colombia has made continuous progress in improving its business environment. While the country ranks well in the region, it has a significant gap with respect to top developing countries. In particular, there is substantial room to improve when compared to the regional top performer (Chile) and even more when compared with the OECD countries. Lagging areas include evaluation of regulatory impacts, and effectiveness of consultation processes.

69. **Improving individual business regulations is a necessary condition but may not be sufficient if a country lacks a coherent and efficient strategy for the production of regulations.** Improving the efficiency of regulations is crucial for allocative efficiency and aggregate productivity. However, strengthening the regulatory environment and making it more efficient might not be enough to improve the quality of regulations and reduce excessive regulatory burden in the long term. As discussed by a recent OECD assessment, while Colombia has made

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34 Colombia Policy Notes, The Urgent Innovation Agenda—Governance, Knowledge, and Firms, 2014
35 Which does not require a joint execution by more than one institution.
important progress in introducing various regulatory reforms, it still lacks a comprehensive policy that promotes regulatory quality. Such a policy will introduce a systematic approach that requires evaluating the rationale behind specific regulations, their costs and benefits, and their legal coherence. This systematic approach should also incorporate a sound and clear consultation process. These issues are being addressed by the actions supported by this DPL series.

**DPL2 Prior Action #10:** In order to prevent new regulations from interfering with competitive practices, and in line with best practices from the Organization for Economic Co-operation and Development (OECD), the Government has established procedures that require all agencies drafting new regulations that could impact competitive practices to first consult with the Government’s Superintendence of Industry and Commerce.

70. This prior action complements the reforms in DPL1 and aims at improving the quality of regulatory policy in Colombia, and as a consequence increases the levels of trust, effectiveness, and transparency of the process of issuing regulations. The first DPL supported the GoC policy to strengthen economic and social efficiency of regulatory reforms, by introducing a comprehensive evaluation of externalities and implicit costs for the state, citizens, and businesses imposed by regulatory change to ensure the quality of regulations produced. The trigger contemplated for this operation, the “creation of a committee for improving the production of regulations” was partially achieved. The committee is currently operating and has held two meetings to date. However, the regulatory framework supporting its creation has been delayed because the Government decided to expand the scope of the committee. In addition to overseeing the evaluation of content, the committee is also responsible for improving the legal coherence and consultations of reforms. The procedures related to these last two aspects of regulatory productions, which, among other things, prevent reforms that increase barriers to competition, were established by Decree 1609 of August 10, 2015, in line with international best practices and OECD recommendations.

71. **Expected results:** Number of pilots implementing the new regulatory evaluation process, i.e., regulations whose efficiency, economic and social impacts have been evaluated (increased from 0 regulations in 2013 to 5 regulations 2016). This indicator has been updated. The Government has decided to pilot the evaluation procedures in a larger variety of sectors, focusing on one regulation per sector.

**Trade facilitation**

72. To expand its integration into global markets and comply with its international obligations, Colombia has to improve its trade facilitation. The Ministerial Conference of the World Trade Organization reached an ‘Agreement on Trade Facilitation’ in December 2013, which requires Colombia to align its trade facilitation framework with international standards. The country currently lags behind in this area with regard to regional and income peers; it ranks 97 (of 160) in the Bank’s 2014 trade logistics performance index—behind Mexico, Brazil, Peru, Chile, Ecuador, Venezuela, and Argentina—and a recent Bank Customs Assessment revealed that Colombian custom authorities apply only 40 percent of benchmark practices with respect to trade facilitation. This underperformance may limit the competitiveness-inducing effects of international trade and is especially detrimental to integration into global value chains in high-tech sectors where reliable and cost-effective movement of goods is essential. Overcoming
international trade bottlenecks helps decrease transaction costs and will makes Colombian exports more competitive.

73. **Given the relevance of this area, the programmatic operation supports Government efforts on trade facilitation reform.** The GoC has expressed its intention to address the existing lag in trade logistics performance. It outlined the role of enhanced public sector management for competitiveness in its development plan and regards trade facilitation as an important component of this goal. Bank involvement in this area is supportive to reform success. The reforms envisaged for trade facilitation have proven difficult in many other countries because these reforms usually involve many different agencies and asymmetrically affect different interest groups. In the case of Colombia, the GoC has outlined its political will for these reforms and it is committed to their implementation, particularly for streamlining customs procedures and increasing efficiency. The trigger considered for DPL2, “the restructuring of the Tax and Revenue Authority (DIAN), with the purpose of streamlining processes and improving efficiency and effectiveness,” could not be implemented. This reform would have important budgetary implications that are unfeasible under the current environment of low Government revenues due to low oil prices. Instead, the Government advanced other areas of the trade facilitation agenda.

**DPL2 Prior Action #11:** In order to facilitate international trade, the Government has: (i) streamlined the procedures for issuing authorizations to Authorized Economic Operators (AEO), and allowed AEO to be considered for streamlined procedures to clear customs; and (ii) implemented an integrated transit of goods with the Republic of Ecuador.

74. **The GoC continues to take steps to facilitate trading across borders.** In line with international best practices, the country has strengthened the figure of Authorized Economic Operator, selected through a risk-based framework comprising the four border institutions: Agriculture, Health, Customs, and Police (Decree 1894, September 22 2015). Operators, recognized as low risk, are eligible to streamline trade procedures by all four institutions under the single window for border services, significantly reducing border crossing time and cost for this operators. The regulation applies not only to exports but also to imports, transit, and special regimes. In parallel, the GoC has implemented the Andean International Transit of Goods (TIM) with Ecuador (Circular 22/DIAN, May 2015). The TIM system is a tool that allows the exchange of information, including customs procedures and quarantine concerns, in advance—before the arrival of transport to border crossings, ports, and airports. The TIM also allows traceability to transportation from the home country to the final destination and passing through transit countries. Ecuador is the third largest market for Colombia exports (4% of total exports in 2014) and an important destination for non-extractive products.

75. **Expected results.** The number of Authorized Economic Operators increased from 0 in 2013 to 30 in 2016 (there are currently 4 Authorized Economic Operator), and the release time of goods crossing the Ecuadorian border has decreased. By September 2015, 13 Authorized Economic Operators have been created.

76. **In addition, it is relevant to note that the GoC is in the advanced stages for the preparation of a new Customs Statute, which is at the core of the Governments’ customs modernization strategy.** Against the background of a rather complex institutional setup and political economy with respect to trade issues, Colombia’s current customs legislation is scattered
across various decrees, often patched and not aligned to international norms (such as the Revised Kyoto Convention on the Simplification and Harmonization of Customs and the recent World Trade Organization Agreement on Trade Facilitation). Therefore, the GoC is working on the legal reform (implemented through a decree) to create a new Customs Statute (Estatuto Aduanero).\textsuperscript{37} Once it is finalized, it will directly affect international trading firms and their competitiveness by alleviating the burden of excessive customs paperwork but also have a longer-term impact on further trade facilitation measures by establishing a legal basis for future reforms such as information technology-based customs procedures and an integrated and efficient risk administration system, which are expected to reduce processing time. The new Customs Statute is expected to modernize and simplify Colombia’s customs regulation while harmonizing it with international practices.

\textit{77. The policy actions supported under this second programmatic DPL are grounded in sound analytical work.}

\begin{table}[h]
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\begin{tabular}{|l|l|}
\hline
\textbf{Pillar 1: Fostering solutions to develop infrastructure financing and increasing access to finance for firms} & \\
\hline
\textbf{Prior Action #1:} In order to promote the financing of projects under the 4G Concession Program, the Government has: (i) reduced restrictions for pension funds to invest in private capital infrastructure funds; and (ii) eased the requirements for funding operations in international markets. & The Bank’s Colombia Financial Sector Assessment Program Update Capital Markets Technical Note (2014) analyzed that pension funds could be the main source of demand for infrastructure fixed-income instruments given their long-term investment horizons. It also highlighted the relevance of infrastructure financing for the 4G program and the country’s economic growth. In addition, CONPES 3760 of 2013 recommended that the MHCP consider alternative sources of financing for projects of the 4G program.
Government Policy Note (May 15, 2015) “Justification for the Decree Amending the Investment Regime of Institutional Investors” describes the Decree 1385 and explains the rationale behind the changes. \\
\hline
\textbf{Prior Action #2:} In order to improve and promote firms’ access to credit, the Government has: (i) further strengthened the collateral registry by regulating the mechanisms for the execution of guarantees, and electronically linking the collateral registry with the existing vehicle registry; and (ii) created a central registry for electronic invoices (Registro de Facturas Electrónicas) which, among other things, facilitates the use of invoices as collateral. & Insolvency Report on the Observance of Standards and Codes (2014) states that the Secured Transactions Act, adopted in August 2013, represents the modernization and reform of Colombian credit protection law. \\
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\end{tabular}
\caption{DPL Prior Actions and Analytical Underpinnings}
\end{table}

\textsuperscript{37} The old statute was approved in the early 1990s and is outdated.
**Prior Action #3:** In order to continue fostering capital markets development, the Government has: (i) established new governing rules for the management of mutual funds (Fondos de Inversión Colectiva); and (ii) set internal policies, procedures and operating systems for the custody of securities. "Documento Conceptual Reforma Normativa Fondos de Inversión en Colombia" describes the proposed regulations and explains the rationale behind the changes.

**Pillar 2: Building productive skills and improving their allocation**

**Prior Action #4:** In order to strengthen the Public Employment Service (PES), the Government has defined the institutional arrangements, responsibilities and information requirements for the implementation of the PES management and job placement tools.

**Prior Action #5:** In order to improve the formation of professional skills, the Government has: (i) created the national framework of professional qualifications and competencies, (ii) established a system of transfers and credits connecting the different branches of tertiary education, and (iii) defined the Ministry of Education as responsible for implementing this system.

**Prior Action #6:** In order to improve inclusive skills and income generation opportunities, the Government has established a special regime for the administration of the educational system for Indigenous Communities, including tertiary education.

**Pillar 3: Strengthening regulations that affect innovation and business efficiency**

**Prior Action #7:** In order to improve the effectiveness of public investment in innovation, the Government has: (i) defined the criteria for formulation, selection and approval of innovation projects financed with Royalties’ Resources, and (ii) created an information platform to monitor projects financed by royalties (MAPAREGALIAS).

**Prior Action #8:** In order to strengthen the system of tax benefits for innovation, the Government has defined the specific eligible expenses that could be granted as fiscal benefits, including firm-led innovation.

**Prior Action #9:** In order to improve the coordination and allocation of resources for productive development, the Government has unified its Governance System of Competitiveness and Innovation with its Governance System for Science Technology and Innovation at national and regional levels.

**Prior Action #10:** In order to prevent new regulations from interfering with competitive practices, and in line with best practices from the Organization for Economic Co-operation and Development (OECD), the Government has established procedures that require all agencies drafting new regulations that could impact competitive practices to first consult with the Government’s Superintendence of Industry and Commerce.


Regulatory Policy in Colombia: Going Beyond Administrative Simplification (OECD 2013).
**Prior Action #11:** In order to facilitate international trade, the Government has: (i) streamlined the procedures for issuing authorizations to Authorized Economic Operators (AEO), and allowed AEO to be considered for streamlined procedures to clear customs; and (ii) implemented an integrated transit of goods with the Republic of Ecuador.

| World Bank’s Logistics Performance Index and OECD’s 2013 Trade Facilitation Indicators outline Colombia’s potential for improvements in trade facilitation. OECD’s 2013 Trade Facilitation Indicators conclude that Colombia lags behind with respect to institutional coordination (such as electronic exchange of data and the use of risk management). |

### 4.3 LINK TO CPS AND OTHER BANK OPERATIONS

78. The DPL series is fully aligned with the FY12-FY16 Country Partnership Strategy (CPS) (discussed in July 2011) and with the CPS Progress Report (discussed in May 2014). In particular, the series contributes to the strategic Pillar 1, ‘Expanding Opportunities for Social Prosperity’ and Pillar 3, ‘Inclusive Growth and Enhanced Productivity’. Specifically, it supports the development objectives of: (a) improving coverage and monitoring of select social services, in particular for the poor; (b) increasing education for students from disadvantaged households; and (c) improving instruments to mobilize capital. While the DPL series was not contemplated in the CPS, it directly supports a number of overall intended outcomes and result indicators. In particular, the program of reforms supported by the DPL is expected to contribute to the following revised CPS results indicators: (a) increase in the coverage of municipalities that offer active labor market policies (including **Servicio Publico de Empleo** centers); (b) percentage of students enrolled in first year tertiary education; (c) strengthened capital markets oversight and institutions; (d) new financial products launched for the low-income population and SMEs; and (e) number of new instruments for infrastructure finance launched in the market.

79. This DPL is supported by the technical work developed under different thematic programmatic approaches (PAs) for Colombia. For example, reforms under Pillar 1 are closely related to the work of the Sound Financial Sector Development PA, which contributes to the sound development of the Colombian financial system with a view to support inclusive economic growth, through strengthening financial sector oversight, developing the capital markets, and supporting financial inclusion. Reforms under Pillar 2 have close links with the Institutional Development Fund Grant’s ‘Strengthening the Ministry of Labor’s Capacity to Design Interventions and Manage for Results’, which, among other things, supports the strengthening of the labor intermediation system and the Ministry of Labor’s capacity to respond to crises through the design and implementation of a temporary employment program and cyclical tools. Reforms under Pillar 3 are supported by the Innovation and Competitiveness PA, including an Innovation Public Expenditure Review (PER) currently under preparation. Additionally, reforms under Pillar 3 are closely related to the technical work carried out by the Public Sector PA and its support to the Modernization of the Colombian Tax and Customs System. The definition of the PDO and the overall diagnostic that supported the design of the operation were based on the work under the Strengthening Fiscal Policy for Sustained and Inclusive Growth PA and the Colombia Policy Notes. This DPL series follows a long engagement with Colombia through DPLs, including the Fiscal Sustainability and Growth Resilience DPL I (2011) and II (2012) and the Fiscal Policy for Shared Prosperity DPL (2013), and builds on the engagement developed during these operations.
This DPL also builds on a previous DPL series on business productivity and efficiency,\textsuperscript{38} implemented between 2006 and 2011. The DPL series focused on: (a) facilitating the operation of businesses and promoting investment to boost productivity and employment levels; and (b) consolidating the financial sector and capital markets as pillars of economic growth to address the needs of individuals and the productive sector. Many of the reforms supported by the proposed operation build on or provide continuity to early reforms supported by the previous DPL series.

4.4 CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

The policies supported by this DPL have been defined as a development priority in Colombia and many of them are embodied within the NDP 2014–2018. The NDP 2014–2018 is developed in consultation with the civil society; and a wide range of governmental and nongovernmental agencies and once approved, it will become a law of the GoC. According to Article 12 of Law 152 of 1994 the National Planning Council (Consejo Nacional de Planeación) is the responsible entity for conducting the public consultation process associated with Colombia’s NDP. The council must comprise national and local agencies and organizations that provide suggestions and recommendations on the most important chapters and building blocks of the NDP. The council is in charge of ensuring that a broad-based consultative process is conducted, representing a wide range of non-state organizations such as academia, religious groups, private sector, minorities, and so on.

The NDP is the result of a broad-based consultative process. For the 2014–2018 NDP, the main objective of the consultations was to have various sectors and local authorities participate and voice their opinion with respect to the proposed areas of action covered both in the base document as well as in the articles of the law. Between October 2014 and January 2015, 33 regional and 27 thematic forums were held around the country including over 7,000 participants. In December 2014, a National Congress of Participatory Planning (XVIII Congreso Nacional de Planeación Participativa) in the city of Ibague, Tolima was also conducted. Moreover, a pre-consultation process with indigenous communities and the Gitano community\textsuperscript{39} took place to agree on certain key protocols included in the ‘bases’ of the NDP document. Official consultations with minorities were concluded in mid-January 2015.

In addition to the consultation and participatory measures associated with the NDP, some prior actions were subject to other consultation processes. The Government has relied on several mechanisms to reach agreement on the reforms and to reflect not only rigorous technical analysis but also national consultative processes. For instance, the decrees regarding the Financial Regulation Unit (Unidad de Regulación Financiera [URF]) of the MHCP included a technical proposal paper explaining the rationale of the reform and the draft decree was then subject to consultations through the website of the MHCP. Reforms regarding Pillar 2, particularly the NQF, were discussed over meetings with a broad range of stakeholders, including SENA, private sector associations, and academia. Moreover, the decree involving indigenous communities (Decree

\textsuperscript{38} The DPL series comprises IBRD 73340 (P094301), IBRD 74130 (P095213), and IBRD 75340 (P105029) for a total of US$1.1 million.

\textsuperscript{39} Forty-three meetings with 30 entities and over 150 delegates from the indigenous communities were held, as well as 4 national meetings and 10 sectorial meetings with 28 entities and 22 delegates from the Gitano community.
1953), was drafted in a consultative manner after approximately 68 meetings with relevant stakeholders between November 2013 until September 2014.

84. **In terms of collaboration with other development partners, the Bank has collaborated with the IMF, OECD and IFC.** Overall, the proposed DPL program is consistent with the IMF policy advice. Particularly, the Bank has collaborated with the IMF on the review of macroeconomic developments, including fiscal projections and the analysis of debt sustainability. Moreover, the program supported by the operation is also consistent with the recommendation of the OECD accession process. Within the World Bank Group, we have also coordinated with the International Finance Corporation (IFC) on issues of access to finance and trade facilitation.

5. **OTHER DESIGN AND APPRAISAL ISSUES**

5.1 **POVERTY AND SOCIAL IMPACT**

85. **The Government policies supported under the proposed Second Programmatic Sustained Growth and Income Convergence Development Policy Operation are expected to have a positive poverty and social impact.** The actions supported by this operation that are intended to increase growth and productivity are likely to have similar impacts on poverty reduction and shared prosperity as those supported by the first DPL. The Poverty and Social Impact Assessment (PSIA) has been carried out, documenting these expected impacts from a social, gender, and distributional perspective. This assessment, explained in more detail in annex 5, presents the potential outcomes of the policy actions on overall growth, employment, and welfare of the poor and those in the bottom 40 percent of the income distribution.

86. **The PSIA is organized around the policy pillars outlined in this DPL2.** In particular, in Pillar 1, the policies that strengthen infrastructure financing and increase access to credit for firms are expected to have positive effects on employment (and formalization) and lead to a reduction in both moderate and extreme poverty, reduce transport and logistic costs helping to the reduction of regional disparities, and increase engagement of the poor in entrepreneurial activities contributing to the growth of the incomes of those in the bottom 40 percent of the income distribution. With respect to Pillar 2, the strengthening of the system for matching workers and vacancies is expected to increase the employability of the bottom 40 percent, as these groups rely more on their own informal networks to find employment. In addition, strengthening the professional training system targeted to the unemployed is expected to increase the probability of employment for the moderate and the extreme poor, particularly in the formal sector. Moreover, the creation of a special regime for indigenous territories that transfers resources for human capital formation to indigenous communities could increase access to general education and productive skills for these populations while preserving cultural traces and norms. This is expected to enhance the opportunities for indigenous communities which currently exhibit a higher incidence of extreme, moderate and multidimensional poverty with respect to the national average. Within Pillar 3, a better allocation of resources to fit regional priorities, and a better information platform to monitor financing from royalties, are expected to affect the efficiency of spending of limited public resources, although the direct effects on poverty and shared prosperity are not immediately clear. A proper implementation of incentives for R&D may potentially enhance growth, but the
direct effects on poverty and inequality reduction are ambiguous. Finally, trade facilitation has positive indirect effects on poverty and shared prosperity and may contribute to economic growth.

5.2 ENVIRONMENTAL ASPECTS

87. The proposed operation is not likely to have significant effects on the environment, forests, and other natural resources, and potential effects would be of indirect nature only. Based on a policy environmental assessment conducted by the World Bank in the context of this DPL series, a majority of the prior actions are not expected to produce significant effects on the environment. The reforms supported by the operation are regulatory and administrative in nature, with no direct link to physical infrastructure. Most relevant in this regard is prior action 1 (reducing restrictions of pension funds to invest in private infrastructure funds), which is expected to result in more efficient private sector financing for the 4G program, which includes a number of selected transport infrastructure investment projects. The construction of new roads under this program may have a negative environmental impact. This being said, the construction of alternative roads could reduce heavy traffic in urban areas and thereby have positive effects on noise and outdoor air pollution.

88. Colombia’s environmental legal and policy framework is expected to mitigate the negative effects. Colombia’s environmental licensing system dates back to the 1974 Code on Renewable Natural Resources and Environmental Protection. The requirement to carry out environmental assessments for projects with possible environmental impacts, in its current form in Colombia, is regulated by Law 99, adopted in 1993, and a series of subsequent modifications. As stipulated by the law, the Ministry of Environment and Sustainable Development, the regional environmental authorities, and municipalities, depending on the nature of the works, are responsible for issuing environmental licenses. In the case of the 4G program, which is centrally implemented and monitored, there are additional provisions for environmental protection and due diligence based on the national environmental regulations. The Government approved a 4G CONPES that sets guidelines for the allocation of environmental risks (particularly the responsibility for obtaining and managing environmental licenses) in the new pipeline of road concessions. More broadly, the Government continues its efforts to further strengthen its environmental management system in line with the green growth strategy adopted under the National Development Plan 2014-2018.40

5.3 PUBLIC FINANCIAL MANAGEMENT, DISBURSEMENT, AND AUDITING ASPECTS

89. The public financial management (PFM) systems are adequate to support the development policy operation. The national-level PFM systems show advanced levels of performance that are moving toward good international practices, according to the most recent

40The Colombia Second Programmatic Productive & Sustainable Cities Development Policy Loan” (P145766), and the “Colombia: Programmatic Development Policy Loan for Sustainable Development” (150475) support policies such as stringent standards for air and water quality; use of pollution charges and economic instrument for pollution management; policies associated with congestion charges and vehicle inspection; and the National Inventory of Settlements in High Risk.
reports from the IMF and Bank. There remain areas for further strengthening of PFM systems, such as budget management and integration with administrative management systems. In 2012, a new financial and administration system (Sistema Integrado de Información Financiera [SIIF II]) was put into operation, and an effort is under way to adopt a Unified System of Investment and Public Finance. The GoC has increased the coverage of SIIF II and is working on its integration with the different PFM tools. Colombia has an effective track record of implementing PFM reforms, which the Bank has supported. Salient features of the PFM systems are summarized below:

- **The budget is comprehensive, well documented, and implemented as planned, with actual expenditures deviating only slightly from planned levels.** Budget planning is based on a multiyear perspective, and annual formulation reflects a mostly well-functioning policy-based system. Execution of budgeted expenditures suggests a largely credible budget. The Government has published its annual budget in a timely fashion.

- **Revenue and expenditure controls are comprehensive, and there is a continuous effort to improve them.** Of significant relevance are strong measures to safeguard the overall integrity and accuracy of revenue data by integrating or reconciling the different accounting systems used by the tax administrator, ensuring consistency between the information from accounting and statistical records, and guaranteeing timely recording of transactions. Records and controls on cash flows, balances, and public debt support sound fiscal management and provide public institutions with the tools for predicting funding to execute their budgets in an orderly manner.

- **The consolidated public accounts are prepared within six months after the end of the fiscal year.** They include full information on revenues, expenditures, and financial assets and liabilities. Year-end accrual-based financial statements are issued by the Accountant General and presented by May 15 of the following year to the Controller General for audit purposes. The Controller General’s auditing policies and procedures provide for the application of financial, compliance, and performance procedures consistent with the National Government’s auditing standards. Audit reports are submitted before July 1 of the following fiscal year to the Congress and the President.

90. **The GoC is implementing an accounting and auditing reform agenda to adopt and implement international accounting (International Financial Reporting Standards) and auditing standards (International Standards on Auditing).** In the last three years, there have been significant developments toward implementing this reform, including new legislation and an inter-institutional commission involving key Government authorities to operationalize transitional

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42 These include the NDP, the fiscal rules, the Public Investment Program, the MTFF, the Medium-term Expenditure Framework, the Operative Annual Investment Plan, and the financial plan.
43 The country has developed key PFM multiannual instruments since 2003, such as the MTFF and Medium-term Expenditure Framework. However, they are presently not used adequately because they are developed in parallel with the budget instead of sequentially.
44 See IMF 2012 and the World Bank reviews 2013 for more information.
45 Law 1737 of December 2, 2014.
arrangements toward completing implementation.\textsuperscript{46} Going forward, there are still a few challenges for the GoC to overcome in the reform process.

91. **Disbursement arrangements.** Once the DPL becomes effective and the Borrower complies with any withdrawal tranche release conditions, following the Borrower’s request, the Bank will deposit the funds into an account denominated in U.S. dollars at the Central Bank (*Banco de la República*) for subsequent credit into the Treasury Single Account of the MHCP, thus becoming available to finance budgeted expenditures. The MHCP will provide the Bank with a written confirmation of the transaction within the 30 days after the funds are disbursed by the Bank. If the Bank determines at any time that an amount of the loan was used to make a payment for an excluded expenditure, the Borrower shall promptly, upon notice from the Bank, refund an amount equal to the amount of such payment to the Bank; and amounts refunded to the Bank upon such notice shall be cancelled from the loan.

92. **There is no evidence that the banking control environment into which the DPL proceeds would flow is inadequate.** This assessment is based on a review of the 2014 and 2013 external audit report of the *Banco de la República*, the latest IMF Central Bank safeguards assessment (2012), and the 2015 IMF Article IV Consultation. Because the borrower’s PFM systems and the fiduciary arrangements for this financing are assessed as adequate, the Bank will not require an audit of the designated account and no additional fiduciary arrangements are considered necessary at this time.

93. **In the area of public procurement, Colombia has made significant progress over the past six years in strengthening the performance of the procurement systems.** Procurement is based in the legal framework, i.e. the Law 1150/2007, and ruling decrees, the most recent 1510/2013. One of the most relevant steps forward is the creation (November 2011) of a Procurement Directorate (*Agencia Nacional de Contratación Pública, Colombia Compra Eficiente – CCE*) to oversee and lead the procurement reforms. The Agency has undertaken important steps to further improve the system, consolidate gains and ensure sustainability. To this end, the newly created Agency is working to implement an ambitious program including: (i) adopting a more strategic approach to procurement as an essential component of public sector expenditure management; (ii) establishing a transactional electronic procurement system, expected to become operational in 2015; and (iii) professionalizing the procurement staff while providing increased exposure to new, more efficient ways of doing business in Colombia and around the world. The Bank has been cooperating through direct dialogue with CCE and through a RAS in some of the initiatives to achieve these objectives. They may be mentioned as preliminary results of the measures being implemented by the Agency: (i) the use of the first framework contracts for fuel and insurance vehicles at local and national level respectively; (ii) the publication of standard bidding documents available for public works; (iii) Improved mechanisms for complaints and combating corruption. However, important challenges remain to continue adjusting the legal, institutional and operational frameworks to respond to the challenges in the market for new technologies and international practices.

\textsuperscript{46} Application of International Financial Reporting Standards started in January 1, 2015, for listed companies and will finish in January 1, 2016, for SMEs. Application of International Standards on Auditing is required from January 1, 2017.
5.4 MONITORING AND EVALUATION

94. The MHCP, DNP, and DANE are responsible for coordinating actions among the concerned agencies. The MHCP’s Department for Public Credit will collect the necessary data to assess the implementation progress for which the MHCP is responsible (including Pillar 1 and Pillar 3 - trade facilitation) and report it to the Bank. Similarly, the DNP will collect and report to the Bank the information related to the implementation progress of the program (Pillar 2 and Pillar 3 - promoting innovation and technological progress and improving regulatory efficiency). Finally, the DANE will be responsible for online release of national accounts, household survey microdata for replicating poverty, and other social indicators.

6. SUMMARY OF RISKS AND MITIGATION

95. This DPL is subject to risks related to a deteriorating external economic environment, possible changes in Government, and delays in reform program implementation. Despite solid fundamentals, Colombia’s near-term macroeconomic outlook could be adversely affected by deeper external shocks. This risk is mitigated by the country’s high policy response capacity. In addition, the Government has made important regulatory changes to help mitigate risks associated with implementing the reform program.

Macroeconomic Risks

96. Despite its relatively high exposure, Colombia has developed capacity to counter external shocks. Colombia is exposed to two main types of external shocks: a larger than expected decline in oil and mining prices, larger than expected impacts of low oil prices on commercial partners in LAC, and higher financial volatility associated with a possible tapering of the U.S. monetary policy. As discussed in the macroeconomic outlook section, Colombia has been already experiencing the effects of low international oil prices, through a slowdown in growth, tighter fiscal revenues, a larger current account deficit and a sharp currency depreciation. Real side impacts have been partially mitigated by sound economic policies. Colombia’s macro resilience is based on solid initial conditions and policy buffers built in the last decade. In addition, structural reforms, including those supported by this operation, will contribute to medium term growth, even if they are not able to compensate for adverse changes in the external environment. Prudent fiscal and monetary management are expected to smooth the transition to a lower potential growth level in light of the likely non-temporary commodity price shocks. Comfortable levels of foreign reserves remain an important buffer. Moreover, the contingent support of the FCL with the IMF is also another precautionary line of defense.

Institutional Capacity for Implementation and Sustainability Risks

97. While direct risks associated with the implementation of the prior actions are moderate, indirect risks associated with the armed conflict, which might affect the ability to reach desired results. The Government has made important regulatory changes to help mitigate risks associated with implementing reforms, but Colombia’s track record suggests that delays and interruptions could arise. Implementation risk could also arise from the armed conflicts, which could lead to blockages and interruptions or even risk the security of workers. Progress towards the conflict resolution can help reduce such implementation risks.
Environment Risks

As discussed in the environmental aspects sections, indirect environmental risks may arise from supporting private sector financing for transport infrastructure projects. Colombia’s environmental legal and policy framework is expected to mitigate these risks.

<table>
<thead>
<tr>
<th>Risk Categories</th>
<th>Rating (H, S, M, or L)</th>
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<tbody>
<tr>
<td>1. Political and governance</td>
<td>L</td>
</tr>
<tr>
<td>2. Macroeconomic</td>
<td>M</td>
</tr>
<tr>
<td>3. Sector strategies and policies</td>
<td>L</td>
</tr>
<tr>
<td>4. Technical design of project or program</td>
<td>L</td>
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<tr>
<td>5. Institutional capacity for implementation and Sustainability</td>
<td>M</td>
</tr>
<tr>
<td>6. Fiduciary</td>
<td>L</td>
</tr>
<tr>
<td>7. Environment and social</td>
<td>M</td>
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<tr>
<td>8. Stakeholders</td>
<td>L</td>
</tr>
<tr>
<td>9. Other</td>
<td>L</td>
</tr>
<tr>
<td><strong>Overall</strong></td>
<td>M</td>
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**ANNEX 1: POLICY AND RESULTS MATRIX**

<table>
<thead>
<tr>
<th>Prior Actions under DPL1</th>
<th>Prior Actions under DPL2</th>
<th>Results Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pillar 1 -- Fostering solutions to develop infrastructure financing and increasing access to finance for firms</strong></td>
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<tr>
<td><strong>Prior Action 1:</strong> The GoC has increased the individual credit limit of credit institutions to invest in projects under the 4G Concession Program (Decree #816, April 2014).</td>
<td><strong>Prior Action 1:</strong> In order to promote the financing of projects under the 4G Concession Program, the Government has: (i) reduced restrictions for pension funds to invest in private capital infrastructure funds; and (ii) eased the requirements for funding operations in international markets, as evidenced by the Government’s Decree No. 1385, dated and published in the Official Gazette on June 22, 2015; and the Government’s Bank of the Republic (Banco de la República) Resolution No.4, dated April 24, 2015.</td>
<td>Amount of financing allocated to the 4G concessions program by type of institution (increase from a baseline of 0 in 2013 to COP$6.5 billion from Banks, COP$ 2 billion from FDN, and COP$ 1.5 billion from AFPs in 2016).</td>
</tr>
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<td><strong>Prior Action 2:</strong> The GoC has authorized the use of movable assets as collateral in financial operations to improve access to credit (Law No.1676, August 20, 2013, Decree No. 400, February 24, 2014).</td>
<td><strong>Prior Action 2:</strong> In order to improve and promote firms’ access to credit, the Government has: (i) further strengthened the collateral registry by regulating the mechanisms for the execution of guarantees, and electronically linking the collateral registry with the existing vehicle registry; and (ii) created a central registry for electronic invoices (Registro de Facturas Electrónicas) which, among other things, facilitates the use of invoices as collateral, as evidenced by the Government’s Decree No. 1835, dated and published in the Official Gazette on September 16, 2015, and the Government’s Law No. 1753-2015 (National Development Plan 2014-2018), dated and published in the Official Gazette on June 9, 2015.</td>
<td>Number of registrations in the collateral registry (increase from a baseline of 0 transactions in 2013 to 1 million transactions in 2016).</td>
</tr>
<tr>
<td><strong>Prior Action 3:</strong> The GoC has expanded access to capital markets to a more diversified group of issuers and investors through: (i) the reform of the alternative issuance scheme (Segundo Mercado); (ii) the provision of specific guidelines related to the administration and management of mutual funds; and (iii) the establishment of stronger custody schemes for</td>
<td><strong>Prior Action 3:</strong> In order to continue fostering capital markets development, the Government has: (i) established new governing rules for the management of mutual funds (Fondos de Inversión Colectiva); and (ii) set internal policies, procedures and operating systems for the custody of securities, as evidenced by the following Circulares Externas (CE) from the Government’s Financial Superintendence</td>
<td>Number of new issuers that entered the market through the hybrid regime (increase from a baseline of 0 issuers in 2013 to 10 issuers in 2016) and the number of investors in mutual funds (Fondos de Inversión Colectiva).</td>
</tr>
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| Securities markets (Decree No. 1019, May 28, 2014; and Decrees 1242 and 1243, June 2013). | (Superintencencia Financiera de Colombia): CE No.015, dated and published on June 13, 2014; CE No.026, dated and published on September 15, 2014; CE No.031, dated and published on November 21, 2014; and CE No. 005 of 2015, dated and published on March 30, 2015. | Increase from a baseline of 1.34 million in 2013 to 1.5 million in 2016. |

**Pillar 2—Improving the quality and allocation of productive skills**

**Prior Action 4:** The GoC has created the Public Employment Service (PES) within its Ministry of Labor, including an upgraded unified national registry for unemployment and a system to match workers and vacancies (Law No. 1636, June 18, 2013; Decree No. 2521, November 15, 2013; Decree No. 2852, December 6, 2013; Decree No. 722, April 2013).

**Prior Action 4:** In order to strengthen the Public Employment Service (PES), the Government has defined the institutional arrangements, responsibilities and information requirements for the implementation of the PES management and job placement tools, as evidenced by the Government’s Ministry of Labor Resolution No. 1397, dated April 20, 2015 and published in the Official Gazette on April 27, 2015, the Government’s PES Special Administrative Unit (Unidad Administrativa Especial del Servicio Público de Empleo) Resolution No. 129, dated March 3, 2015 and published in the Official Gazette on March 4, 2015, the Government’s Ministry of Labor Resolution No. 3418, dated August 14, 2014, and the Government’s Ministry of Labor Resolution No. 2605, dated June 25, 2014 and published in the Official Gazette on July 1, 2015.

**Prior Action 5:** The GoC has strengthened professional training and skill formation by: (i) developing training courses for unemployed individuals that match labor market needs; and (ii) expanding the provision of training services through the authorization of non-profit entities as training providers (Decree 681, April 4, 2014; Decree No. 2852, December 6, 2013).

**Prior Action 5:** In order to improve the formation of professional skills, the Government has: (i) created the national framework of professional qualifications and competencies, (ii) established a system of transfers and credits connecting the different branches of tertiary education, and (iii) defined the Ministry of Education as responsible for implementing this system, as evidenced by the Government’s Law No. 1753-2015 (National Development Plan 2014-2018), dated and published in the Official Gazette on June 9, 2015.

**Prior Action 6:** In order to improve inclusive skills and income generation opportunities, the Government has established a special regime for the administration of the educational system for Indigenous Communities, including tertiary education, as evidenced by the Government’s Decree No. 1953, dated and published in the Official Gazette on October 7, 2014.

**Prior Action 6:** In order to improve inclusive skills and income generation opportunities, the Government has established a special regime for the administration of the educational system for Indigenous Communities, including tertiary education, as evidenced by the Government’s Decree No. 1953, dated and published in the Official Gazette on October 7, 2014.

Number of job placements achieved through the new system (increase from 166,000 in 2013 to 315,000 in 2016) and number of persons occupationally oriented and referred to management and placement services (increase from a baseline of 386,910 in 2013 to 1,120,000 in 2016)

Number of firms providing professional training (increase from a baseline of 0 UVAEs in 2013 to 40 in 2016) and number of qualification matrixes (defining the skills, knowledge, and aptitudes expected for each of the 8 education levels) prepared (increase from 0 in 2013 to 4 in 2016)

Number of communities certified and able to directly manage resources of the SGP, including earmarked transfers for education (increase from 0 in 2013 to 4 in 2016).
<table>
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<tr>
<th>Prior Action 6:</th>
<th>Prior Action 7: In order to improve the effectiveness of public investment in innovation, the Government has: (i) defined the criteria for formulation, selection and approval of innovation projects financed with Royalties’ Resources, and (ii) created an information platform to monitor projects financed by royalties (MAPAREGALIAS), as evidenced by the Government’s Law No. 1753-2015 (National Development Plan 2014-2018), dated and published in the Official Gazette on June 9, 2015; the Government’s National Planning Department Accord No. 0023, dated June 26, 2014 and published in the Official Gazette on June 27, 2014; the Government’s National Planning Department Accord No. 0027, dated April 30, 2015 and published in the Official Gazette on May 5, 2015; and the Government’s National Planning Department Accord No. 0032, dated and published in the Official Gazette on July 28, 2015.</th>
<th>Number of pilots implementing the new regulatory evaluation process, i.e. regulations whose efficiency, economic and social impacts have been evaluated</th>
<th>Number of innovation projects finance with royalties resources evaluated under the new methodology is expected to increase from 0 in 2013 to 20 in 2016.</th>
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<tr>
<td>The GoC has strengthened its system of tax credits for innovation, science and technology by: (i) defining the roles and responsibilities of its National Council of Tax Credits for innovation; and (ii) clearly identifying expenditure eligible for tax credits as well as mechanisms for monitoring and evaluation of tax credit resources (Decree No. 121, January 28, 2014; and Agreement No. 09, July 31, 2014).</td>
<td>In order to strengthen the system of tax benefits for innovation, the Government has defined the specific eligible expenses that could be granted as fiscal benefits, including firm-led innovation, as evidenced by the Government’s CONPES document No.3834, dated July 2, 2015.</td>
<td>Share of budgeted tax benefits for science, technology and innovation used by firms (increased from 16% of budget resources in 2013 to 50% of budget resources by 2016) Number of instruments, i.e. projects and programs, designed and implemented in a coordinated manner by institutions under the new unified Governance system (increased from 0 in 2013 to 30% of instruments designed and implemented in 2016).</td>
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<tr>
<td>Prior Action 8: In order to strengthen the system of tax benefits for innovation, the Government has defined the specific eligible expenses that could be granted as fiscal benefits, including firm-led innovation, as evidenced by the Government’s CONPES document No.3834, dated July 2, 2015.</td>
<td>In order to improve the coordination and allocation of resources for productive development, the Government has unified its Governance System of Competitiveness and Innovation with its Governance System for Science Technology and Innovation at national and regional levels, as evidenced by the Government’s Law No. 1753-2015 (National Development Plan 2014-2018), dated and published in the Official Gazette on June 9, 2015.</td>
<td>Number of instruments, i.e. projects and programs, designed and implemented in a coordinated manner by institutions under the new unified Governance system (increased from 0 in 2013 to 30% of instruments designed and implemented in 2016).</td>
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<tr>
<td>Prior Action 9: In order to improve the coordination and allocation of resources for productive development, the Government has unified its Governance System of Competitiveness and Innovation with its Governance System for Science Technology and Innovation at national and regional levels, as evidenced by the Government’s Law No. 1753-2015 (National Development Plan 2014-2018), dated and published in the Official Gazette on June 9, 2015.</td>
<td>In order to prevent new regulations from interfering with competitive practices, and in line with best practices from the Organization for Economic Co-operation and Development (OECD), the Government has established procedures that require all agencies drafting new regulations to consider the implications of their regulatory actions.</td>
<td>Number of instruments, i.e. projects and programs, designed and implemented in a coordinated manner by institutions under the new unified Governance system (increased from 0 in 2013 to 30% of instruments designed and implemented in 2016).</td>
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Prior Action 7: The GoC has established a procedure for the drafting of regulations, in line with OECD best practices, which reduces potential distortions and inefficiencies from regulatory reforms. (CONPES 3816, October 2, 2014).
that could impact competitive practices to first consult with the Government’s Superintendence of Industry and Commerce, as evidenced by the Government’s Decree No. 1609, dated and published in the Official Gazette on August 10, 2015.

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<th>Prior Action 11:</th>
<th>In order to facilitate international trade, the Government has: (i) streamlined the procedures for issuing authorizations to Authorized Economic Operators (AEO), and allowed AEO to be considered for streamlined procedures to clear customs; and (ii) implemented an integrated transit of goods with the Republic of Ecuador, as evidenced by the Government’s Decree No. 1894, dated and published in the Official Gazette on September 22, 2015; and the Government’s Direction of National Taxes and Customs (DIAN) Circular No. 22, dated May 28, 2015.</th>
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<tbody>
<tr>
<td>Number of Authorized Economic Operators</td>
<td>(increased from 0 in 2013 to 5 in 2016).</td>
</tr>
</tbody>
</table>

Number of Authorized Economic Operators (increased from 0 in 2013 to 30 in 2016)
Bogotá D.C., octubre 23 de 2015

Señor
JIM YONG KIM
Presidente
Grupo Banco Mundial
Washington, D.C.

Asunto: Carta de Política – DPL de Crecimiento Sostenido y Convergencia del Ingreso II

Estimado Señor Kim,

La economía colombiana ha presentado un crecimiento promedio cercano al 5 % durante los últimos años, el cual es el más alto desde la década de los setenta. Este crecimiento, acompañado de políticas adecuadas, ha sido fundamental para la generación de empleo y la reducción de la pobreza y la informalidad. Es gracias a esta dinámica económica que el Plan Nacional de Desarrollo (PND) 2014 – 2018 “Todos por un nuevo país” pudo trazarse como principal objetivo el obtener avances especialmente en términos de paz, equidad y educación, a partir de un crecimiento económico fuerte y ambientalmente sostenible.

En 2014 la economía alcanzó un crecimiento de 4,6 %, cifra muy similar a la proyectada por el gobierno (4,7 %). Los sectores que más dinamizaron la economía fueron el de servicios financieros, actividades sociales y construcción, los cuales contribuyeron conjuntamente con 2,5 puntos porcentuales al crecimiento del PIB total. El sector minero no presentó el comportamiento que se esperaba y cerró el año exhibiendo una contracción de 0,2%. La industria, por su parte, tampoco tuvo la dinámica proyectada inicialmente, al crecer 0,2%.

La mejora en los indicadores macroeconómicos y fiscales generó un aumento en la confianza de los inversionistas en Colombia. Un reflejo de lo anterior es que en 2014 la inversión como porcentaje del PIB haya alcanzado el 26,5 %, casi 2 puntos porcentuales por encima del valor observado en 2013 (24,3 %), y que en el primer trimestre de 2015 se haya podido observar un máximo histórico de 30,5 %, 1,2 puntos porcentuales más que el registro del primer trimestre de 2014.

Para el 2015 prevemos una desaceleración de la economía colombiana como resultado de la fuerte caída en los precios del petróleo, coyuntura que ha impactado el ingreso
permanentemente los colombianos y, en particular, los ingresos fiscales. Los menores precios se han traducido en un menor valor de las exportaciones y en una caída en los términos de intercambio para el país, aumentando así el déficit en cuenta corriente. Por su parte, la tasa de cambio ha actuado como un estabilizador automático -al depreciarse, lo que ha incentivado la desaceleración de las importaciones, y se proyecta que impulse el aumento paulatino de las exportaciones no-minero energéticas.

Esperamos que la recuperación de las economías avanzadas (Estados Unidos y Eurozona) incremente la demanda por bienes manufacturados, lo cual contrarrestaría en parte la disminución de la demanda por materias primas, contribuyendo a la corrección de los desequilibrios externos que muestra América Latina. Lo anterior, acompañado de un ajuste en la estructura fiscal de algunos países de la región, de tal forma que puedan soportar su crecimiento y amortiguar el valor de su deuda externa. A pesar de los ajustes financieros y las decisiones de política monetaria que se tomen en Estados Unidos, anticipamos un aumento gradual de los flujos de capital dirigidos al sector productivo de las economías emergentes y mejoras en su competitividad, esto último como resultado de la devaluación de sus monedas.

Por otro lado, y en virtud del manejo coherente que el Gobierno Nacional ha dado a su política monetaria, la tasa de inflación en 2014 se ubicó en 3,66 %, mientras que en lo corrido de 2015 (a septiembre) se ha presentado una aceleración que la ubica en 5,35 %. Este comportamiento se explica por los choques de oferta de alimentos relacionados con el Fenómeno del Niño, así como por la depreciación de la moneda que se ha traducido en el aumento de los precios de bienes transables.

Para 2015 esperamos que el consumo privado crezca a una tasa de 3,4 %, mostrando una leve desaceleración con respecto al resultado de 2014, como consecuencia del enfriamiento de la economía, lo que afectará el ingreso disponible de los hogares. Cabe destacar que los resultados en materia de reducción de la pobreza, la contracción del desempleo y los avances en formalización laboral alcanzados en los últimos años han contribuido con la consolidación de una nueva clase media que continuará sustentando el consumo de los hogares.

En consideración a los logros obtenidos y al contexto descrito en los párrafos anteriores, reconocemos que aún falta afianzar aspectos de política que permitan garantizar una senda de crecimiento sostenido en el mediano plazo, entre otros, a través de incremento de la productividad y la competitividad.

En materia de empleo, se crearon 263 mil puestos de trabajo en agosto de 2015 frente a mismo mes del año anterior. Por su parte, en agosto de 2015 la tasa de desempleo para el total nacional se ubicó en 9,1 %, levemente superior a la registrada un año atrás (8,9 %); el promedio de los últimos 12 meses se ubica en 8,9 %, manteniéndose en niveles históricamente bajos.

A pesar de lo anterior, reconocemos que aún tenemos un amplio camino por recorrer para incrementar la productividad y competitividad, y contar con el acompañamiento del Banco
para alcanzar estos propósitos, a través del ciclo programático de ‘Crecimiento Sostenido y Convergencia del Ingreso’, será un factor crucial para continuar impulsando políticas públicas en estas materias.

La segunda fase del programa diseñado con el Banco mantiene los mismos objetivos de la primera fase, implementados bajo tres pilares: i) promoción del financiamiento y el incremento del acceso al crédito por parte de las empresas privadas para el desarrollo de la infraestructura, ii) mejoramiento de la calidad y la focalización de los esfuerzos estatales para el desarrollo de las capacidades productivas de la población, y iii) aumento de la productividad mediante la promoción de la innovación y un entorno regulatorio eficiente.

En el marco del primer pilar, el Gobierno Nacional pudo avanzar significativamente en la expedición de normativa relacionada con la financiación de infraestructura. Con el fin de impulsar el programa de concesiones de cuarta generación (4G), que funciona bajo el esquema de Asociaciones Público-Privadas (APP), adoptó medidas para facilitar a los intermediarios del mercado cambiario, entre otros, el acceso al financiamiento en el exterior (Resolución Externa Nº 4 de 2015, Banco de la República), y otorgó incentivos para que los inversionistas institucionales se involucren en el financiamiento de los proyectos 4G (Decreto 1385 del 22 de junio de 2015 a través del cual se realizan modificaciones al régimen de inversiones de las Sociedades Administradoras de Fondos de Pensiones y Cesantías (AFP), las Entidades Aseguradoras y las Sociedades de Capitalización, permitiéndoles adquirir compromisos y realizar inversiones en empresas y proyectos productivos).

De igual forma, y en línea con los objetivos planteados en el PND 2014-2018, se implementaron acciones para mejorar la competitividad de las empresas a través del mejoramiento de su acceso a fuentes de financiamiento y la generación de incentivos que combatan la informalidad, tales como: i) aumento la bancarización y profundización del mercado de capitales, ii) profundización de la implementación de la Ley de Garantías Mobiliarias (Ley 1676 de 2013), y iii) masificación de la factura electrónica como título valor.

Para profundizar el mercado de capitales, el Gobierno Nacional estableció reglas para la administración, gestión y distribución de los Fondos de Inversión Colectiva, definiendo y ajustando las políticas, esquemas y procedimientos para el manejo de estos recursos. Así mismo, a través de la Superintendencia Financiera, definimos los ajustes en políticas, procedimientos, reglas y sistemas operativos que deben adelantar las entidades responsables por la custodia de valores (Sociedades Fiduciarias, Fondos de Inversión Colectiva) para garantizar el adecuado ejercicio de su actividad, así como las instrucciones y cronogramas que deberán cumplir los proveedores de infraestructura y custodiados con quienes estas últimas interactúen para efecto.

Por otra parte, seguimos avanzando en la implementación del uso de garantías mobiliarias como colateral para el acceso a crédito, reduciendo el periodo de ejecución de garantías, los costos de transacción e incentivando la transparencia a través del registro de vehículos como colaterales (Decreto 1835 de 2015). Finalmente, a través del
Artículo 9 de la Ley del PND, creamos el Registro de Facturas Electrónicas mediante el cual se incluirán las facturas electrónicas que sean consideradas como título valor, permitiendo consultar información y tener trazabilidad con las mismas, cumpliendo así con los principios de unicidad, autenticidad, integridad y no repudio de la factura electrónica.

Relacionado con el segundo pilar, implementamos estrategias transversales y acciones de política cruciales en materia de educación y empleo de alta calidad para alcanzar uno de los objetivos principales del PND: la movilidad social. La educación es una de las dimensiones más importantes para la movilidad social, dado que permite formar el capital humano y construir competencias para el desarrollo social y productivo de las personas, por esta razón, el Gobierno Nacional creó el ‘Marco Nacional de Cualificaciones’ como un instrumento para clasificar y estructurar los conocimientos, las destrezas y las aptitudes de la población y así mejorar sus capacidades profesionales (artículo 58 del PND 2014-2018). En paralelo se ha avanzado en la consolidación de las Unidades Vocacionales de Aprendizaje en Empresa (UVAES) mediante la definición de directrices y lineamientos que dicten la reglamentación general de la operación de las mismas, con el fin de incentivar la creación de nuevas UVAES por parte de las empresas, incentivando así la formación profesional del capital humano.

En otra dimensión, el Gobierno nacional, a través del Ministerio del Interior, estableció los lineamientos para la administración del Sistema Educativo Indígena Propio (SEIP) con el fin de garantizar la formación de capital humano en las comunidades indígenas. Lo anterior incluye la etapa semillas de vida, preescolar, básica y media, y establece la naturaleza y creación de ‘Instituciones de Educación Superior Indígenas Propias’; esto, a través del Decreto 1953 de 2014 mediante el cual se dictaron disposiciones en los Territorios Indígenas relacionadas con la administración de los propios sistemas de estos pueblos.

En materia de empleo de alta calidad, hemos trabajado para fortalecer los procesos de gestión e intermediación laboral mediante la creación del ‘Servicio Público de Empleo’ (SPE), cuya operación se espera consolidar y masificar en todo el país. Específicamente, avanzamos en la reglamentación e implementación del SP a través de la definición de los procedimientos para el registro de vacantes por parte de los empleadores, las condiciones básicas y el procedimiento para el registro de prestadores del mismo, así como en la definición de las obligaciones que tendrán estos prestadores (Resolución 2605 de 2014; Resolución 129 de 2015 y Resolución 1397 de 2015).

Adicionalmente, y en línea con el objetivo de incrementar la competitividad nacional, el Gobierno ha logrado importantes avances incentivando la innovación y mejorando el ambiente regulatorio. Es así que, con el fin de mejorar la eficiencia y efectividad en el gasto de los recursos de regalías destinados a ciencia, tecnología e innovación, el Gobierno Nacional, a través del Acuerdo 0023 de 2014 del DNP, creó ‘Maparegalías’ como una plataforma de información mediante la cual se monitorea el uso de los recursos del Sistema General de Regalías.
Finalmente, y desarrollo del tercer y último pilar de la línea programática, el Gobierno continuó trabajando en la definición de incentivos tributarios para promover la inversión en ciencia, tecnología e innovación por parte de las empresas. (Documento CONPES 3384 de Beneficios Tributarios). Adicionalmente, a través del artículo 186 del PND, dispuso la integración del 'Sistema de Competitividad e Innovación' con el 'Sistema de Ciencia, Tecnología e Innovación', para consolidar un único 'Sistema de Competitividad, Ciencia, Tecnología e Innovación' y de esta manera mejorar la coordinación y distribución de recursos destinados para el desarrollo productivo tanto a nivel nacional como territorial, razón por la cual el mencionado artículo estipula claramente que las distintas instancias departamentales que promueven agendas de competitividad, productividad, ciencia, tecnología e innovación deberán integrarse a las Comisiones Regionales de Competitividad en cada departamento, con el propósito de articular sus agendas de trabajo y garantizar implementación de la Agenda Nacional de Competitividad, Ciencia, Tecnología e Innovación.

En cuanto a mejora normativa, y de conformidad con las buenas prácticas de la OCDE, definimos una estrategia en el PND que nos permita racionalizar la regulación y así incrementar la productividad de las empresas colombianas. Como resultado de la misma, creamos la 'Comisión Intersectorial para la Armonización Normativa', con el fin de apoyar al Estado en el proceso de depuración del ordenamiento jurídico y formular recomendaciones sobre producción normativa. En forma paralela, estamos trabajando en dos frentes: por un lado, expedimos el Decreto 1609 de 2015, el cual establece directrices generales de técnica normativa para la elaboración de proyectos de decretos y resoluciones para la firma del Presidente de la República, con el fin de racionalizar la expedición de normas y así mejorar procedimientos para la emisión de nueva regulación que pueda representar barreras a la competitividad. Por el otro lado, estamos trabajando en la definición de un documento de política a través del cual establezcamos lineamientos claros en el proceso de producción normativa de la rama ejecutiva del poder público, promoviendo la consistencia e integridad legal de las normas y complementando las acciones del Documento CONPES 3816 de 2014.

Para terminar, hacemos referencia al 'Programa del Operador Económico Autorizado (OEA)' que tiene el país desde el 2011, el cual ha sido implementado bajo el liderazgo de la Dirección de Impuestos y Aduanas Nacionales de Colombia, en coordinación con otras entidades de gobierno, el sector privado y otras autoridades de control, y cuyo propósito es la adopción de mejores prácticas en materia de seguridad de la cadena de suministro internacional y facilitación del comercio global. Fortalecimos el mencionado programa expidiendo el Decreto 1894 de 2015, con el fin de ajustar el esquema de la autorización del OEA a los estándares internacionales establecidos en el 'Marco Normativo para Asegurar y Facilitar el Comercio Global de la Organización Mundial de Aduanas', redefinir el objeto y funciones de la Comisión Intersectorial del OEA, ajustar el alcance y la estructura de la autorización mediante la creación de categorías con sus correspondientes condiciones, requisitos y beneficios, y reducir las etapas del procedimiento de autorización para garantizar las condiciones de seguridad, facilitar el comercio exterior y fortalecer los lazos comerciales entre países.
Como medida adicional para fortalecer el comercio exterior de los países de la Comunidad Andina de Naciones, actualmente está en curso una iniciativa para establecer una 'Red de Transmisión Electrónica de Datos' entre las autoridades aduaneras de los miembros. Enmarcado en lo anterior, junto con la República de Ecuador, estamos desarrollando un piloto para la implementación de un Sistema Informático TIM (Tránsito Internacional de Mercancías) que nos permitirá intercambiar información aduanera, adoptar formatos electrónicos y esquemas de seguridad, con miras a facilitar y automatizar los procedimientos que realizan los usuarios aduaneros de nuestros países.

En virtud de lo antes expuesto, reiteramos la importancia que tiene para Colombia el acompañamiento del Banco Mundial como socio estratégico para la implementación de esta agenda de acciones de política que sin duda contribuirán significativamente a darle sostenibilidad al crecimiento de nuestra economía, en línea con los objetivos y metas en materia de paz, equidad y educación que nos trazamos como país y que refleja nuestro Plan Nacional de Desarrollo 2014-2018.

Agradeciendo su atención, reciba un cordial saludo,

Mauricio Cárdenas Santa María
Ministro
Ministerio de Hacienda y Crédito Público

Simón Gaviria Muñoz
Director General
Departamento Nacional de Planeación
English Translation of Letter of Development Policy

Bogota, October 23, 2015

Mr.
JIM YONG KIM
President
World Bank Group
Washington DC.

Subject: Letter of Development Policy – Sustained Growth and Income Convergence
DPL II

Dear Mr. Yong,

The Colombian economy has had an average growth of nearly 5% in recent years, which is the highest since the seventies. This growth, together with appropriate policies, has been instrumental in generating employment and reducing poverty and informality. It is thanks to this economic dynamic that the National Development Plan (NDP) 2014-2018 "All for a new country" could trace its main objective to obtain advances especially in terms of peace, equality and education, from environmentally sustainable and strong economic growth.

In 2014, the economy grew 4.6%, very similar to the government’s projection (4.7%). The sectors that stimulated the economy the most were financial services, social activities and construction, which all together contributed 2.5 percentage points to overall GDP growth. The mining sector did not present the behavior expected and ended the year showing a contraction of 0.2%. Meanwhile, the industry sector, also failed the initial projected dynamic, growing 0.2%.

The improvement in the macroeconomic and fiscal indicators generated an increase in investor confidence in Colombia. A reflection of this is that in 2014 the investment to GDP ratio reached 29.5%, almost 2 percentage points above the value observed in 2013 (27.6%), and in the first quarter of 2015 it has been observed a record high of 30.5%, 1.2 percentage points higher than in the first quarter of 2014.

For 2015 we expect a slowdown of the Colombian economy as a result of the sharp decrease in oil prices, situation that has impacted the permanent income of Colombians and, particularly, tax revenues. The lower oil prices have led to lower value of exports and a fall in the terms of trade for the country, increasing the current account deficit. Meanwhile, the exchange rate has performed as an automatic stabilizer -as it depreciated, which has promoted a deceleration in imports, and it is projected to boost the gradual increase in non-mining energy exports.

We expect that the recovery in advanced economies (United States and Eurozone) will increase the demand for manufactured goods and thereby partially offset the decline in demand for raw materials, contributing to the correction of external imbalances shown in Latin America. This, accompanied by an adjustment to the tax structure of some countries in the region, so that they can support growth and dampen the value of its foreign debt. Despite the financial adjustments and
monetary policy decisions taken in the United States, we anticipate a gradual increase in capital flows to the productive sector of emerging economies and improve their competitiveness, the latter as a result of the devaluation of their currencies.

On the other hand, and pursuant to the coherent management that the Government has given to its monetary policy, the inflation rate in 2014 stood at 3.66%, while thus far in 2015 (through September) inflation has increased to 5.35%. This behavior is explained by food supply shocks related to El Niño, as well as the depreciation of the currency that has led to increasing prices of tradable goods.

For 2015 we expect private consumption to grow at a rate of 3.4%, showing a slight deceleration compared to 2014 results, due to the cooling-off of the economy, thereby affecting households’ disposable income. It is noteworthy that the results in poverty reduction, unemployment contraction and the advances in labor formalization made in recent years have contributed to the consolidation of a new middle class that will continue to sustain household consumption.

Considering the achievements made and in the context described above, we recognize that there are still policy aspects to be strengthened to guarantee a path of sustained growth in the medium term, among others, through increased productivity and competitiveness.

In terms of employment, 263 thousand jobs were created in August 2015 compared to the same month in the prior year. In turn, in August 2015 the national unemployment rate stood at 9.1%, slightly higher than that recorded a year ago (8.9%); the average of the last 12 months stands at 8.9%, remaining at historically low levels.

Despite this, we recognize that we still have a long way to go to increase productivity and competitiveness, and having the Bank's support to achieve these purposes, through the programmatic cycle of 'Sustained Growth and Income Convergence', will be a critical factor to continue promoting public policies in these areas.

The second phase of the program designed with the Bank maintains the same objectives of the first phase, implemented under three pillars: (i) fostering solutions to develop infrastructure financing and increasing access to finance for firms; (ii) building productive skills and improving their allocation; and (iii) increasing productivity through innovation promotion and an efficient regulatory environment.

In the framework of the first pillar, the national government could make significant progress in the issuance of regulations related to the financing of infrastructure. In order to promote the fourth generation concessions program (4G), which functions under the scheme of Public-Private Partnerships (PPPs) the government adopted measures to facilitate to the exchange rate market intermediaries, among others, the access to external financing (External Resolution No. 4 of 2015, Bank of the Republic), and provided incentives to promote institutional investors involvement in financing 4G projects (Decree 1385 of June 22, 2015 through which modifications are made to the investment regime of the Pension Funds (AFPs), Insurance Companies and Capitalization Companies, enabling them to acquire commitments and investments in firms and productive projects).
Similarly, and in line with the objectives outlined in the NDP 2014-2018, actions were implemented to improve the competitiveness of companies by improving their access to funding sources and the creating incentives to combat informality, such as: i) increase access to banking and development of capital markets, ii) deepening the implementation of the Law on Secured Transactions (Law 1676 of 2013), and iii) standardization of electronic invoicing as securities.

To deepen capital markets, the Government established rules for the administration, management and distribution of Collective Investment Funds, defining and adjusting policies, structure and procedures for the management of these resources. Likewise, through the Financial Superintendence, we defined adjustments to policies, procedures, rules and operating systems that the entities responsible for the custody of securities (Corporate Trust, Investment Funds Collective) must implement to ensure the proper exercise of their activity as well as instructions and schedules to be met by providers of infrastructure and guarded with whom the latter interact to effect.

On the other hand, we continue to make progress in implementing the use of movable assets as collateral for access to credit, reducing the period of execution of guarantees, transaction costs and encouraging transparency through vehicle registration as collateral (Decree 1835 2015). Finally, through Article 9 of the NPD Law, we created the Registry Electronic Invoice through which electronic invoices are considered as a title, allowing to access and trace information, thus complying with the principles of uniqueness, authenticity, integrity and non-repudiation of electronic invoicing.

Related the second pillar, cross-cutting strategies, crucial policy actions in education, and high quality employment have been implemented to achieve one of the main objectives: social mobility. Education is one of the most important dimensions of social mobility, since it allows human capital formation and to build skills for social and productive development of the people, for this reason, the National Government created the “National Qualifications Framework” as an instrument to classify and structure knowledge, skills and abilities of the population and improve their professional skills (Article 58 of the NPD 2014-2018). Parallel progress has been made in strengthening the Firms’ Vocational and Learning Units (UVAES) by defining directives and guidelines that dictate the general rules of their operation, in order to encourage the creation of new UVAES by firms, and thus encouraging human capital professional formation.

In another dimension, the Government, through the Ministry of the Interior, established guidelines for the administration of the Indigenous Education System (SEIP) in order to ensure the formation of human capital in indigenous communities. This includes the stages of seeds of life, preschool, primary and secondary education, and establishes the nature and creation of their own “Higher Education Institutions Indigenous”; this, through Decree 1953 of 2014 by which provisions were enacted in relation to the own administration of systems of these indigenous territories.

Regarding employment of high quality, we have worked to strengthen management processes and job placement through the creation of 'Public Employment Service' (SPE), whose operation is expected to consolidate and expand across the country. Specifically, we have advanced in the regulation and implementation of the SPE through the definition of the procedures for registration
of vacancies by employers, the basic conditions and the procedure for registration of providers, as well as defining the obligations of these providers (Resolution 2605 of 2014, Resolution 129 of 2015 and Resolution 1397 of 2015).

Additionally, and in line with the objective of increasing national competitiveness, the Government has made significant progress by encouraging innovation and improving the regulatory environment. Thus, in order to improve efficiency and effectiveness in the royalty resources for science, technology and innovation, the National Government, through the DNP Resolution 0023 of 2014 created 'Maparegalías' as an information platform whereby the use of resources of the General System of Royalties is monitored.

Finally, in the third and final pillar of the programmatic line, the government continued to work on the definition of tax incentives to promote investment in science, technology and innovation by firms. (Tax Benefit CONPES 3384). Additionally, Article 186 of the NDP, ordered the integration of the 'System for Competitiveness and Innovation' with the “System of Science, Technology and Innovation”, to consolidate a unique governance system for “Competitiveness, Science, Technology and Innovation” and thus improve coordination and distribution of resources for productive development at national and regional level, which is why the article clearly states that the various departmental agencies which promote agendas of competitiveness, productivity, science, technology and innovation must be integrated in Regional Competitiveness Committees in each department, in order to articulate their agendas and ensure implementation of the National Agenda on Competitiveness, Science, Technology and Innovation.

Regarding the improvement of regulatory efficiency, and in accordance with best practices of the OECD, we defined a strategy in the NDP that allows us to rationalize regulation and thereby increase productivity of Colombian firms. As a result, we created the “Intersectoral Commission for Regulatory Harmonization” in order to support the Government in the process defining a coherent organization of the legal process and precise formulation of recommendations on the production of normative. In parallel, we are working on two fronts: first, we issued Decree 1609 of 2015, which establishes general guidelines for technical standards for the drafting of decrees and resolutions signed by the President of the Republic, to streamline the issuance of rules and improve procedures for issuing new regulation that may pose barriers to competitiveness. On the other hand, we are working on defining a policy document that establishes clear guidelines in the process of normative production on the executive branch of government, promoting consistency and legal integrity of the rules and complementing actions of the CONPES 3816 of 2014.

Finally, we refer to the “Authorized Economic Operator Program” (OEA) that the country has since 2011, which has been implemented under the leadership of the National Tax and Revenue authority of Colombia, in coordination with other government entities, the private sector and other supervisory authorities, with the purpose of adopting the best practices in international supply chain safety and global trade facilitation. We strengthened the program by issuing the Decree 1894 of 2015, in order to adjust the OEA authorization scheme to international standards set forth in the “Framework of Standards to Secure and Facilitate Global Trade of the World Customs Organization”, redefining the purpose and functions of the OEA’s Inter-Sectoral Commission, adjusting the scope and structure of the authorization by creating categories with their specific
conditions, requirements and benefits, and reducing the stages of the authorization procedure to ensure safety conditions, facilitate trade and strengthen commercial ties between countries.

As an additional measure to strengthen foreign trade of the countries of the Andean Community, an initiative is currently underway to establish “Electronic Data Transmission” between member customs’ authorities. Framed within this, along with the Republic of Ecuador, we are developing a pilot project for the implementation of a computer system TIM (International Transit of Goods) that will enable us to exchange customs information, adopt electronic formats and security schemes in order to facilitate and automate procedures performed by customs users of our countries.

Taking into consideration the above, we reiterate the importance of the World Bank's support for Colombia, as a strategic partner to implement this agenda of policy actions that will certainly contribute significantly to the sustainable growth of our economy, in line with the objectives and goals on peace, equity and education that we set for ourselves as a country, and which are reflected in our National Development Plan 2014-2018.

Sincerely yours,

Mauricio Cárdenas Santa María
Minister
Ministry of Finance and Public Credit

Simón Gaviria Muñoz
General Director
National Development Department
Press Release No. 15/281
June 17, 2015
IMF Executive Board Approves New Two-Year US$5.45 Billion Flexible Credit Line
Arrangement for Colombia

The Executive Board of the International Monetary Fund (IMF) today approved a successor two-year arrangement for Colombia under the Flexible Credit Line (FCL) in an amount equivalent to SDR 3.87 billion (about US$5.45 billion). The Colombian authorities stated their intention to treat the new arrangement as precautionary and do not intend to draw on it.

Following the Executive Board’s discussion on Colombia, Mr. David Lipton, First Deputy Managing Director and Acting Chairman of the Board, issued the following statement: “Colombia has a track record of very strong policy frameworks, including an inflation-targeting regime, a flexible exchange rate, effective financial sector supervision and regulation, and a fiscal policy guided by a structural balance rule. The authorities are firmly committed to maintain such policies and undertake further initiatives to strengthen the resilience of the economy, boost competitiveness, and foster inclusive growth.

“Colombia’s macroeconomic policies have provided flexibility to mitigate the impact of the recent sharp decline in world oil prices. The fiscal rule represents an important buffer against oil price fluctuations, allowing a smooth adjustment of expenditure to a dimmer medium-term oil outlook. The flexible exchange rate regime continues to play an important shock-absorbing role in helping the economy adapt to shifts in global economic and financial conditions, and the banking and corporate sectors remain in good financial health. The central bank has also taken advantage of abundant capital inflows to further build up international reserves.

“However, adverse external risks pose strong headwinds, and, if they materialize, could weaken the country’s external position. Access to the Fund’s FCL will continue to play a significant role in supporting the authorities’ policies in the presence of these downside risks. A successor FCL arrangement, which the authorities intend to continue to treat as precautionary, will provide policy flexibility and serve as a temporary insurance that reinforces market confidence. The authorities intend to phase out the use of the FCL facility as global risks affecting Colombia decrease substantially.”

Press Release No. 15/236
May 29, 2015
IMF Executive Board Concludes 2015 Article IV Consultation with Colombia

On May 18, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Colombia.

Colombia has enjoyed strong growth over the past several years, among the highest in Latin America. Credible fiscal and inflation targeting frameworks have supported sound macroeconomic policy management, which underpinned robust economic performance during the last decade.
Social indicators have improved steadily over this period. Public debt remained low, Colombia’s foreign exchange reserve position strengthened, and the Flexible Credit Line arrangement provided a buffer against elevated external tail risks. The authorities continued to improve the fiscal policy framework and strengthen the social safety net.

Real GDP grew by 4.6 percent in 2014. Unemployment declined to an average of about 9 percent during the year. In the second half of 2014, global oil prices fell sharply by about 40 percent and the peso depreciated, especially in the fourth quarter. As inflation began rising to the mid-point of the target band, and given the slightly positive output gap, the central bank raised the policy rate by 125 basis points to 4.5 percent between May and August. The central Government fiscal balance remained broadly unchanged from 2013, meeting the structural balance target, although the headline fiscal deficit increased slightly. The consolidated public sector deficit rose to 1.6 percent of GDP, pushing public debt to about 39 percent of GDP.

The current account deficit widened to 5.2 percent in 2014, but capital inflows were buoyant. Strong inflows of foreign direct investment and portfolio flows more than offset the current account deficit, and gross international reserves rose to 47 billion at year end. This level appears adequate for precautionary purposes but may be insufficient for tail risks. The current account deficit is projected to widen in 2015 due to the oil price decline, but would gradually narrow over the medium term with the slight recovery in oil prices and growth in Colombia’s trading partners, especially the U.S. Moreover, the sharp peso depreciation should help contain imports and spur non-traditional exports.

The banking system and corporate sector have remained in good financial health. Financial soundness indicators have been strong and financial system exposure to the oil sector is very low. Growth in credit to the private sector was buoyant, at 14.7 percent in 2014 (nominal year-over-year) and house price growth has slowed. Corporate profitability was strong, and liquidity remained adequate. Corporate and household debt has increased in 2014, but remains modest by international standards and leverage is within historical norms.

Growth is expected to slow to 3.4 percent in 2015 given a subdued outlook for investment, especially oil-related, and private consumption. Inflation rose to 4.6 percent in March, due to a weather-related agricultural output supply shock and some pass-through from exchange rate depreciation, but is expected to diminish to 3.6 percent year-over-year by end-December with inflation expectations remaining anchored within the target band of 2–4 percent. In response to lower corporate profits and a partial postponement of dividends from the state oil company, the central Government announced an expenditure reduction of 0.7 percent of GDP in 2015, which will also act as a drag on growth. However, the impact of oil shock on the budget and economic growth will be mitigated by the sharp depreciation of the peso (20 percent vis-à-vis the U.S. dollar since mid-2014), and the operation of the fiscal rule, which allows a smoother adjustment to the permanent decline in wealth.

Growth is expected to gradually rise toward its potential (around 4.25 percent) over the medium term, supported by the Government’s Public-Private Partnership-based infrastructure program and a gradual recovery in oil prices and external demand. However, risks threaten on the downside, including higher interest rates and financial volatility, a protracted period of slower growth in
advanced and emerging economies, economic or political stress in neighboring countries, and a delayed implementation of the infrastructure program.

**Executive Board Assessment**

Executive Directors welcomed Colombia’s continued robust economic performance and financial stability, underpinned by prudent management and strong policy frameworks including a fiscal rule, an inflation targeting regime, and a flexible exchange rate. Substantial progress has also been made in reducing unemployment and poverty in recent years. Directors noted, however, that Colombia is facing headwinds from the sharp fall in the price of oil, a key export. Given elevated external risks, Directors stressed the need for stepped-up efforts to further enhance the resilience of the economy. They supported an eventual exit from the Flexible Credit Line arrangement with the Fund once external risks have receded.

Directors commended the authorities for their commitment to the structural fiscal rule. They highlighted the importance of mobilizing non-oil revenues to meet the authorities’ medium term fiscal targets while protecting social and infrastructure spending. This requires a comprehensive tax reform, with the objectives of simplifying the tax structure, increasing progressivity, broadening the tax base, and improving tax administration. Directors looked forward to the recommendations of the recently established expert commission on these matters.

Directors supported the broadly neutral stance of monetary policy, but encouraged the authorities to stand ready to take appropriate action if growth falters. They noted that the current level of official international reserves provides adequate insurance in normal times, and that the exchange rate has adjusted flexibly in line with fundamentals. Directors considered that the widening current account deficit, largely financed through foreign direct investment, is likely to narrow over time on the back of the exchange rate depreciation and ongoing fiscal consolidation.

Directors noted that the financial system is sound, profitable, and well-provisioned, with low exposure to the oil sector. They commended the authorities for the progress in addressing cross-border risks and strengthening the regulatory and supervisory frameworks. Continued efforts are nonetheless crucial to boost the resilience of financial institutions, and to strengthen supervision of complex financial conglomerates. Directors also underscored the importance of further improving risk-based supervision, enhancing regional cooperation primarily in Central America, deepening the capital market, and promoting financial inclusion.

Directors welcomed the authorities’ inclusive growth agenda. They agreed that key priorities are to reduce informality in the economy, improve competitiveness and infrastructure, and foster social mobility, especially through better education and health care. Directors recognized the benefits of the authorities’ fourth generation road investment program—implemented with appropriate funding and safeguards—in reducing infrastructure gaps and helping diversify sources of growth. More broadly, they supported initiatives to promote private participation in the economy, including through divestiture of a public utility company.
### Colombia: Selected Economic Indicators 1/

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>Proj. 2015</th>
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<tbody>
<tr>
<td><strong>National Income and Prices</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real GDP</td>
<td>4.9</td>
<td>4.6</td>
<td>3.4</td>
</tr>
<tr>
<td>Consumer price index (period average)</td>
<td>2.0</td>
<td>2.9</td>
<td>3.9</td>
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<tr>
<td>Consumer price index (end of period)</td>
<td>1.9</td>
<td>3.7</td>
<td>3.6</td>
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<tr>
<td>GDP deflator</td>
<td>1.9</td>
<td>1.8</td>
<td>1.0</td>
</tr>
<tr>
<td>Terms of trade (deterioration -)</td>
<td>-4.1</td>
<td>-3.2</td>
<td>-18.0</td>
</tr>
<tr>
<td>Real effective exchange rate (depreciation -)</td>
<td>-3.3</td>
<td>-5.3</td>
<td>-14.3</td>
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(In annual percentage changes, unless otherwise indicated)

<table>
<thead>
<tr>
<th><strong>Public finances</strong></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Central government balance</td>
<td>-2.3</td>
<td>-2.6</td>
<td>-2.6</td>
</tr>
<tr>
<td>Combined public sector</td>
<td>-1.1</td>
<td>-1.6</td>
<td>-3.4</td>
</tr>
<tr>
<td>Public debt 2/</td>
<td>35.6</td>
<td>38.7</td>
<td>39.7</td>
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(In percent of GDP, unless otherwise indicated)

<table>
<thead>
<tr>
<th><strong>External Sector</strong></th>
<th></th>
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<tbody>
<tr>
<td>Current account (deficit -)</td>
<td>-3.3</td>
<td>-5.2</td>
<td>-5.9</td>
</tr>
<tr>
<td>External debt</td>
<td>24.2</td>
<td>29.3</td>
<td>30.9</td>
</tr>
<tr>
<td>of which: Public sector</td>
<td>12.8</td>
<td>14.8</td>
<td>15.1</td>
</tr>
<tr>
<td>GIR in percent of short-term debt</td>
<td>181.9</td>
<td>187.0</td>
<td>198.8</td>
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<table>
<thead>
<tr>
<th><strong>Savings and Investment</strong></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross domestic investment</td>
<td>24.2</td>
<td>26.0</td>
<td>24.0</td>
</tr>
<tr>
<td>Gross national saving</td>
<td>20.9</td>
<td>20.8</td>
<td>18.1</td>
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(12-month percentage changes, unless otherwise indicated)

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<tr>
<th><strong>Money and credit</strong></th>
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<tr>
<td>Broad money (M2)</td>
<td>13.4</td>
<td>10.0</td>
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<td>4.3</td>
<td>n.a.</td>
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<tr>
<td>Nominal</td>
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</table>

Sources: Colombian authorities; and IMF staff estimates and projections.

1/ Based on information available on May 1, 2015.

2/ Includes Ecopetrol and Banco de la Republica’s outstanding external debt.
ANNEX 4: DEBT SUSTAINABILITY ANALYSIS

**Debt, Economic and Market Indicators**

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<td>Public gross financing needs</td>
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<td>Real GDP growth (in percent)</td>
<td>4.8</td>
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<td>Inflation (GDP deflator, in percent)</td>
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<td>1.8</td>
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<tr>
<td>Nominal GDP growth (in percent)</td>
<td>10.5</td>
<td>6.9</td>
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<td>Effective interest rate (in percent)</td>
<td>10.2</td>
<td>8.3</td>
<td>7.5</td>
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**As of April 02, 2015**

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**Contribution to Changes in Public Debt**

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<td>Change in gross public sector debt</td>
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<td>Identified debt-creating flows</td>
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<tr>
<td>Primary deficit</td>
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<td>-0.9</td>
<td>0.0</td>
<td>-0.7</td>
<td>-0.8</td>
<td>-1.3</td>
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<tr>
<td>Primary (noninterest) revenue and grants</td>
<td>26.6</td>
<td>28.1</td>
<td>27.8</td>
<td>26.6</td>
<td>26.5</td>
<td>26.4</td>
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<td>Primary (noninterest) expenditure</td>
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<td>Of which: real interest rate</td>
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<td>2.0</td>
<td>2.8</td>
<td>1.4</td>
<td>1.6</td>
<td>1.7</td>
<td>1.7</td>
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<td>Of which: real GDP growth</td>
<td>-1.6</td>
<td>-1.6</td>
<td>-1.6</td>
<td>-1.4</td>
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<td>-1.7</td>
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<td>-1.6</td>
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<td>Exchange rate depreciation</td>
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<td>3.1</td>
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<td>-1.6</td>
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<td>-1.7</td>
<td>-1.7</td>
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<td>Other identified debt-creating flows</td>
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<td>Privatization proceeds (negative)</td>
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<td>Short-term debt 1/</td>
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<td>Residual, including asset changes 6/</td>
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<td>4.0</td>
<td>3.9</td>
<td>-0.6</td>
<td>-0.3</td>
<td>0.0</td>
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**Debt-Creating Flows (in percent of GDP)**

- Primary deficit
- Exchange rate depreciation
- Real GDP growth
- Real interest rate
- Other debt-creating flows
- Residual

**Cumulative debt-stabilizing primary balance 8/**

Source: Fund staff estimates.

1/ Public sector is defined as general government.
2/ Based on available data.
3/ EMBIG.
4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.
5/ Derived as ($r - π(1+g) - g + α(1+g)/(1+π+g+π+g)) times previous period debt ratio, with $r =$ interest rate; $π=$ growth rate of GDP deflator; $g =$ real GDP growth rate; $α=$ share of foreign-currency denominated debt; and $e =$ nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
6/ The real interest rate contribution is derived from the numerator in footnote 5 as r(1+g) and the real growth contribution as g.
7/ The exchange rate contribution is derived from the numerator in footnote 5 as α(1+g).
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.
Composition of Public Debt

By Maturity
(In percent of GDP)

By Currency
(In percent of GDP)

Alternative Scenarios

Gross Nominal Public Debt
(In percent of GDP)

Public Gross Financing Needs
(In percent of GDP)

Underlying Assumptions
(In percent)

Baseline Scenario

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<td>3.4</td>
<td>3.7</td>
<td>4.0</td>
<td>4.2</td>
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<tr>
<td>Inflation</td>
<td>1.0</td>
<td>1.7</td>
<td>3.1</td>
<td>3.0</td>
<td>2.9</td>
<td>3.0</td>
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<tr>
<td>Primary Balance</td>
<td>0.0</td>
<td>0.7</td>
<td>0.8</td>
<td>1.3</td>
<td>1.6</td>
<td>1.8</td>
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<tr>
<td>Effective interest rate</td>
<td>7.6</td>
<td>7.3</td>
<td>7.3</td>
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Constant Primary Balance Scenario

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<tr>
<td>Real GDP growth</td>
<td>3.4</td>
<td>3.7</td>
<td>4.0</td>
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<td>Inflation</td>
<td>1.0</td>
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<td>3.1</td>
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<td>2.9</td>
<td>3.0</td>
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<tr>
<td>Primary Balance</td>
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<tr>
<td>Effective interest rate</td>
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Historical Scenario

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<tbody>
<tr>
<td>Real GDP growth</td>
<td>3.4</td>
<td>4.8</td>
<td>4.8</td>
<td>4.8</td>
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<tr>
<td>Inflation</td>
<td>1.0</td>
<td>3.7</td>
<td>3.1</td>
<td>3.0</td>
<td>2.9</td>
<td>3.0</td>
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<td>Primary Balance</td>
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<td>1.9</td>
<td>1.9</td>
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<tr>
<td>Effective interest rate</td>
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<td>7.3</td>
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30 percent depreciation

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<tr>
<td>Real GDP growth</td>
<td>3.4</td>
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<td>4.2</td>
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<tr>
<td>Inflation</td>
<td>1.0</td>
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Source: Fund staff estimates.
1. This PSIA follows the Bank guidelines and is designed to provide an analysis of the potential outcomes on poverty and growth of incomes of the policy actions outlined in DPL2, especially for those individuals at the bottom of the income distribution. The PSIA documents the expected impacts of each of the policy actions on growth and income convergence. In addition, it describes the potential effects of the policy actions on poverty reduction and shared prosperity. In general, the policies supported by this operation, including further facilitating investment in infrastructure and access to finance, improving the allocation of productive skills, and promoting innovation and an efficient regulatory environment are expected to positively affect growth and regional convergence, as well as to expand employment opportunities for the poor. The last policy actions regarding improving the formulation of regulations and reforms, streamlining custom processes, and implementing an integrated transit of goods, potentially have indirect effects on poverty and shared prosperity but could still contribute to economic growth.

2. This PSIA builds on the quantitative analysis elaborated for the policies supported in DPL1, along with additional quantitative analysis and literature reviews for the new prior actions of this operation. Useful information to define parameters and assumptions to perform the analysis, as well as to organize the literature review, was gathered from the PSIA of DPL1; policy reports of the MHCP and the Ministry of Labor of Colombia; previous evaluations by the Bank, IFC, and similar multilateral organizations; and academic research papers.

3. Colombia has experienced significant economic growth coupled with large declines in poverty reduction. In particular, Colombia experienced sustained levels of strong economic growth and reductions in extreme and moderate poverty between 2002 and 2014. For instance, extreme poverty declined from 17.7 percent in 2002 to 8.1 percent in 2014; similarly, moderate poverty fell from 49.7 percent to 28.5 percent. Poverty reduction has been accompanied by progress in shared prosperity, with the income growth of the bottom 40 percent of the population reaching 6.3 percent over the period 2008–2014 compared to 4.2 percent for the total population. Many households in Colombia joined the middle class while many others are no longer poor, but are still vulnerable to fall back into poverty. These trends are mostly explained by sustained economic growth. Moreover, during the period 2002–2013, growth explained 84.1 percent of reduction in moderate poverty and 72.9 percent for extreme poverty in Colombia, providing evidence of the importance of growth on poverty reduction over recent years. The policy areas discussed in this document are expected to have positive impacts on fundamental drivers of economic growth and, therefore, are expected to help reduce poverty.


48 Between 2010 and 2013, the average annual growth elasticity of poverty in Colombia was -0.59, that is, a 1 percent change in per capita GDP translated into a 0.59 percentage point reduction in poverty rate. However, conditional on its economic performance, this pace of poverty reduction observed in Colombia was moderate compared with its regional peers.
PILLAR 1: FOSTERING SOLUTIONS TO DEVELOP INFRASTRUCTURE FINANCING AND INCREASING ACCESS TO FINANCE FOR FIRMS

Prior Action #1: In order to promote the financing of projects under the 4G Concession Program, the Government has: (i) reduced restrictions for pension funds to invest in private capital infrastructure funds; and (ii) eased the requirements for funding operations in international markets, as evidenced by the Government’s Decree No. 1385, dated and published in the Official Gazette on June 22, 2015; and the Government’s Bank of the Republic (Banco de la República) Resolution No.4, dated April 24, 2015.

4. Enhanced access to financing for key infrastructure projects is expected to promote growth, regional equity, and employment opportunities for the low skilled and to put downward pressure on consumer prices due to lower transport and logistic costs. Colombia suffers from regional inequality and poor road infrastructure development.49 Investments in 4G projects are expected to improve road infrastructure and expand market opportunities to previously isolated regions, with the potential to boost economic activities, increase productivity, and reduce regional disparities.50 GoC estimates suggest that new highways will raise Colombia’s long-term GDP growth rate by 0.8 percentage points (until 2026),51 and even though this is an upper bound estimate, it sheds light on the importance of these investments. Moreover, investment in road infrastructure puts downward pressure on consumer prices, positively affecting all households, but with a relatively stronger impact on poor households due to the composition of their consumption basket.52

5. Facilitating investments in road infrastructure will lead to more job opportunities for the unskilled or low skilled and will translate into a reduction of both moderate and extreme poverty rates. Enhanced employment opportunities can improve the living conditions of marginalized populations, increase productivity, and spur economic growth. DPL1 reports the expected job creation effects of investment injections to be generated by the 4G program on employment, growth, and productivity, based on micro-simulations from a Competitive General Equilibrium model elaborated by the DNP-DEE (2013).53 According to DPL1, even under a


50 Several theoretical and empirical studies have demonstrated the positive effects that road infrastructure investments have on productivity and hence on growth and poverty reduction (Antle 1983; Baffes and Shah 1993; Martinicus, Carvallo, and Cusolito 2012; and Jouanjean et al. 2015). Recent papers by Donaldson (2010) and Duflo et al. (2012) also find positive impacts of railroads infrastructure on income levels in India and China (although the effects on growth are negligible in the latter case). In particular, Donaldson (2010) finds that railroads decreased trade costs and interregional price gaps and increased interregional and international trade. For a more detailed treatment of this topic, see “First Programmatic Sustained Growth and Income Convergence Operation for Colombia - DPL-I” (2014:47).


conservative scenario, which only considers the effects of projects that will be developed in the short term, results indicate that new jobs will lead to a reduction of moderate and extreme poverty by 0.5 and 0.3 percentage points, respectively. Under the more optimistic scenario, which considers the realization of both the expected short- and medium-term infrastructure projects, moderate and extreme poverty decline by 1.1 and 0.5 percentage points, respectively.  

6. A regional growth convergence analysis on the potential impacts of infrastructure investment on territorial disparities, conducted for DPL1, suggests a higher convergence rate among Departamentos due to the 4G investments in infrastructure. The convergence analysis followed the concepts of absolute and conditional convergence proposed by Barro and Sala-i-Martin (1991), focusing on the trend of per capita GDP convergence among Departamentos between 2003 and 2012. The findings suggest that, after controlling for public spending in road infrastructure, the poorest Departamentos in Colombia experienced higher economic growth than the richer ones during the period 2003–2012. Moreover, a prospective conditional convergence model shows that 4G investment is expected to increase the rate of income convergence among Departamentos over the period 2013–2018.

Prior Action #2: In order to improve and promote firms’ access to credit, the Government has: (i) further strengthened the collateral registry by regulating the mechanisms for the execution of guarantees, and electronically linking the collateral registry with the existing vehicle registry; and (ii) created a central registry for electronic invoices (Registro de Facturas Electrónicas) which, among other things, facilitates the use of invoices as collateral, as evidenced by the Government’s Decree No. 1835, dated and published in the Official Gazette on September 16, 2015, and the Government’s Law No. 1753-2015 (National Development Plan 2014-2018), dated and published in the Official Gazette on June 9, 2015.

Prior Action #3: In order to continue fostering capital markets development, the Government has: (i) established new governing rules for the management of mutual funds (Fondos de Inversion Colectiva); and (ii) set internal policies, procedures and operating systems for the custody of securities, as evidenced by the following Circulares Externas (CE) from the Government’s Financial Superintendence (Superintencencia Financiera de Colombia): CE No.015, dated and published on June 13, 2014; CE No.026, dated and published on September 15, 2014; CE No.031, dated and published on November 21, 2014; and CE No. 005 of 2015, dated and published on March 30, 2015.

7. Further strengthening of the collateral registry has the potential to improve access to credit and increase the engagement in entrepreneurial activities of the poor. This in turn will allow SMEs to increase investment, generate more jobs, become more competitive, and increase productivity. Based on the 2014 labor force survey, approximately 4 out of 5 employed workers from the bottom 40 percent of the income distribution worked in small firms. They were either

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54 First Programmatic Sustained Growth and Income Convergence Operation for Colombia - DPL-1 (2014:50–51).
56 For further details regarding the convergence analysis, see “First Programmatic Sustained Growth and Income Convergence Operation for Colombia - DPL-I” (2014:48-50).
self-employed (50.48 percent) or working in firms with less than two employees (26.89 percent) (figure 5.1). According to Beck and Demirguc-Kunt (2006)\(^57\) there is substantial evidence that small firms face larger growth constraints and have less access to formal sources of external funding. In this context, financial and institutional development\(^58\) help alleviate smaller firms’ growth constraints (especially for SMEs) and increase their access to external finance, leveling the playing field between firms of different sizes. Love et al. (2013) find that introducing collateral registries for movable assets increases the firms’ access to bank financing, in particular for smaller and newer firms.\(^59\) Similarly, Madeira et al. (2010) conclude that the implementation of payroll credit as a new instrument to offer credit with lower risk for the poor in Brazil increased the probability of engagement in entrepreneurial activities.\(^60\) These findings build on an extensive body of literature that documents the different mechanisms through which access to finance allows individuals to modify their production and employment decisions, helping them to exit poverty (Banerjee and Newman 1993;\(^61\) Burgess and Pande 2005;\(^62\) or Bruhn and Love 2014\(^63\)).

![Figure 5.1. Distribution of Employed by Per Capita Household Income Groups](image)

**Source:** GEIH 2014.

**Note:** This includes wages of the employed and self-employed. Any consideration about informality was done here.

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\(^{58}\) Financial and institutional development refers to low entry and exit barriers, well-defined property rights, effective contract enforcement, and firm access to finance as characteristics of a business environment that is conducive to competition and private commercial transactions.


8. Promoting access to credit for firms through factoring activities is expected to be beneficial for smaller enterprises, which are responsible for a large portion of employment in poor countries. Like traditional forms of commercial lending, factoring provides SMEs with working capital financing. Klapper (2006)\(^6\) argues that factoring is a powerful tool in providing financing to high-risk sellers and is particularly useful in countries with weak contract enforcement, inefficient bankruptcy systems, and imperfect records of upholding seniority claims.\(^6\) Additionally, Beck and Demirguc-Kunt (2006)\(^6\) suggest that, compared to large firms, SMEs are more constrained by limited access to finance and that factoring is an example of a technology that could help relax the growth constraints SMEs face and facilitate their contribution to economic growth. Similarly, Duda (2013)\(^6\) argues that the growth of Polish small and medium firms is largely dependent on access to external sources of financing. Regarding job creation in smaller enterprises, Gindling and Newhouse (2014)\(^6\) show that non-agricultural self-employment accounts for a relatively large fraction of employment in poor countries, although this participation diminishes for richer countries. Additionally, Covarrubias et al. (2012)\(^6\) find that self-employment is responsible for between 30 percent and 80 percent of total income in 15 low- and lower-middle-income countries and argue that the overall employment share of microenterprises is higher in poor countries.

9. The poor and vulnerable have low access to financial services in Colombia. Access to financial services is a crucial mechanism for poverty alleviation as it allows individuals to save and borrow to smooth consumption over time and potentially change their employment decisions. In 2014, only 24 percent of those in the bottom 40 in Colombia had an account at a formal financial institution, whereas 49 percent in the top 60 had one, depicting a significant gap in access to financial services across income groups.\(^7\) In contrast, this gap in Latin American countries with


\(^6\) A key characteristic of factoring is that underwriting in factoring is based on the risk of the accounts receivable themselves rather than the risk of the seller. Factoring may also be particularly attractive in financial systems with weak commercial laws and enforcement.


\(^7\) According to de Lis et al. (2014), the access to financial services is measured through two indicators: (a) the percentage of the population that uses some kind of financial product and (b) the development of the infrastructure through which these services are provided. In Fernández de Lis, S., M.C. Linares, C. López-Moctezuma, J.C. Rojas, and D. Tuesta. 2014. “Financial inclusion and the role of mobile banking in Colombia: developments and potential.” Working Paper No. 14/04. BBVA Research. Madrid, February 2014. https://www.bbvareshuresearch.com/wp-content/uploads/migrados/WP_1404_tcb348-420839.pdf.

10. **Improved access to finance for individuals and firms has the potential to contribute to poverty reduction and shared prosperity.** Relaxing the cash flow constraint to firms is expected to have marginal positive impacts on firm productivity. Beck (2013) finds that financial deepening can contribute to economic growth and ultimately poverty reduction by alleviating SMEs’ financing constraints and enabling firm entry and entrepreneurship, as well as better resource allocation across the economy.\footnote{Beck, T. 2013. “Bank Financing for SMEs: Lessons from the Literature”. *National Institute Economic Review* 225 (1): R23–R38. doi: 10.1177/002790511322500105.} The PSIA elaborated for DPL1 shows how enhanced access to finance could provide the poor and smaller enterprises a different set of financial opportunities.\footnote{First Programmatic Sustained Growth and Income Convergence Operation for Colombia - DPL-1 (2014:54).} Broader access to financial resources will allow SMEs to increase productivity and competitiveness, which in turn can lead to job creation and sustainability of current jobs for the bottom 40. More importantly, it will also give vulnerable populations an alternative to smooth consumption and increase their probability of engaging in entrepreneurial activities.

**PILLAR 2: IMPROVING THE QUALITY AND ALLOCATION OF PRODUCTIVE SKILLS**

**Prior Action #4:** In order to strengthen the Public Employment Service (PES), the Government has defined the institutional arrangements, responsibilities and information requirements for the implementation of the PES management and job placement tools, as evidenced by the Government’s Ministry of Labor Resolution No. 1397, dated April 20, 2015 and published in the Official Gazette on April 27, 2015, the Government’s PES Special Administrative Unit (Unidad Administrativa Especial del Servicio Público de Empleo) Resolution No. 129, dated March 3, 2015 and published in the Official Gazette on March 4, 2015, the Government’s Ministry of Labor Resolution No. 3418, dated August 14, 2014, and the Government’s Ministry of Labor Resolution No. 2605, dated June 25, 2014 and published in the Official Gazette on July 1, 2015.

**Prior Action #5:** In order to improve the formation of professional skills, the Government has: (i) created the national framework of professional qualifications and competencies, (ii) established a system of transfers and credits connecting the different branches of tertiary education, and (iii) defined the Ministry of Education as responsible for implementing this system, as evidenced by the Government’s Law No. 1753-2015 (National Development Plan 2014-2018), dated and published in the Official Gazette on June 9, 2015.

11. **Information asymmetries in the Colombian job market limit employment opportunities of those in the labor force, particularly of those belonging to the bottom 40 of the income...**
distribution. According to Uribe and Gomez (2005)\textsuperscript{74} and Oviedo (2007)\textsuperscript{75} both the poor and non-poor use informal channels as their main source to find a job (figure 5.2). However, the poor use informal channels more intensively, although they face limitations to find adequate employment because they lack ‘better’ networks in high earning jobs. The use of informal channels in the job search is positively correlated with lower quality jobs, in particular for the poor.

12. **The relatively intensive use of informal channels for employment search by the poor is correlated with lower quality jobs.** The PSIA elaborated for DPL1 provides evidence on how the poor use informal channels more intensively than the non-poor as their main source to find a job. Poor workers are relatively unsuccessful in using informal methods to find adequate jobs as they lack networks in high-quality jobs, so better information on vacancies and promotion of more formal mechanisms have potential benefits for this group. The regulation may alleviate information asymmetries and match individuals better between jobs and skills.

13. **Improvements of the PES have the potential to improve job opportunities for the poor, both in terms of quality and quantity.** Labor markets present some unavoidable frictions that hinder the efficiency of the markets. As shown by Diamond and Maskin (1979\textsuperscript{76} and 1981\textsuperscript{77}), Diamond (1982),\textsuperscript{78} Mortensen (1982),\textsuperscript{79} and Pissarides (1984),\textsuperscript{80} efficiency cannot always be expected in labor markets, so policy interventions may therefore become desirable.\textsuperscript{81} To the extent that the PES system is able to reduce the search costs and frictions on the Colombian labor market, it can have positive effects on its efficiency and potentially increase the opportunities to access quality jobs for those in the bottom 40 percent of the income distribution.

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Figure 5.2. Channels to Search for a Job by Income Quintile

Source: Own calculations based on GEIH 2014.
Note: Informal search channels include the search for a job through relatives or friends; moderate informal channels include the search for a job through visits to employers or firms; and formal channels include the search for a job using newspapers, employment agencies, and other official institutions. We include the labor force between 15 and 65 years old. The income quintile represents a fifth of the total population, not only workers. Considering the lower labor force participation of the less well-off, there is a lower proportion of the labor force the lower the quintile is.

14. Colombia’s gap in the supply and quality of skills has limited labor productivity and growth. Even though Colombians are more educated than ever, their labor market outcomes are below the average for Latin America and the Caribbean and the OECD member countries. In addition, the education quality is also lagging relative to Colombia’s level of development. Lack of better skills affects employment prospects and income generation opportunities for Colombians in the bottom 40 percent. This problem is aggravated by skills mismatches in the labor market. As a result, Colombia’s informality and unemployment rates are high compared to the region (9.1 in 2014, which has been the lowest for that month since 2001, and informality rates of 75 percent in 2014 for workers with secondary schooling).

15. Strengthening professional training and skill formation has the potential to improve employment opportunities for the poor. Rosas et al. (2014) show that Colombia’s workforce does not meet labor skill requirements in the productive sector. There is a gap between labor skills demand and supply. The biggest challenge in the recruitment process across all sectors is the lack of experience and skills of candidates. In addition, the Human Capital Formation and Productivity Survey shows that firms that offer training do so for job-specific skills, which are less transferable to other firms and have less impact on employability and alternative income opportunities. The system of professional training for unemployed individuals could expand economic opportunities for the bottom 40 percent of the income distribution.

16. The creation and development of a national framework of professional qualifications and competences is expected to increase the skills of the Colombian labor force through

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83 Colombia Systematic Country Diagnostic (SCD), World Bank, 2015.
85 *Encuesta de Formación de Capital Humano y Productividad* 2013.
professional training, contributing to increase their labor earnings. Quantitative analysis on the PSIA elaborated for DPL1 assessed the skill gap of Colombian youths who finished secondary school and had professional training (measured by technical education) with respect to those who finished secondary school but did not have professional training. The results indicate that those with technical training earned higher wages. The analysis finds suggestive evidence that professional training increases wages between 10.3 percent and 16.5 percent. Even though these increases may be overestimated because the model does not control for ability and other unobservable characteristics, these results are suggestive of the direction of the possible effect of training on technical skills.

Prior Action #6: In order to improve inclusive skills and income generation opportunities, the Government has established a special regime for the administration of the educational system for Indigenous Communities, including tertiary education, as evidenced by the Government’s Decree No. 1953, dated and published in the Official Gazette on October 7, 2014.

17. The indigenous communities are an important group among Colombia’s population that has benefitted little from Colombia’s recent growth. While the region has seen significant progress in terms of poverty reduction over the past decade, the indigenous population have benefited little. In Colombia, the indigenous population is about 1.5 million, approximately 3.4 percent of the total population, according to Angulo (2014). Despite an overall expansion in coverage of basic services to indigenous households, the indigenous population continues to have lower access to basic services such as sanitation and electricity. Several studies show that the Colombian indigenous population is in worse conditions than the rest of the population on several key indicators of well-being and quality of life.

18. In addition to regional differences, indigenous people and Afro-descendants face high rates of poverty. According to Angulo et al. (2011), indigenous households have the highest rate of multidimensional poverty (58 percent in 2010) and the smallest multidimensional poverty index (MPI) reductions from 2003–2010. The indigenous population also shows the highest incidence of poverty in every dimension of the MPI, it has the largest number of simultaneous

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87 In the Latin America and the Caribbean region, based on census information from 16 countries, the indigenous population represents about 8 percent of the total population. Latin America and the Caribbean Equity Lab. Information available at: http://www.worldbank.org/en/topic/poverty/lac-equity-lab1/ethnicity
88 This is a lower participation than in neighboring countries like Peru or Panama, where the indigenous population is 14.5 and 12.3 percent of the population, respectively; but substantially larger than the indigenous population participation in Venezuela (0.8 percent) or Brazil (0.4 percent).
deprivations, and its poverty rate is almost twice the rate of non-ethnic groups. Angulo et al. (2014) find that Colombian Departamentos with the highest concentration of the indigenous population are also the poorest ones. While income comparisons based on ethnic categories present some bias related to the large participation of non-market incomes for specific ethnic groups (Cárdenas et al. 2012), it is important to note, for example, that the unconditional family per capita income of Afro-Colombian households is 59 percent lower than that of households belonging to a different ethnic group (26 percent), suggesting that the prevalence of monetary poverty among Afro-Colombian groups is likely to be significantly higher. Moreover, nearly 30 percent of the displaced people belonged to indigenous (6.4 percent) and Afro-Colombian (22.5 percent) ethnic groups in 2010, suggesting that they were disproportionately affected by conflict, relative to the rest of the population.

19. There are large education gaps among ethnical groups in Colombia. Data from the 2005 population census shows that 30 percent of those with indigenous ethnicity have received no schooling, compared to 10 percent of the general population. In addition, only 2.7 percent of those with indigenous ethnicity have reached higher education versus 37.2 percent of all Colombians. Furthermore, the incidence of school absenteeism in indigenous households is 2.9 times the rate of non-indigenous ones and the illiteracy rate is 2.67 times the rate in non-indigenous households.

20. The development of an indigenous self-education system has the potential to increase access to general education and productive skills of the indigenous population while preserving cultural traces and norms. According to Baskin (2002), despite the diversity of today's classrooms, minority world views are not provided a space within educational discourse. Consequently, indigenous students tend to be marginalized, may struggle to achieve self-esteem, and have high dropout rates. In this context, a curriculum that reflects an appreciation of all students’ backgrounds can help encourage the acceptance of differences among individuals, enhance self-esteem, develop critical thinking, and promote social justice. Johannessen (2009) provides some evidence of positive education projects for indigenous education in Brazil, which combined respect for knowledge, culture, language, and social values of each indigenous group with the provision of new skills and knowledge necessary for dealing with new challenges. Moreover, Paqueo and Lopez-Acevedo (2003) show that appropriately designed and reasonably

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93 Commission of monitor public policy IDPs 2010. Third report of verification of the fulfillment of rights of the displaced population.

94 DANE, General Census 2005.


98 Based on an examination of Mexico's PARE (Programa para Abatir el Rezago Educativo) program, Paqueo and Lopez-Acevedo (2003) find that supply-side interventions can have positive effects on the learning achievement of
well-implemented interventions can increase learning achievement. Thus, the creation of indigenous higher education institutions have the potential to enhance the comprehensive training and research under the indigenous education system itself and contribute to the recognition of ethnic and cultural diversity of the Colombian nation. The special regime is expected to have positive implications as indigenous households have relatively high rates of multidimensional poverty, partially driven by low access to education and relatively low per capita income (less than 59 percent of the income of different ethnic groups), a consequence of limited income generation opportunities.

PILLAR 3: PROMOTING INNOVATION AND AN EFFICIENT REGULATORY ENVIRONMENT

Prior Action #7: In order to improve the effectiveness of public investment in innovation, the Government has: (i) defined the criteria for formulation, selection and approval of innovation projects financed with Royalties' Resources, and (ii) created an information platform to monitor projects financed by royalties (MAPAREGALIAS), as evidenced by the Government’s Law No. 1753-2015 (National Development Plan 2014-2018), dated and published in the Official Gazette on June 9, 2015; the Government’s National Planning Department Accord No. 0023, dated June 26, 2014 and published in the Official Gazette on June 27, 2014; the Government’s National Planning Department Accord No. 0027, dated April 30, 2015 and published in the Official Gazette on May 5, 2015; and the Government’s National Planning Department Accord No. 0032, dated and published in the Official Gazette on July 28, 2015.

Prior Action #8: In order to strengthen the system of tax benefits for innovation, the Government has defined the specific eligible expenses that could be granted as fiscal benefits, including firm-led innovation, as evidenced by the Government’s CONPES document No.3834, dated July 2, 2015.

21. Colombia has relatively low levels of private investment in R&D. The investment in R&D in Colombia during 2012 was 0.17 percent of GDP, below the 0.5 percent or higher registered in Chile, Mexico, and Argentina, and substantially lower than the 1 percent of GDP in Brazil and Spain. Moreover, about 40 percent of the R&D sector in Colombia corresponds to the private sector, while in countries like South Korea or Israel, the public sector participation is beyond 75 percent. Thus, there is significant room for improvement in this area in Colombia and policies that promote innovation across different sectors may have a positive impact on growth.


22. Promoting innovation and technology adoption can increase earnings by improving firms’ productivity and sales. Arbeláez and Parra (2011) study the relationship between innovation and productivity in Colombia, finding strong evidence that innovation increases firms’ sales and efficiency, leading to potential job creation and stronger economic activity. Crespi and Zuñiga (2012) study the determinants of technological innovation and its impact on firm labor productivity across six Latin American countries (including Colombia), finding evidence of the importance of knowledge for innovation and a very strong association between innovation and productivity. In addition, for the case of services industries in Chile, Colombia, and Uruguay, Crespi et al. (2014) show that firms that invest the most in innovation activities are more likely to introduce changes or improvements in their production process and/or product mix and firms that innovate have higher labor productivity than non-innovative firms. In a study for the services sector in Colombia, Umaña-Aponte et al. (2013) find that funding programs designed to promote innovation activities may have a positive impact in terms of labor productivity for small companies, especially for short-term projects (less than a year). The PSIA from DPL1 shows that there is significant room for improvement in the innovation and technology adoption sector in Colombia. Thus, policies to promote innovation across different sectors may have an important role in promoting growth and competitiveness.

23. A better alignment of efforts to promote innovation and technology adoption can increase earnings by improving firms’ productivity and sales, potentially aiding to fight poverty. Innovation is one of the engines for development of modern economies and is a distinguishing feature of emerging countries that exceed poverty traps and pass the threshold to progress. Moreover, innovation applies to multiple economic activities; extends to different linkages; and translates into growth, quality jobs, and greater prosperity. Crespi et al. (2015) analyze the long-term effects of matching-grant and contingent credit lines managed by COLCIENCIAS and find that financial incentives had a significant effect on firms’ labor productivity. The PSIA on DPL1 includes an analysis of the potential channels on how an
increase in labor productivity triggered by more innovation can contribute to the dual goals of poverty reduction and shared prosperity.\textsuperscript{109}

24. **Better allocation of resources to fit regional priorities and a better information platform to monitor royalties’ finance are expected to have positive impacts on the spending of limited financial resources.** The development of a system of information that improves the transparency of information can have positive effects on Government accountability and governance, aiding a more transparent allocation of resources on higher-impact projects and potentially contributing to poverty reduction. The Colombian Competitiveness Council also highlights the importance of defining long-term strategic objectives, as well as the roles to be played by all the institutions and a sound system of monitoring and evaluation programs to effectively promote innovation and technology adoption.\textsuperscript{110}

25. **However, it is necessary to keep a proper balance between competition, private patents, and fiscal responsibility to effectively contribute to poverty reduction and shared prosperity.** The Federal Trade Commission (2003)\textsuperscript{111} highlights the importance of maintaining a proper balance between competition and patents as both promote innovation and are not necessarily inconsistent. For instance, it is necessary to keep a strict control over the quality of patents and their duration. Protecting inventions with no added value could affect the objective of the patent of increasing the benefit of the consumer.\textsuperscript{112} Even though a tax-based intervention seems to be the market-oriented response to the under provision of R&D, Hall and Van-Reenen (2000)\textsuperscript{113} point out that this tool has received critiques for being ineffective in raising private R&D spending.\textsuperscript{114} However, based on a sample of OECD countries, Hall and Van-Reenen (2000) find that, even though the response to an R&D tax credit tends to be fairly small at first, it does increase over time. Similarly, Bloom et al. (2002)\textsuperscript{115} argue that tax incentives have only marginal positive effects in R&D, estimating that a 10 percent fall in the cost of R&D stimulates just over a 1 percent rise in R&D in the short term and a below 10 percent rise in the long term. In addition, Cappelen et al. (2011) find that the introduction of tax-based incentives results in the development of new production processes and, somehow, the development of new products for the firm but does not appear to contribute to innovations in the form of new products for the market or patenting.\textsuperscript{116}

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\textsuperscript{109} First Programmatic Sustained Growth and Income Convergence Operation for Colombia - DPL-1 (2014:56).


\textsuperscript{114} The response elasticity is so low that it will take a large tax change to generate the socially desirable level of spending.


Thus, if the distributional effects of the use of fiscal incentives to promote investment in science, technology, and innovation are not immediately clear, then this type of policy requires a careful cost-benefit analysis as fiscal resources are limited and there is potential for crowding out of social spending.

**Prior Action #9:** In order to improve the coordination and allocation of resources for productive development, the Government has unified its Governance System of Competitiveness and Innovation with its Governance System for Science Technology and Innovation at national and regional levels, as evidenced by the Government’s Law No. 1753-2015 (National Development Plan 2014-2018), dated and published in the Official Gazette on June 9, 2015.

**Prior Action #10:** In order to prevent new regulations from interfering with competitive practices, and in line with best practices from the Organization for Economic Co-operation and Development (OECD), the Government has established procedures that require all agencies drafting new regulations that could impact competitive practices to first consult with the Government’s Superintendence of Industry and Commerce, as evidenced by the Government’s Decree No. 1609, dated and published in the Official Gazette on August 10, 2015.

26. **Improving regulatory efficiencies can support economic growth and development.** It is a strategic instrument the Government can use to manage the economy and implement policies. The Colombian Government can maximize its influence on regulatory policy and deliver regulations which contribute to social well-being through a more effective framework. Evidence suggests the quality of regulation is strongly associated to economic growth and productivity (Djankov et al. 2006; Jacobzone et al. 2010; Jalilian et al. 2007). In addition, better quality of regulatory policy can also minimize corruption opportunities and reduce its negative economic and social impact (Djankov et al. 2002).

27. **Transparency and inclusion in the policy design may improve credibility for the Colombian Government both domestically and abroad.** Colombia is below the median on some political indicators, such that it has room for improvement. For instance, it ranks 43 out of 60 countries for Government transparency. A stronger regulatory framework that also considers citizens’ views can enhance credibility and transparency for public policies. This in turn may allow greater foreign investment and stimulate economic growth.

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120 Quality of legal and regulatory framework - 33/60; Capacity of decision for the government - 42/60. *World Competitiveness Yearbook (WCY)* for International Institute for Management Development (IMD).
Prior Action #11: In order to facilitate international trade, the Government has: (i) streamlined the procedures for issuing authorizations to Authorized Economic Operators (AEO), and allowed AEO to be considered for streamlined procedures to clear customs; and (ii) implemented an integrated transit of goods with the Republic of Ecuador, as evidenced by the Government’s Decree No. 1894, dated and published in the Official Gazette on September 22, 2015; and the Government’s Direction of National Taxes and Customs (DIAN) Circular No. 22, dated May 28, 2015.

28. The facilitation of international trade due to the streamlined border procedures for the authorized economic operators is expected to increase competition in the industry although the effects of this action on poverty reduction and shared prosperity are marginal. Higher competition among the custom agencies and smoother international trade activities could put downward pressure on import costs and increase trade. In this scenario, and depending on the elasticities of the market, this action could have a marginal but positive effect in terms of lower consumer prices and positive second-order effects on poverty reduction. Moreover, the distributional effects of the trade facilitation are not immediately clear. Tambunan (2013)\textsuperscript{121} analyzes access to trade facilitation in Indonesia, finding that the benefits from trade facilitation measures are maximized by larger firms. Similarly, Karunaratne and Abayasekara (2013) argue that export processing zones have clear economic benefits with regard to poverty reduction but, at the same time, seem to be correlated with some negative impacts. For example, even though export processing zones are an important employment generator, proper nutritional intake is poor among many of their employees.\textsuperscript{122} Finally, Viet-Cuong (2013) finds that improvement in trade facilitation is positively correlated with exports and per capita GDP and negatively correlated with poverty and inequality, as countries where a larger number of documents and more time are needed for imports and exports tend to have higher poverty and higher inequality (Gini index) than other countries.\textsuperscript{123}


\textsuperscript{122} Export processing zones can function as a mechanism of trade facilitation through processes such as simplification of customs procedures, streamlined administration, and socioeconomic welfare in the immediate surroundings of these zones.