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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT FOR A PROPOSED FINANCING

WITH THE GLOBAL CONCESSIONAL FINANCING FACILITY SUPPORT

IN THE AMOUNT OF US$750 MILLION TO

THE REPUBLIC OF COLOMBIA

FOR THE

SECOND FISCAL SUSTAINABILITY, COMPETITIVENESS, AND MIGRATION DEVELOPMENT POLICY FINANCING

April 23, 2019

Finance, Competitiveness and Innovation Global Practice
Macroeconomics, Trade and Investment Global Practice
Latin America and the Caribbean Region

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Colombia - Government Fiscal Year

January 1 – December 31

Currency Equivalents

(Exchange rate effective as of April 15, 2019)
Currency unit: Colombian peso (COP)
USD 1 = COP 3,109.3

Abbreviations and Acronyms

BEPS	Base Erosion and Profit Shifting
CONPES	National Council for Economic and Social Policy (Consejo Nacional de Política Económica y Social)
CPF	Country Partnership Framework
DIAN	National Tax and Customs Administration (*Dirección de Impuestos y Aduanas Nacionales*)
DNP	National Planning Department (*Departamento Nacional de Planeación*)
EPS	Health Insurance Provider (*Entidad Promotora de Salud*)
ESAL	Not-for Profit Entities (*Entidades sin Ánimo de Lucro*)
FONPET	National Pension Fund for Territorial Entities (*Fondo Nacional de Pensiones de las Entidades Territoriales*)
FTE	Fiscal Transparency Evaluation
GCFF	Global Concessional Financing Facility
GEM	Special Migration Group (*Grupo Especial Migratorio*)
ICA	Colombian Agricultural Institute (*Instituto Colombiano Agropecuario*)
IMF	International Monetary Fund
IOM	International Organization for Migration
IPS	Health Services Provider (*Institución Prestadora de Servicios de Salud*)
MHCP	Ministry of Finance and Public Credit (*Ministerio de Hacienda y Crédito Público*)
MTFF	Medium-Term Fiscal Framework
NDP	National Development Plan
NIT	Tax Identification Number (Número de Identificación Tributaria)
OECD	Organization for Economic Cooperation and Development
PAED	Departamental Plans and Strategic Agreements (*Planes y Acuerdos Estratégicos Departamentales*)
PEP	Special Permanence Permit (*Permiso Especial de Permanencia*)
PER	Public Expenditure Review
PFM	Public Financial Management
PIT	Personal Income Tax
PMR	Product Market Regulation
POS	Mandatory Benefit Package (*Plan Obligatorio de Salud*)
RAS	Reimbursable Advisory Services
RAMV	Administrative Registry of Venezuelan Migrants (*Registro Adminstrativo de Migrantes Venezolanos*)
R&D	Research and Development
RUT	Single Tax Registry
SAS	*Sociedades Anónimas Simplificadas*
SIC	Competition Authority (*Superintendencia de Industria y Comercio*)
SIFAI	System for the Facilitation of Investments (*Sistema de Facilitación para la Atracción de Inversión*)

SIIF	Integrated Financial Information System (*Sistema Integrado de Información Financiera*)
STI	Science, Technology, and Innovation
TFA	Trade Facilitation Agreement
TFP	Total Factor Productivity
UNHCR	Office of the United Nations High Commissioner for Refugees
UVT	Tax Value Unit (*Unidad de Valor Tributario*)
VAT	Value-Added Tax
VUCE	Single Window for Foreign Trade (*Ventanilla Única de Comercio Exterior*)
WTO	World Trade Organization

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REPUBLIC OF COLOMBIA
SECOND FISCAL SUSTAINABILITY, COMPETITIVENESS, AND MIGRATION DEVELOPMENT POLICY FINANCING

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SUMMARY OF PROPOSED LOAN AND PROGRAM

Colombia Second Fiscal Sustainability, Competitiveness, and Migration Development Policy Financing

Borrower	Republic of Colombia
Implementing Agency	Ministry of Finance and Public Credit, National Department of Planning
Financing Data	Financing Amount: US$750 million consisting of: IBRD loan in the amount of US$718.5 million on a variable spread with a 20.5 year-maturity including 16.5 years of grace period, and Concessional financing of US$31.5 million from the Global Concessional Financing Facility on a non-reimbursable basis
Operation Type	Single-tranche operation. Second in a series of two Development Policy Financing operations.
Pillars of the Operation And Program Development Objective(s)	The PDOs of the operation are to: (i) support fiscal sustainability measures and improved contingent liabilities management; (ii) foster productivity and growth in non-extractive sectors by strengthening the policy framework for trade facilitation, business regulation, innovation and green growth; and (iii) support regularization and integration of migrants.
Result Indicators	- Reduction in central government personnel expenditures and general operating expenditures (*gastos generales*[1]) as a share of GDP. Baseline (2015): personnel expenditures and general operating expenditures of 3.1% of GDP; target (2019): personnel expenditures and general operating expenditures of 2.8% of GDP. - Increase in the use of FONPET savings to finance subnational contributions to the subsidized health regime. Baseline (2015): 0; target (2016-19): COP3.7 trillion. - Non-oil central government tax revenue, excluding the equity tax and surcharge CREE. Baseline (2015): 12.5% of GDP; target (2019): 13% of GDP. - VAT evasion. Baseline (2015): estimated VAT gap of 22.2%; target (2019): estimated VAT gap of 23.1%. - Number of new income tax taxpayers. Baseline (2015) 0; target (2016-2019): 420,000 new taxpayers. - Reduction of customs clearance import times (average across all modes of transport). Baseline (2015): 23.85 hours; target (2019): 20 hours. - Increase in the number of firms applying to the leniency program and collaborating with the competition authority in antitrust investigation. Baseline (2012- June 2015): 4; target (July 2015-2019): 7 - Increase in the number of firms[2] registered online through the new electronic single window. Baseline (2015): 0; target (2019): 12,000. - Expansion in number of programs that are revised (modified, discontinued, introduced) on the basis of the CONPES. Baseline (2015): 0; target (2019): 18. - Increase in the total value of the projects that are registered in the *Planes y Acuerdos Estratégicos Departamentales en Ciencia, Tecnología e Innovación* (PAED) and that have been approved by OCAD (*Organismo Colegiado de Administración y Decisión*). Baseline (2015): 326.1 Billion Colombian Pesos; target (2019): 410 Billion Colombian Pesos - Increase in the share of existing fiscal incentives granted by the National Council of Fiscal Incentives for STI to firms that come from sectors other than mining and energy. Baseline (2015): 16%; target (2019): 24%. - Increase in the installed capacity of auto generated (and co-generated) electricity. Baseline (2015): 86.6 MW; target (2019): 198.64 MW. - Increase in number of Venezuelan migrants on the RAMV (*Registro Adminstrativo de Venezolanos*). Baseline (2015): 0; target (2019): 280,000 of which 125,000 are women. - Number of migrants from Venezuela receiving services from the National Employment Agency. Baseline (2015): 0; Target (2016-2019): 50,000 of which 25,000 are women (cumulative value between 2016-2019)
Overall risk rating	Moderate
Climate and disaster risks	(i) Are there short and long term climate and disaster risks relevant to the operation (as identified as part of the SORT environmental and social risk rating)? Yes ☐ No ☒
Operation ID	P162858

[1] It refers to general operating expenditure excluding post-conflict related expenditure.
[2] Including individual persons ("*personas naturales*") and legal entities ("*personas juridicas*").

IBRD PROGRAM DOCUMENT FOR A PROPOSED LOAN TO THE REPUBLIC OF COLOMBIA

1. INTRODUCTION AND COUNTRY CONTEXT

1. **The proposed Development Policy Financing (DPF) is the second in a series of two DPFs that support Colombia's efforts to maintain fiscal sustainability, further strengthen the foundations for productivity growth and support regularization and integration of refugees and migrants in a complex external environment.** Colombia's economy displayed resilience to the large oil income shock faced over the 2014-2015 period and, through adequate macroeconomic and fiscal policies, managed to adjust gradually to the lower terms of trade. The less favorable external environment led to reforms for re-orienting the engines of growth, which complemented structural reforms undertaken as part of the OECD accession process. Economic growth has begun recovering since mid-2017, supported by sound fiscal and monetary policies. The reliance on extractive industries continues to expose the economy to external shocks in an environment of rising uncertainties related to global trade tensions and tightening financial conditions. Moreover, the on-going process of peace consolidation[3], together with the large migration inflow from Venezuela,[4] pose significant challenges while also providing opportunities. Both have the potential to support growth in the long term, if managed well, but they also entail additional spending pressures and risks in the short and medium term. Continued adjustments in Colombia's public finances and structural reforms to enable productivity growth, diversification, and advance the competitiveness agenda remain important priorities for the new government that took office on August 7, 2018. The proposed DPF supports critical reforms to maintain fiscal sustainability, enhance competitiveness, and facilitate the integration and inclusion of refugees and migrants from Venezuela. The proposed operation is benefiting from concessional financing approved by the Global Concessional Financing Facility (GCFF) to address the needs of middle-income countries hosting large numbers of refugees (see Box 2).

2. **The post-conflict context and the unprecedented surge in migration from Venezuela give these reforms even greater urgency**. In November 2016, the government signed a peace agreement with the Revolutionary Armed Forces of Colombia (*Fuerzas Armadas Revolucionarias*

[3] The new administration is committed to the implementation of the peace process. One of the principal elements of the new National Development Plan (NDP 2018-2022) currently being finalized is a commitment to the implementation of a "Peace that brings together". As a key component of the new NDP the peace component considers, among other things, better coordination mechanisms and instruments for peace sustainability.

[4] The migration is comprised of Colombian returnees, Venezuelan migrants (regular and irregular, in transit and pendular) and refugees and, as such, is considered a mixed migration. Irregular migrants are considered those migrants that have entered through non-authorized checkpoints or are going beyond the limits of authorized human mobility, according to the Ministry of External Relations definition. Nonetheless, the situation shares key elements with refugee crises in other parts of the world, including (i) the accelerated pace at which it is evolving; (ii) the refugee-like conditions of migrants based on their level of vulnerability; and (iii) related to these conditions, the lack of valid documentation for migrants to enter other countries, including passports. Accordingly, in the assessment of UNHCR, "*an important proportion of the 935,000 Venezuelans currently present in Colombia may be eligible for refugee status or equivalent protection under applicable international, regional, and national standards, including the 1951 Convention relating to the Status of Refugees, its 1967 Protocol, and the aforementioned Cartagena Declaration.*" (UNHCR Assessment Letter, October 19, 2018)

de Colombia, FARC) to end more than 50 years of civil conflict. The peace process has the potential to boost inclusive growth, particularly in regions that were affected by the conflict. At the same time, Colombia has been receiving a massive and accelerating inflow of migrants, from Venezuela. More than 1.2 million Venezuelans had arrived in Colombia as of January 31, 2019 with the intention to stay, and depending on developments in Venezuela, considering that 73 percent of migrants registered in the Administrative Registry of Venezuelan Migrants (*Registro Administrativo de Migrantes Venezolanos*, RAMV) report they have family in Venezuela, migration trends could continue or even accelerate. To manage the challenges generated by the peace process and the Venezuelan migration inflow, key structural reforms will be important to foster diversification and productivity growth, while at the same time promoting integration and inclusion of migrants, including refugees, in the Colombian economy. The proposed DPF series supports the Colombian authorities' policy and institutional reform efforts in these areas.

3. **Migration of this scale generates both significant short-term challenges and medium-term opportunities to contribute to growth**. **It also involves coordination with neighboring countries, as receiving countries provide public good services to the entire region.** Harnessing the medium-term growth-enhancing potential of migration requires an adequate integration and inclusion of migrants and refugees into the economy, which would at the same time help mitigate the short-term negative impacts. At the same time faster growth will be key for the adequate integration of these vulnerable populations. Migrants and refugees have significant needs in terms of public services, such as education and health. Since according to the RAMV seven departments (*departamentos*) have received 80 percent of migrants, the pressures on service delivery and labor markets in specific communities is significant. This DPF supports Colombia in proactively managing the integration of this large inflows of migrants.[5] Additionally, with many migrants transiting through Colombia, the government has taken a leading role in adopting an open borders policy and implementing good practices in the provision of services to migrants and support to host communities, from education to health to employment services and humanitarian aid. The government is aware of the regional public good dimensions of adequately responding to migration and is promoting a regional approach to the crisis with its neighbors and partners. This regional and public good dimension provides an important additional rationale for the proposed DPF support.

4. **Fiscal sustainability remains a central priority for the government in the context of additional spending needs related to the implementation of the peace agreement and migration-related expenditure.** Fiscal sustainability requires additional consolidation measures to accommodate peace and migration-related expenditure and avoid further capital spending cuts that would negatively affect medium-term growth. Furthermore, prudent fiscal policy is critical in the current external environment in which emerging markets are facing stronger headwinds amid uncertainties surrounding global trade tensions and tightening financial conditions. In this context, the authorities remain strongly committed to fiscal sustainability, through the implementation of the reforms supported by this operation.

[5] Migración desde Venezuela a Colombia: impactos y estrategia de respuesta en el corto y mediano plazo"; World Bank, 2018.

5. **Reducing the vulnerability to terms of trade fluctuations requires further reforms to enable diversification and productivity growth in non-extractive sectors.** Factor accumulation (rather than total factor productivity) supported economic growth over the last decades,[6] and Foreign Direct Investment (FDI) heavily concentrated in the extractive sectors. The current external environment implies headwinds for these "traditional" drivers of growth and elevate the importance of faster productivity growth for the policy agenda. Accelerating reforms to reduce burdensome business regulation, promote better allocation of resources, improve the innovation policy framework, and attract investment in infrastructure will therefore be crucial for Colombia. In particular, further progress is needed in areas including facilitating trade, reducing barriers to entry, streamlining regulations, and increasing the effectiveness of public investments to promote innovation.[7] Supported by this operation, and in line with the new National Development Plan (NDP) currently under discussion in Congress,[8] the authorities are undertaking reforms to remove rigidities, support entrepreneurship, and enable the drivers of productivity growth.

Box 1: The impact of migration from Venezuela

As of March 2019, an estimated 3.7 million people have left Venezuela in response to the economic and social crisis, as well as food scarcity and insecurity. Migration accelerated rapidly during 2018. Approximately 75 percent of migrants went to LAC countries. Colombia is the main recipient of Venezuelan migrants in Latin America (1,202,408 as of January 31, 2019), followed by Peru (708,000), Chile (288,000), Ecuador (221,000, and Argentina (130,000), according to Office of the United Nations High Commissioner for Refugees (UNHCR), International Organization for Migration (IOM), the Platform for the Coordination of Refugees and Migrants from Venezuela (R4V), Migración Colombia, Superintendencia Nacional de Migraciones de Perú. While this constitutes a situation of mixed migration, comprised of economic migrants, returnees to the country of origin, and in a smaller proportion refugees, according to the UN most of the migrants are in urgent need of international protection. Therefore, this situation shares multiple characteristics with the refugee crisis taking place around the world, including: (a) the high volume of migrants, (b) the accelerated rate at which they are leaving the country, and (c) the multidimensional vulnerabilities reported by most migrants, including the lack of travel documents. Migrants arrive with an urgent need to find livelihoods as well as the need to access health, education and housing services, amongst others. The risks for Colombia associated with the migration are substantial. A surge in migration flows that is not adequately managed, including failure to mitigate the multiple impacts in host areas and on migrants could translate into a range of risks in public health, security and stability.

In November 2018, the World Bank jointly with President Duque launched an impact assessment of the Venezuelan migration for Colombia. The analysis found that this unprecedented migration is putting a significant economic, social and institutional toll in host areas, totaling a potential fiscal impact of between 0.26 and 0.41 percent of GDP. The provision of services such as health, education and water and sanitation is particularly problematic. Housing, urban development and infrastructure are also experiencing significant pressures due to the high number of Venezuelans living in deficient conditions. Socially, this migration is putting pressure on the peace consolidation process, with many migrants settling in conflict-affected areas, where there is also a strong presence of Colombian internally displaced people. Negative perceptions vis-à-vis the migrants are increasing as systems for service delivery become overstretched and underemployment and informality increase. Yet, an adverse short-term impact could be off-set in the medium to long term as migrants integrate into the labor market. An additional 0.5 million working-age migrants would lead to an increase in economic growth of 0.2 percentage points, conditional on their integration into the labor market. Therefore, an adequate management of the migration is key to ensuring that negative impacts are mitigated and opportunities for growth and development materialize.

[6] World Bank (2014a).
[7] World Bank (2014a).
[8] Colombia National Development Plan 2018-2022: A New Pact for Colombia (Sources: https://www.pactoporcolombia.gov.co/; https://goo.gl/y3rkzY; https://goo.gl/EyfE2z).

6. **The three pillars supported by this DPF series are mutually reinforcing.** Reforms in the fiscal and the competitiveness pillars are likely to raise investor confidence, support de-risking of the Colombian economy in the context of strong headwinds, and help strengthen foundations for growth. The fiscal space created by the reforms would help protect priority social spending and investment needed to support private sector growth. It would also create fiscal space for the integration of refugees and migrants while continuing the implementation of peace-related activities. At the same time, the short-term economic costs of the fiscal consolidation would be, to some extent, mitigated through competitiveness-enhancing reforms. Similarly, the successful integration of migrants and refugees can generate growth dividends, and expand the tax base, in the medium to long term enhancing the impact of productivity and diversification-related reforms. These reforms build on the strong engagement under previous DPF operations, which supported the adoption and implementation of the fiscal rule, a first wave of tax policy measures, the reform of the General System of Royalties, social security liability management, firms' access to finance, trade facilitation, innovation, and productive development policies among others.[9] The reforms to integrate migrants and refugees are supported by flexibly adjusting the DPF program to respond to a significantly changed external environment.

Box 2: The Global Concessional Financing Facility

The Global Concessional Financing Facility (GCFF) is a partnership sponsored by the World Bank, the UN, and the Islamic Development Bank Group to mobilize the international community to address the financing needs of middle-income countries hosting large numbers of refugees. By combining donor contributions with multilateral bank loans, the GCFF enables eligible middle-income countries that are facing refugee crises to borrow at below regular multilateral development bank rates for providing a global public good. The GCFF represents a coordinated response by the international community to the Syrian refugee crisis, bridging the gap between humanitarian and development assistance and enhancing the coordination between the UN, donors, multilateral development banks, and benefitting (host) countries. The GCFF is currently supported by Canada, Denmark, the European Commission, Germany, Japan, Netherlands, Norway, Sweden, the United Kingdom, and the United States.

7. **There are risks associated with the large migration flow to Colombia, both on the social and macroeconomic front.** On the social front, failure to ensure adequate provision of basic services, including health, basic water and sanitation would increase the public health and contamination risks. Furthermore, the lack of access to sanitary services poses security risks for women and children, given the lack of privacy. Migration also affects host communities adversely in the near term and mitigating this negative impact will be important. On the macroeconomic side, the additional spending needed to provide access to basic public services to the migrants and returnees could pose challenges, resulting in additional financing needs. This DPF helps mitigate these risks.

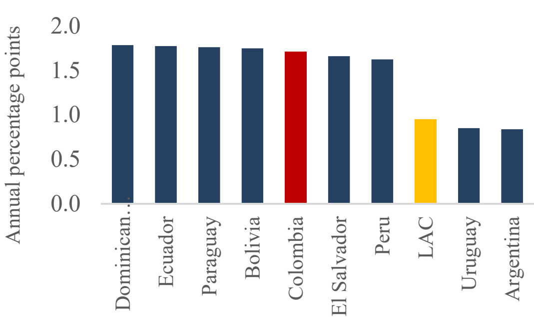
8. **The operation contributes to the peace and post-conflict agenda and is well-aligned with the objectives of the World Bank Group's Colombia Country Partnership Framework (CPF) FY2016-2021[10].** This operation supports Pillar 3 of the CPF, which aims at improving fiscal sustainability and productivity. The operation also supports Pillar 2 of the CPF specifically the objective of improved access to and quality of service delivery by supporting the regularization and integration of refugees and migrants. By contributing to these objectives, the operation further

[9] Fiscal Sustainability and Growth Resilience DPF series (FY11/13); Enhancing Fiscal Capacity to Promote Shared Prosperity DPF (FY14); and Sustained Growth and Income Convergence DPF series (FY15/16).
[10] The CPF (Report No. 101552-CO) was presented to the Board of Directors on April 4, 2016.

supports the CPF's crosscutting area of constructing peace. Furthermore, this DPF complements the reforms supported by the Territorial Development Development Policy Loan (P158520) (approved in FY 2017) such as land management and territorial planning, which in turns fosters regional productivity as well as increased tax collections and investment prioritization at the subnational level. This operation also complements the Sustainable Development and Green Growth DPLs (P150475 and P161642) through measures such as the implementation of a carbon tax and reforms to promote firms' energy efficiency.

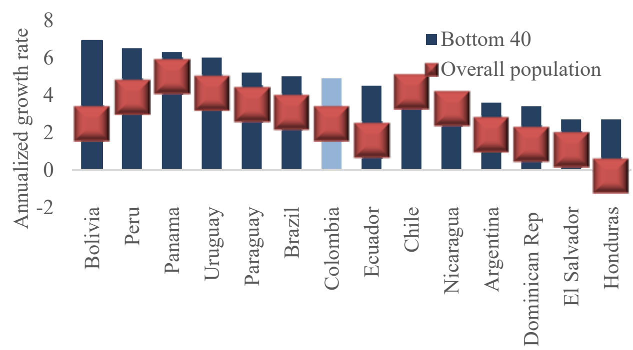
9. **Sound macroeconomic and structural policies contributed to pro-poor economic growth and shared prosperity** (Figures 1 and 2). The moderate poverty rate declined by nearly 20 percentage points since 2004 to 26.9 percent by 2017, while extreme poverty nearly halved to 7.4 percent. More than 6.5 million people were lifted out of poverty over this period and multidimensional poverty declined significantly to 17 percent in 2017, in large part due to increased access to health care and education, and higher educational attainment. Per capita incomes among the bottom 40 percent of the population grew above 4 percent, faster than the national average over the period 2002-2016. Inequality declined significantly to 50.8 by 2017, primarily due to labor income dynamics and, to a lesser extent, transfers.

Figure 1. Growth has been pro-poor (poverty reduction in percent)



Source: World Bank staff calculations based on LAC Equity Lab; Change in poverty rate over circa 2008-16, using a daily poverty line of 5.5 USD (PPP 2011).

Figure 2. Growth has been broadly shared (average annual per capita income growth)



Source: World Bank staff calculations based on SEDLAC and LAC Equity Lab. Note: Data for circa 2009-16.

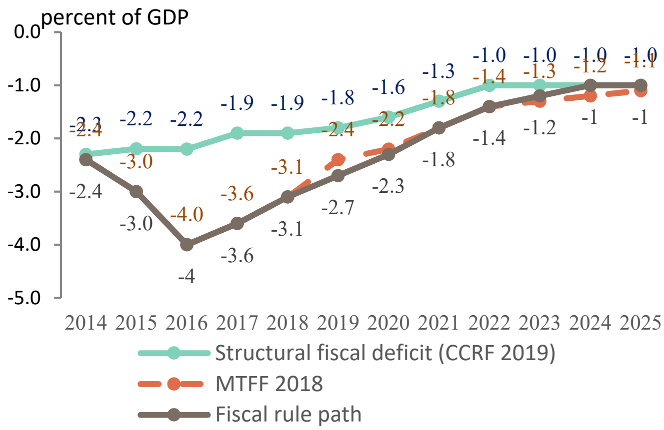
2. MACROECONOMIC POLICY FRAMEWORK

2.1 RECENT ECONOMIC DEVELOPMENTS

10. **Colombia's robust macroeconomic policy framework enabled gradual and orderly fiscal and external adjustments to the significant external shocks experienced over the mid-2014-2015 period.** The economy weathered well the large negative oil income shock of more than 3 percent of GDP, displaying a resilience underpinned by far-reaching macroeconomic and structural reforms undertaken over the last decade. Adequate macroeconomic policies ensured gradual external and fiscal adjustments, with growth decelerating to 1.4 percent in 2017, before accelerating gradually to 2.7 percent in 2018. Lower inflation and interest rates are supporting a recovery in consumer confidence and private consumption in 2018. General government

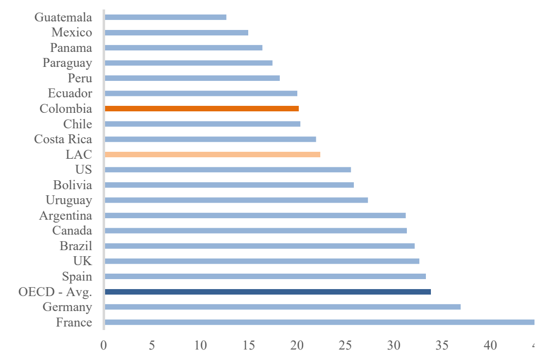
consumption remains supportive of growth, while stronger external demand is also supporting domestic production. Private sector investment is recovering, with 18 4G projects having reached financial closing for a total of US$6.7 billion, as concerns about the Odebrecht-related corruption scandals that slowed the implementation of the 4G road infrastructure program in 2017[11] are dissipating. However, spending on civil works, investments in commercial real estate and residential buildings remain soft, affecting construction and related sectors. Commerce and public administration support growth, while growth in manufacturing, utilities, financial sector, and real estate services is more subdued.

Figure 3. Central government deficit path



Source: MTFF, Comité Consultivo de la Regla Fiscal 2019.

Figure 4. General government tax revenues to GDP ratio, 2012-2016 average



Source: OECD.

11. **A sharp deterioration in the terms of trade led to a widening in the current account deficit in 2014-15, a trend reversed since 2016.** Exports declined by 40 percent between 2014 and 2016, largely due to the sharp decline in oil exports, down 71.7 percent over this period, and of other traditional exports such as coal, coffee, and ferronickel. The current account deficit widened to 6.3 percent of GDP by 2015, before narrowing to 3.3 percent in 2017. Consistent with the inflation-targeting regime, the flexible exchange rate acted as the main shock absorber. The sharp depreciation contributed to the marked decline in imports, while non-oil exports responded only gradually. The deficit widened to 3.8 percent of GDP in 2018, due to stronger demand for imports and as higher profits at foreign companies operating in Colombia resulted in higher income outflows. The deficit was financed primarily by FDI inflows, which declined to 3.3 percent of GDP in 2018 from 4.3 percent of GDP in 2017. International reserves remained broadly stable, ending the year 2018 at US$48.4 billion, enough to cover 170 percent of the outstanding external short-term debt at remaining maturity and the current account deficit.

12. **Monetary policy was adjusted to limit pass-through, and inflation converged towards the targeted range in early 2018.** Inflation had exceeded the targeted range since February 2015, reaching a peak of 8.96 percent in July 2016, fueled by the pass-through of the currency depreciation to domestic prices, drought-induced higher food prices, and the truck drivers' strike

[11] Colombia has been very successful in structuring and launching one of the largest concessions road programs (4G) in emerging markets, accounting for around 7 percent of GDP. The entire program is comprised of 31 key projects, of which 18 have reached financial closure.

in mid-2016. As a result, between September 2015 and August 2016, the central bank gradually raised its policy rate by 325 basis points, to 7.75 percent and inflation converged to the targeted range of 3% ± 1 pp and has been broadly in line with the central bank's target since early 2018. Well-anchored price expectations and weaker economic activity enabled the central bank to adopt a slightly expansionary monetary stance, cutting the policy rate gradually by a cumulative 350 basis points to 4.25 percent by early May 2018, where it has been maintained.

13. **The bank-dominated financial system is sound and resilient amid less favorable external financing conditions as economic growth show signs of recovery.** The banking system's capital adequacy ratio at 16.2 percent in January 2019 is among the highest in the region and is considerably above the regulatory limit. Bank profitability remained strong during the first half of 2018, with return on assets (ROA) and return on equity (ROE) increasing to 1.8 percent and 12.9 percent, respectively, in January 2019 (compared with 1.1 percent and 8.3 percent in January 2018). The quality of the banking sector's loan portfolio (including leasing) has slightly deteriorated, with the NPL ratio reaching 4.8 percent in January 2019 -up 0.2pp year-on-year. Nonetheless, loan loss provisions have risen with a coverage ratio of 133.7 percent at end-January 2019. Liquidity buffers appear adequate. Monetary easing is expected to support credit growth. On February 23, 2018, Moody's changed the credit outlook to negative on Colombian banks following a similar move for the sovereign.[12]

14. **The financial system remains dominated by a few large and complex financial and cross-sectoral conglomerates, with operations spanning multiple industries and large single-name concentration for banks.** Financial system assets increased rapidly to more than 176.7 percent of GDP as of January 2019, with credit institutions accounting for 38 percent of assets. The top three banks hold about 50 percent of the sector's assets, a degree of concentration above that of Brazil, Chile, or Mexico. In addition, the wave of acquisitions by Colombian banks of systemically important Central American banks resulted in a high cross-border exposure to that region, as well as exposure to exchange rate risks, given the countries' high rates of dollarization. Foreign assets under management by Colombia banks stand at US$85 billion and represent 25 percent of the three main groups' assets in Colombia, a major cross-border exposure with complex control and organizational models. The deterioration of corporate balance sheets since 2013 is a source of vulnerability. A new Law on Financial Conglomerates became effective in 2018, with complementary regulations issued in 2018.

15. **Authorities have maintained a fiscal adjustment path consistent with the fiscal rule, implementing a tax reform and expenditure containment measures (Figure 3)[13].** Since 2016, the country has experienced an important adjustment in the non-oil fiscal deficit in response to the decline in oil-related fiscal revenues of nearly 3.3 percent of GDP. The fiscal rule allows for variations in the oil price cycle, which enabled the government to comply with the structural deficit targets despite lower revenue. In 2018, the central government deficit narrowed to 3.1 percent, with a structural deficit of 1.9 percent of GDP, and the independent fiscal council (*Comité*

[12] The change in credit outlook to negative for the sovereign ahead of the May presidential elections was influenced by slower than expected pace of fiscal consolidation and the perceived risks regarding the political mandate to pass additional fiscal measures.
[13] The fiscal rule mandates a reduction of 1.7 percentage points of GDP in the central government fiscal deficit between 2018 and 2022, which is equivalent to cutting the structural deficit of the central government to 1 percent of GDP by 2022.

Consultivo de la Regla Fiscal) confirmed that the government has complied with the fiscal rule in 2018. Central government revenues, excluding the one-off fees paid by telecom companies Claro and ColTel in 2017, remained relatively stable at 15.1 percent of GDP. Meanwhile, central government general operating expenses and some capital spending were reduced while protecting critical social spending. The general government deficit narrowed to 2.3 percent of GDP in 2017, as regional and local governments posted a surplus of 0.5 percent of GDP. The central government fiscal impulse[14] in 2018 is estimated at -0.2 percent of GDP, with the central government deficit having declined to 3.1 percent of GDP. In December 2017, the S&P credit rating agency downgraded one notch the long-term foreign and local currency and the short-term foreign currency ratings, still at investment grade, on weaker than expected economic growth and underperformance in tax revenues despite the 2016 tax reform, which underscores challenges in complying with the fiscal rule. The S&P affirmed the rating and the stable outlook in December 2018 citing expectations of improvements in the external accounts despite global headwinds and continued commitment to solid fiscal management. Meanwhile, Fitch affirmed the "BBB" sovereign credit rating with a stable outlook in November 2018, on expectations of continued prudent monetary and fiscal policies, including compliance with the fiscal rule, and improvements in the business climate. In March 2019, the independent fiscal council revised the fiscal consolidation path required by the rule, to accommodate a sharp increase in migration related expenditures expected to continue in the near term.

16. **The authorities are implementing the 2016 structural tax reform, with a view to increasing the efficiency of the tax system and raise revenues, which remain lower than the regional average (Figure 4), while creating fiscal space for post-conflict and migration-related spending.** This structural reform is comprised *inter alia* of an increase of 3 percentage points in the VAT to 19 percent, a simplification of the tax code (primarily of income taxes), a modest reduction in exemptions, and reforms of selected excise and subnational taxes, including taxes on cigarettes and alcohol. The reform gradually reduces the high corporate income tax burden and allows VAT paid on capital goods purchases to be credited against the corporate income tax. It also contains measures to incentivize formalization and strengthen tax administration, including higher penalties for evasion and the adoption of the electronic invoice. The government estimated at the time that the tax reform would generate a cumulative 3.1 percentage points of GDP by 2022. However, the impact of the reforms thus far has been smaller than expected and is reflected in the medium-term projections (Tables 1 & 2). The 2019 Financing Law approved in December 2018 incentivizes investment, reducing the effective tax burden on firms, and introduces some revenue measures to help meet the fiscal rule.

17. **External debt has increased markedly in recent years, in part due to valuation effects and higher public sector borrowing requirements, but this trend has been reversed since 2017.** External debt increased to 42.5 percent of GDP in 2016, from 38.2 percent of GDP the previous year, but declined to 38.9 percent of GDP by November 2018, mainly because of a 3.3 percentage point drop in external public sector debt (to 21.8 percent of GDP). The private sector external debt also declined by 1.9 percentage points of GDP by June 2018 (Figure 5). Gross non-financial public sector debt increased to 52.3 percent of GDP by 2017, before declining to 51.4 percent of GDP by September 2018 (Figure 6). Gross public sector debt, including Ecopetrol and excluding Banco de la República's outstanding external debt, declined from 50.4 percent of GDP

[14] Fiscal impulse is defined as the change in the structural primary deficit.

in 2015 to an estimated 48.7 percent of GDP in 2018 and the currency composition has shifted markedly towards domestic-currency denominated notes.

Table 1. Colombia: Key macroeconomic indicators, 2014–2021

	2014	2015	2016	2017	2018	Proj. 2019	2020	2021
Real sector	Annual percentage change, unless otherwise indicated							
Real GDP	4.7	3.0	2.1	1.4	2.7	3.5	3.7	3.7
Contributions:								
Consumption	3.8	2.8	1.4	2.0	3.3	3.3	2.4	2.5
Investment	2.2	0.7	-0.7	0.4	0.3	0.8	1.1	1.1
Net exports	-1.8	0.5	0.8	0.1	-1.5	-0.6	0.2	0.0
Imports	7.8	-1.1	-3.5	1.2	8.0	5.8	2.6	2.5
Exports	-0.3	1.7	-0.2	2.5	1.2	4.7	5.1	3.9
Unemployment rate (nat. def.)	9.2	9.1	9.2	9.1				
GDP deflator	2.1	2.4	5.1	5.1	3.3	3.9	3.0	4.2
CPI (average)	3.7	6.8	5.7	4.1	3.2	3.2	3.2	3.2
Fiscal accounts (Central Government)^								
Revenues	16.7	16.1	15.0	15.5	15.1	15.7	15.6	15.7
Expenditures	19.1	19.2	18.9	18.9	18.1	18.5	17.9	17.6
Fiscal balance (CG)	-2.4	-3.0	-4.0	-3.6	-3.1	-2.7	-2.3	-1.8
Fiscal accounts (General Government)	Percent of GDP, unless otherwise indicated							
Revenues	27.5	25.4	24.3	24.5	25.2	26.2	25.1	25.0
Expenditures	29.2	28.6	27.4	26.9	27.0	28.4	26.1	26.4
Fiscal balance	-1.7	-3.2	-3.0	-2.3	-1.8	-2.2	-1.0	-1.4
Gross public debt*	46.6	50.4	49.8	49.4	51.8	50.2	48.2	46.8
Selected monetary accounts	Annual percentage change, unless otherwise indicated							
Base money	15.4	17.1	2.5	5.0	10.4			
Credit to private sector	14.6	18.1	9.2	12.1	9.5			
Policy interest rate	4.5	5.8	7.5	4.8	4.3			
External sector	Percent of GDP, unless otherwise indicated							
Current account balance	-5.2	-6.3	-4.3	-3.3	-3.8	-3.9	-3.7	-3.6
Imports GNFS (% change, real)	7.8	-1.1	-3.5	1.2	8.0	5.8	2.6	2.5
Exports GNFS (% change, real)	-0.3	1.7	-0.2	2.5	1.2	4.7	5.1	3.9
Foreign direct investment (net)	3.2	2.6	3.3	3.3	1.8	3.0	3.2	3.3
Gross reserves (US$ billion, eop)	47.3	46.7	46.7	47.6	48.4			
In months of next year's imports	8.8	10.3	9.9	9.4	8.7			
As % of short-term external debt	317	289	312	272	239			
External debt	26.7	38.2	42.5	39.6	38.9			
Terms of trade (% change)	-5.1	-15.9	-3.9	9.6	4.9			
Exchange rate (COP/US$, average)	2000	2743	3,051	2951	2956			
Memo items								
Nominal GDP (US$ million, current)	381,112	293,482	282,825	311,790	330,228			
Nominal GDP (COP billion, current)	762,903	804,692	863,782	920,194	976,056	1,049,268	1,120,345	209761.6
Oil production (hundred thousand barrels/day)	990	1,005	886	854	865	872	890	840
Oil price (Brent spot price, US$/barrel)	99	51	44	54	72	67	64	64

^ The Government of Colombia follows the GFSM 1986. *Includes Ecopetrol and Banco de la Republica's outstanding external debt.

Table 2: Colombia: Key fiscal indicators for the central government, 2014-2021 (% of GDP)

						Proj.		
	2014	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Total revenues	**16.7**	**16.1**	**15.0**	**15.6**	**15.1**	**15.7**	**15.6**	**15.7**
Tax revenues	14.3	14.5	13.6	13.8	13.6	14.0	13.9	13.9
Net income tax and profits	6.6	6.6	6.3	6.3	5.6	5.9	5.7	5.6
Value-added tax	5.1	5.2	4.9	5.5	5.4	5.5	5.0	5.0
International trade	0.5	0.6	0.5	0.4	0.5	0.5	0.5	0.5
Financial transactions tax	0.9	0.8	0.8	0.7	0.7	0.8	0.8	0.8
Stamp and other taxes	1.2	1.3	1.2	0.9	1.3	1.3	1.9	1.9
Non-tax revenues	0.1	0.1	0.1	0.6	0.1	0.2	0.5	0.6
Capital revenues	2.2	1.5	1.2	1.3	1.4	1.5	1.3	1.3
o/w Ecopetrol dividends	1.4	0.5	0.1	0.1	0.3	0.9	0.9	0.9
Total expenditures	**19.1**	**19.2**	**18.9**	**19.2**	**18.1**	**18.5**	**17.9**	**17.6**
Current expenditures	14.8	15.0	15.6	15.8	15.3	15.7	15.3	15.0
Wages and salaries	2.3	2.3	2.3	2.3	2.2	2.2	2.2	2.2
Goods and services	0.8	0.8	0.8	0.6	0.8	1.1	0.7	0.6
Interest	2.2	2.6	2.9	2.9	2.8	2.9	2.8	2.8
Current transfers	9.5	9.3	9.6	9.7	9.4	9.5	9.5	9.3
Other	0.0	0.0	0.0	0.3	0.1	0.0	0.0	0.0
Capital expenditures	4.3	4.3	3.4	3.4	2.8	2.8	2.7	2.6
Fixed capital formation	3.0	3.1	2.0	1.9	1.6	1.5	1.5	1.5
Capital transfers	1.3	1.2	1.3	1.5	1.2	1.2	1.2	1.1
Primary balance	-0.2	-0.5	-1.0	-0.6	-0.2	0.2	0.6	1.0
Overall fiscal balance	**-2.4**	**-3.0**	**-4.0**	**-3.6**	**-3.1**	**-2.7**	**-2.3**	**-1.8**
Structural fiscal balance^	-2.3	-2.2	-2.2	-1.9	-1.9	-1.8	-1.6	-1.0
Financing needs	**7.0**	**8.6**	**8.4**	**8.2**	**7.2**	**8.2**	**6.9**	**6.4**
Overall fiscal balance	2.4	3.0	4.0	3.6	3.1	2.7	2.3	1.8
Amortizations	2.9	3.2	1.9	2.5	1.6	3.3	2.5	2.5
Other*	1.7	2.3	2.5	2.2	2.5	2.2	2.1	2.1
Financing sources	**7.0**	**8.6**	**8.4**	**8.3**	**7.3**	**7.9**	**6.9**	**6.9**
Domestic	4.6	3.8	4.5	4.3	4.3	4.6	4.5	4.5
External	1.4	2.3	1.7	1.6	0.9	1.6	1.2	1.2
Carryover and other	1.0	2.4	2.2	2.4	2.1	1.7	1.2	1.2
Memo items								
Non-oil Central Government tax revenue	13.1	13.8	13.8	13.4	13.3	13.0	13.3	13.3
Regional and local government balance	0.4	-0.5	0.3	0.5	0.3	0.3	-0.1	0.6
Decentralized sector balance	0.7	-0.4	1.6	1.0	0.8	0.5	0.7	0.8
Non-financial Public Sector (NFPS) balance	-1.8	-3.4	-2.4	-2.6	-2.2	-2.3	-1.6	-1.1

*Includes arrears, judicial claims, and savings. ^Adjusted for the economic and mining and oil cycle.
Note: Colombia follows GFSM 1986

Table 3. Balance of Payments financing requirements and sources, 2014-2021 (US$ million)

	2014	2015	2016	2017	2018	2019	2020	2021
Financing requirements	**45,960**	**43,019**	**34,526**	**40,548**	**39,873**	**43,149**	**43,458**	**46,372**
Current account deficit	19,768	18,586	12,027	10,296	12,661	13,172	13,130	13,549
External debt amortization	21,755	24,018	22,334	29,706	26,385	28,930	29,071	31,534
Medium and long term	9,591	9,586	7,572	15,094	9,078	11,660	11,753	14,189
Short term	12,164	14,431	14,762	14,612	17,307	17,270	17,318	17,346
Gross reserve accumulation	4,437	415	165	545	827	1,047	1,257	1,289
Financing sources	**45,960**	**43,019**	**34,526**	**40,548**	**39,873**	**43,149**	**43,458**	**46,372**
FDI (net)	12,268	7,505	9,331	10,146	5,890	10,148	11,186	12,590
o/w inward (net)	16,325	11,723	13,850	14,013	8,390	14,456	15,934	17,935
External debt disbursements	32,525	34,561	31,912	33,105	31,250	33,071	33,148	36,484
Medium and long term	18,094	19,799	17,300	15,798	13,980	15,753	15,802	19,126
Short term	14,431	14,762	14,612	17,307	17,270	17,318	17,346	17,359
Other capital flows (net)	1,166	953	-6,717	-2,703	2,732	-70	-876	-2,703

Figure 5. External debt (% of GDP)

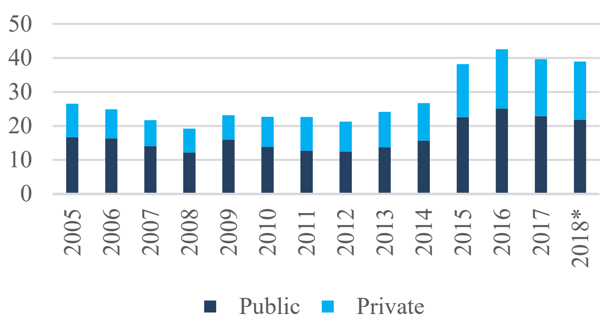
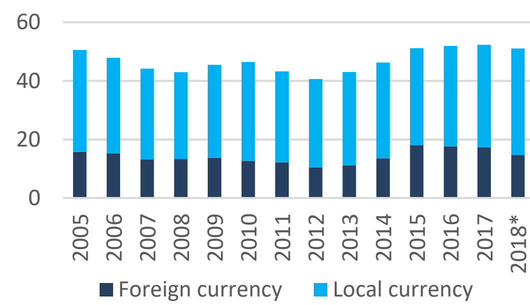


Figure 6. Gross non-financial sector public debt (% of GDP)



Source: Central bank, IMF and World Bank staff calculations.
*2018 data as of November

2.2 MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

18. **Growth is expected to accelerate at a moderate pace over the 2019-2021 period, supported by stronger private consumption and a pick-up in investment supported by lower effective corporate taxes.** Improved confidence, lower inflation, and accommodative monetary policy will support growth in the medium term. Higher profitability in the oil sector is expected to incentivize investments in exploitation and exploration. Meanwhile, a lower tax burden for firms, following the reduction in the corporate income tax and the refund of VAT paid on capital goods is expected to boost investments. More financial closings for the 4G projects and large-scale projects like the Bogota Metro augur well for investment over the 2019-2020 period. Increased investment planning and spending capacity at the subnational level should support public spending. Additional migration-related spending may also provide a modest impulse to support

growth. The revised fiscal rule compliance path provides additional fiscal space to accommodate migration-related spending, requiring the central government deficit to decline by 0.4 percent of GDP in 2019 to 2.7 percent of GDP, and an additional 0.4 percent of GDP in 2020, compared with consolidations of 0.7 percent of GDP and 0.2 percent of GDP required previously. Continued fiscal sustainability efforts should boost investor confidence. Stronger external demand is expected to support growth, while structural reforms are expected to enhance competitiveness and foster diversification over the medium term. Higher commodity prices are expected to boost growth in the extractive sectors, and a pick-up in investment, especially in civil works, should support the construction sector. Meanwhile, growth in the agriculture sector is expected to strengthen over the medium term, supported by an improved security situation and improvements in infrastructure that facilitate access to markets. Ongoing structural reforms, including those supported by this DPF series, will enhance competitiveness and foster diversification, thereby supporting the growth recovery over the medium term.

19. **The current account is expected to improve gradually, supported by higher oil prices and a gradual recovery in non-oil exports**. The current account deficit is expected to narrow marginally over the 2020-2021 period, supported by higher exports of oil and non-traditional goods and services. Imports of services are expected to increase, in line with stronger growth in the oil sector. Furthermore, sluggish domestic demand and the lagged effects of the large currency depreciation are expected to limit import growth. Gross external financing needs will remain sizeable in 2019, comprised primarily of private short- and medium-term debt (Table 3). Net FDI will continue to finance most of the current account deficit, with the remainder being financed by external debt.

20. **Inflation is expected to remain within the central bank's targeted range of 3 ± 1% aided by prudent monetary policy**. In the December central bank survey, inflation expectations increased declined to 3.5 percent from 3.7 percent for end 2019, while excess productive capacity exerts downward pressure on prices. Core inflation has also decelerated to the mid-point of the central bank targeted range, driven slower inflation in tradables. The central bank remains strongly committed to price stabilization.

21. **Further fiscal consolidation is likely necessary to continue complying with the fiscal rule[15] while safeguarding the level of public capital investment and accommodating peace-related as well as migration-related expenditures.** Pressures from post-conflict spending and spending related to the important migration flows from Venezuela, together with the need to ensure sufficient public investment to support medium-term growth, require further fiscal space. Thus, additional fiscal consolidation measures over the 2020-2022 period will be necessary, including targeted expenditure containment and rationalization, as well as efficiency-enhancing measures.[16]

22. **The debt sustainability analysis of the non-financial public sector indicates debt will stabilize and begin a downward trend in the baseline scenario.** In the baseline scenario, the public-debt to GDP ratio will fall below 50 percent of GDP in 2018, declining further to below 43 percent of GDP by 2022. Over the 2018-2022 horizon, primary deficits are expected to subtract 5.7 percentage points from the public debt ratio, growth will lessen the public debt burden by

[15] Complying with the fiscal rule requires cutting the central government fiscal deficit by roughly 1.7 percentage points of GDP between 2018 and 2022 and reducing the structural balance deficit by 0.9 percent of GDP to 1 percent of GDP by 2022.

[16] The 2019 Financing Law incentivizes investment and introduces some revenue measures to help meet the fiscal rule, but additional fiscal consolidation measures may be needed in 2020 to comply with the fiscal rule.

between 1.3 and 1.8 percentage points annually, while the real interest rate is expected to add 5.1 percentage points. With more than 66 percent of the public debt denominated in local currency and a large part at fixed interest rates, depreciation and interest rate shocks do not have a significant impact on the debt trajectory over the short to medium term. Slower than expected economic growth in the short run would push public debt levels slightly above 60 percent of GDP, while a combined macro-financial shock[17] would cause public debt to rise to above 69 percent of GDP by 2020, before declining starting in 2021 (Figure 7).

23. **The Colombian economy faces both external and domestic risks.** On the external front, uncertainties related to the policy mix of major advanced economies could result in disruptive trade and capital flows to emerging economies, including Colombia, whose capital markets have received significant capital flows in recent years and which has a strong foreign investor base. Financial conditions for several emerging economies have deteriorated in recent months due in part to macroeconomic weaknesses in a context of monetary policy normalization in advanced economies and trade disputes. However, there have been limited spillovers to Colombia so far, as indicated by stable risk premia and only a limited depreciation of the peso. As investors reassess risks in an increasingly uncertain global environment, borrowing costs could rise and reversals in portfolio flow are possible. Colombia continues to be vulnerable to such disruptions given important gross external financing needs over the short term. There are also risks stemming from volatility in international prices for Colombia's main exports, including oil, coffee, coal and ferronickel. A faster-than-expected deceleration in the growth of emerging economies would put downward pressure on commodity prices including oil, negatively affecting Colombia's commodity export revenues. Furthermore, changes in trade policies and escalation in trade tensions could negatively affect Colombia as they would heighten international uncertainty and weigh on investment and international commodity prices. On the domestic front, uncertainties surrounding the electoral cycle have dissipated, which should support confidence. Faster implementation of the peace process could boost domestic demand but may also lead to a backloading of fiscal consolidation. Migration from Venezuela represents a source of fiscal risk as large migration flows result in spending pressures, due to increased demand for basic public services, which could make compliance with the fiscal rule more difficult. Other downside risks stem from a slower-than-expected implementation of the 4G infrastructure program. Delays in the implementation of important structural reforms, including the 2016 tax reform and reforms to bolster productivity and competitiveness, could undermine growth prospects over the medium term. Failure to comply with the fiscal rule would negatively affect investor confidence.

24. **Colombia has solid fundamentals and has built strong macroeconomic buffers that mitigate to some extent these risks.** The macroeconomic policy framework remains adequate. Furthermore, Colombia has ample reserves, and recently the central bank has announced a prudential strategy of acquiring additional reserves as a precautionary measure. Colombia also has access to the IMF's Flexible Credit Line of around US$11.4 billion.

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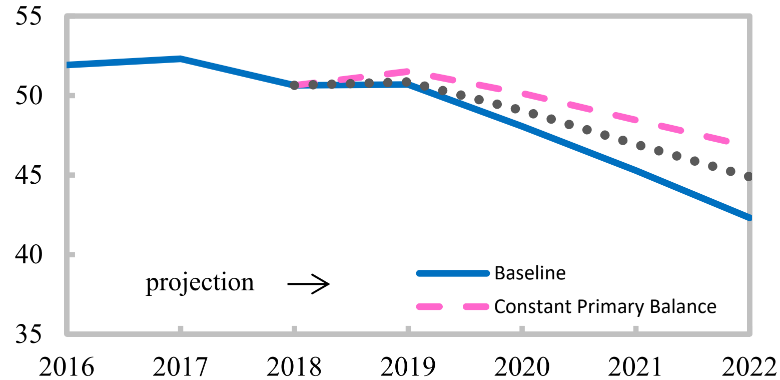
[17] The combined macro-financial shock entails interest rate shock, depreciation shock, and lower growth.

Figure 7. Debt Sustainability Analysis (public debt, % of GDP)



Source: WB staff estimates

2.3 IMF RELATIONS

25. **On April 30, 2018 IMF concluded the Article IV Consultation with Colombia and on May 25, 2018, the IMF Board approved a successor two-year arrangement for Colombia under the precautionary Flexible Credit Line (FCL) facility.** The FCL replaces the 2016 arrangement, to accommodate higher access in the face of increased global risk.[18] The authorities treat the two-year SDR 7.848 billion FCL (equivalent to about US$11.4 billion) only as a precautionary measure. The IMF Board's review concluded that Colombia has very strong economic fundamentals and has a record of very strong policy and institutional frameworks. Furthermore, the authorities are firmly committed to maintain strong policies and implement structural reforms to strengthen the resilience of the economy and support inclusive growth. The authorities have stated that they intend to reduce access in possible requests for subsequent FCL arrangements, to the extent that the reduction of the global risks affecting Colombia allows it. The 2018 Article IV also acknowledges the strong policy framework and the well-executed adjustment policies, the soundness of the financial system and the resilience of corporate and household balance sheets in the smooth adjustment, while also recognizing the downside risks to the outlook. The staff stressed the importance to shift the focus over the medium term to policies that foster inclusive growth. The IMF and World Bank maintain close collaboration. The IMF will provide a Comfort Letter to be included as Annex 3 Fund Relations for the Board distribution package.

3. THE GOVERNMENT'S PROGRAM

26. **A new National Development Plan (NDP) "*Pacto por Colombia – Pacto por la Equidad*" covering the period 2018-2022 is currently under discussion in Congress.** The framework of the proposed NDP is based on three pillars: Legality, Entrepreneurship and Equity; and fifteen crosscutting strategic areas: (i) environment; (ii) science, technology, and innovation; (iii) transport and logistic; (iv) digital transformation; (v) quality and efficiency of public services; (vi) mining and energy resource; (vii) creative industries (orange economy); (viii) peace;

[18] Colombia has had access to FCL arrangements since 2009, renewed every 2 years.

(ix) equality of opportunity for ethnic groups; (x) gender equality; (xi) efficient public administration; (xii) macroeconomic consistency; (xiii) Sustainable Development Targets; (xiv) connecting territories, subnational governments and peoples; and (xv) equity in the regions.

27. **The new NDP builds on the previous NDP that covered the period 2014–2018[19]. It recognizes the importance of complementing growth with social inclusion to promote shared prosperity.** It also maintains a strong regional focus on growth and highlights equity and social inclusion. The two main novelties of the 2018-2022 NDP currently under discussion in Congress is a shift to a focus on legality, and an emphasis on entrepreneurship as both key objective and driver of growth.

28. **Moreover, the new NDP places its three pillars within a consistent macroeconomic framework, anchored around fiscal responsibility.** Specific measures to strengthen fiscal sustainability include the strengthening of tax and customs administration; the reduction of tax compliance costs; the strengthening of transparency in public accounts and the fight against fraud and corruption; and the alignment of the multiannual investment plan with the MTFF.

29. **The new NDP recognizes that productivity and entrepreneurship contribute to poverty reduction and inclusive growth**. It focuses on improvements in productivity and support to entrepreneurship as key strategies to reduce poverty, through job creation and higher household income. This is expected to lead to increased equity and a better educated population. The NDP defines, as part of its strategy, measures to increase productivity and entrepreneurship through the promotion of formalization, the reduction of regulatory barriers, the elimination of barriers that prevent access to markets and finance, and through strengthening the innovation capacity of firms. Additionally, other key components of the new NDP include improved transport and trade facilitation, and the promotion of the national Science, Technology and Innovation system.

30. **With its reforms to integrate and include migrants, including refugees, Colombia is proving a regional leader in the proactive management of the Venezuela migration crisis**. The Colombian authorities have developed a new comprehensive policy framework to address short and medium-term impacts of the migration crisis through the CONPES 3950. This operation supports two key objectives of the CONPES: (1) to identify a roadmap that provides migrants with a pathway to access health, education, early childhood development, water and sanitation, and housing services, as well as to integrate them into the labor market; (2) to strengthen the institutions responsible for addressing the needs of the populations coming from Venezuela.

4. THE PROPOSED OPERATION

4.1 LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

31. **The Fiscal Sustainability, Competitiveness, and Migration DPF series aims to support Colombia's efforts to maintain fiscal sustainability measures and improved contingent liabilities management, foster productivity and growth in non-extractive sectors by strengthening the policy framework for trade facilitation, business regulation, innovation**

[19] A new National Development Plan was submitted to Congress in February 2019.

and green growth and support regularization and integration of migrants, in the context of the ongoing peace process and under a less favorable external environment. The proposed DPF series recognizes and supports the Colombian authorities' reform efforts in the adjustment to this challenging and fast-changing domestic and external environment, and while it builds on the priorities of the NDP 2014-2018, it is also closely aligned with the priorities preliminarily identified for the new NDP 2018-2022, currently under discussion in Congress. The Program Development Objectives (PDOs) are to: (i) support fiscal sustainability measures and improved contingent liabilities management; (ii) foster productivity and growth in non-extractive sectors by strengthening the policy framework for trade facilitation, business regulation, innovation and green growth; and (iii) support regularization and integration of migrants. The reforms under these three objectives reinforce each other. The first two areas of reform are likely to raise investor confidence, reduce costs for the private sector, make the country even more resilient to shocks, and foster stability and growth over the medium term. Additionally, the fiscal sustainability generated through the reform in the first pillar will enable the priority investments for private sector growth as well as the resources required by the integration of migrants and refugees, while also allowing Colombia to reap the potential growth benefits of the peace process. Additionally, the successful inclusion of migrants and refugees can generate growth dividends, and expand the tax base, in the medium-long term, enhancing the impact of the competitiveness and productivity reforms.

32. **With the First Fiscal Sustainability and Competitiveness DPF (P158739) approved in March 2017 and disbursed in March 2018, a new pillar was included in the proposed second operation to support reforms aiming at the inclusion of migrants, including refugees.** Reflecting this new pillar and evolving country developments and the priorities of the new government, some adjustments were made in the prior actions (compared to the indicative triggers) as described in Table 4. While most indicative triggers remained unchanged, new actions have been introduced to fully reflect progress made in the areas supported by the series and to reflect the reforms implemented under the new pillar. Furthermore, new results indicators have been added to strengthen the monitoring and evaluation framework and better track the results.

33. **The design of the proposed operation incorporates lessons learned from previous DPFs and flexibly responds to a changing country context.** The experience of the Fiscal Sustainability and Growth Resilience DPF series (FY12/13) and the Enhancing Fiscal Capacity to Promote Shared Prosperity DPF (FY14) suggests that: (i) the Bank's ability to provide cross-sectoral support through a DPF is an effective tool to address the client's cross-cutting challenges; (ii) DPFs can serve as a vehicle for deepening the policy dialogue on fundamental issues, even beyond the scope of the program supported by the operation; and (iii) the Bank's role as a provider of technical knowledge can further add to the value of a DPF. These three lessons are reflected in the proposed operation, which: (i) supports a crosscutting but interlinked set of reforms; (ii) is based on – and it has led to – several related technical assistance activities; and (iii) is being supported by knowledge activities, including studies that go beyond the scope of the DPF. Among the lessons learned from the preparation of other programmatic DPFs and incorporated was the need to maintain flexibility in the design of the operation to adequately respond to the changing domestic and external conditions, while balancing this flexibility with maintaining rigor to ensure an adequate results framework. The proposed operation has been developed in close collaboration with the Colombian government, reflecting a key lesson learned from other DPFs supporting fiscal and competitiveness reforms on the importance of country ownership and commitment to achieve the program's objectives.

Table 4: Mapping of Indicative Triggers (DPF1) and Prior

Indicative Triggers (DPF1)	Prior Actions (DPF2)	Comments
#1: The government has: (i) maintained the freeze in central government personnel numbers; and (ii) reduced general operating expenditures in the 2017 budget to help support the fiscal adjustment process.	#1: The Borrower has adopted measures to further reduce its Executive Branch's general operating expenditures (*gastos generales*) in the context of the 2019 National Budget, as evidenced by the National General Budget Law 1940 (art 81) dated November 2018, published in the Official Gazette on November 26, 2018.	*No change.* The government remains committed to ensuring compliance with the fiscal rule and has continued to limit public spending accordingly.
#2: The government has issued the regulations implementing the general principles set forth in the Statutory Health Law (Law 1751 of 2015). #3: The government has issued the implementing regulations to centralize procurement of medicines and other measures to promote competition in the pharmaceuticals market.		*Dropped to focus and simplify the program.* The government remains committed to regulate the pharmaceutical market to generate fiscal savings through centralized purchasing, price controls, and promotion of competition and transparency (Resolution 1692 issued by the Ministry of Health on May 23 2017. It remains committed to promote efficiency in public health spending, as evidenced by Decrees 433 and 710, published on March 5 and April 21 of 2018, respectively, and by Circular 7 published in the Official Gazette 50677 on August 6 2018.
#4: The government has issued implementing regulations for the tax reform and for the environmental taxes.	#2: The Borrower has issued the following decrees as part of the implementation of the 2016 tax reform regulating: (i) the tax treatment of dividends and shares, as well as the caps on total deductions and exemptions for personal income, as evidenced by government's Decree 2250 dated 29 of December 2017 and published in the Official Gazette 50461 on 29 of December 2017 to increase progressivity of the tax system; and (ii) the liquor and wine tax, as evidenced by the government's Decree 719 dated April 26 2018 and published in the Official Gazette 50576 on April 26 2018. #3: The Borrower has issued regulations for the national carbon tax and its operationalization, as evidenced by Decree No. 926 published in the Official Gazette on June 1, 2017, and Resolution No. 1447, issued by the Ministry of Environment and Sustainable Development, on August 1, 2018 and published in the Official Gazette on August 2, 2018.	*No change.*

Indicative Triggers (DPF1)	Prior Actions (DPF2)	Comments
#5: The government has issued resolutions on the mandatory use of electronic invoicing for selected taxpayer groups.	#4: The Borrower has issued the following regulations as part of the implementation of the 2016 tax reform: (i) regulation redefining qualification criteria for the not-for-profit entities' special tax regime, as evidenced by Decree No. 2150 published in the Official Gazette on December 20, 2017; (ii) regulation mandating the use of electronic invoicing by Large Taxpayers, as evidenced by Resolution No. 000010 issued by the National Tax and Customs Administration on February 6, 2018 and published in the Official Gazette on February 13, 2018; and (iii) regulation for the detailed reporting requirements for the new transfer pricing regime, as evidenced by Decree No. 2120 published in the Official Gazette on December 15, 2017.	*No change.* The government remains committed to implementing the electronic invoice and strengthen tax administration.
#6: The government has issued implementing regulations for the *regulación aduanera* including the introduction of a risk-based inspection system for customs and the implementation of paperless customs.	#5: The Borrower has adopted a set of regulations to ensure legal certainty, improve risk management and implement paperless customs that include: (i) clarifying the role and responsibilities of public and private stakeholders along the trade logistics chain and fighting smuggling through a more efficient sanctions mechanisms; (ii) simplifying sanitary and phytosanitary requirements for imports of food products and introducing a risk management system for food products with different level of risks, as evidenced, respectively by the Borrower's Decree No. 349 dated February 20th, 2018 issued by the Ministry of Finance; by the Decree No. 2478 issued by the Ministry of Health and dated December 28 2018.	*No change.*
#7: The government has approved a decree that simplifies the rules and procedures for registering foreign investments by introducing new procedures for automatic registration of said foreign investments; and clarifies permitted investments and foreign investors' rights.		*Dropped. Program focus shifted to more recent reforms.* However, the government has simplified the rules for registering foreign investments by eliminating procedures for documental registration, as evidenced by the Borrower's Decree No.119, dated and published on January 26, 2017.
Trigger #8: The government has adopted new competition legislation.		*Dropped,* due to delays in the competition legislation.
Trigger #9: The government has issued an administrative act	#6: The Borrower has adopted measures streamlining the registration of new firms, including, inter alia: (i) the	*This trigger was met, and an additional reform effort was included.* The establishment of a single window

Indicative Triggers (DPF1)	Prior Actions (DPF2)	Comments
establishing the single window for registering new companies under a coordination agency to better articulate business simplification initiatives among the 57 chambers of commerce in Colombia.	simplification of the procedures through the establishment of a single window for registering new firms; (iii) the establishment of a mechanism to identify and eliminate cumbersome regulations, as evidenced respectively in the Decree No. 1875 of 2017, dated and published on November 17, 2017 and Presidential Directive 07 of 2018, dated and published on October 1, 2018.	for registering new companies and a coordination committee to better articulate business simplification initiatives, were completed by the government with the issuance of Decree No. 1875 of 2017 (as described in PA # 10). To complement this reform, the government also established a mechanism to identify and eliminate cumbersome regulations (Presidential Directive 07 of 2018).
Trigger #10: The government has issued the legal framework to articulate and operationalize the merger of the competitiveness and STI systems/programs with a view to improve effectiveness of innovation and productivity programs (Decree for operationalizing the integration of system of STI and Competitiveness).	#7: The Borrower improved the rules for the definition of priorities areas to be funded by the Royalties Fund for STI and improved the transparency and efficiency of the project selection process as evidenced by the Borrower's Decree No. 1467 dated and published on August 6, 2018.	*The trigger was modified* to reflect the new government focus on institutional reform related to sub-national investment funded by royalties ("*regalias").*
	#8: The Borrower has established guidelines to improve efficiency of energy management at the firm level by, inter alia, regulating the sale of surplus energy deriving from the auto-generation of energy at a small scale, as evidenced by the Borrower's Decree No. 348, dated and published on March 1, 2017 (that regulates Law No. 1715 of 2014).	*New prior action.* It supports reforms to promote energy efficiency and firm productivity.
	#9: The Borrower has adopted measures to regularize the legal status of irregular Venezuelan migrants into the national economy, to facilitate their access to the labor market and basic services such as education and health, as evidenced by the Borrower's Decree No.1288, dated and published on July 25, 2018.	*New prior action.* It was added to support measures to integrate Venezuelan migrants into the Colombian economy and society.
	#10: The Borrower has approved a medium term National Policy (up to 2021) to, inter alia, develop a roadmap for the integration of migrants from Venezuela that includes health, education, water and sanitation, support for children, and housing services as well as, services to productively integrate them into labor markets, as evidenced by the CONPES No.3950, dated and published on November 23,2018.[20]	*New prior action.* It was added to reflect national policy for short and mid-term to support integration of migrants from Venezuela into the Colombian economy and harness the opportunities from an unprecedented surge in the number of migrants from Venezuela.

[20] See paragraph 67.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar 1: Support fiscal sustainability measures and improved contingent liabilities management

34. **Colombia's fiscal consolidation process will continue while enabling sufficient fiscal space to cope with post-conflict costs.** The 2016 tax reform and its full implementation are essential to the process of fiscal consolidation. Efforts on the expenditure side, to contain spending and create savings, will also be needed to create additional space for the post-conflict costs[21], to avoid further cuts to public investments, and face additional spending pressures stemming from the large migration flows from Venezuela, while ensuring compliance with the fiscal rule. According to government estimates, the most critical post-conflict related outlays will rise gradually to reach close to 1 percent of GDP over the medium term. It is estimated that in 2017, the resources executed for the compliance with the peace agreement reached 0.83 percent of GDP, of which 0.26 percent of GDP came from the National Central Government (GNC) budget, and 0.25 percent through the General Participation System (*Sistema General de Participaciones*, SGP).[22] Furthermore, it is estimated that migration related spending could amount to between 0.26 and 0.4 percent of GDP. The challenge in reducing spending is that a large share of public spending in Colombia is rigid. According to estimates by the Economic Commission for Latin America and the Caribbean (ECLAC), in 2015-16 the percentage of expenditures that had some degree of flexibility was only 14.5 percent in Colombia, lower than Brazil (21.3 percent), Mexico (22.8 percent), Chile (27.3 percent) and Peru (43.5 percent). Maintaining fiscal sustainability also requires prudent management of contingent liabilities, including measures to mitigate risks and cost-containment measures. Social security and health, among other things, place significant pressures and risks on spending trends. The Colombian authorities remain strongly committed to continue with the fiscal consolidation path established in line with the fiscal rule while addressing emerging spending needs.

Public expenditure and contingent liabilities

***DPL2 Prior Action #1**: The Borrower has adopted measures to further reduce its Executive Branch's general operating expenditures (gastos generales) in the context of the 2019 National Budget, as evidenced by the National General Budget Law 1940 (art 81) dated November 2018, published in the Official Gazette on November 26, 2018.*

35. ***Rationale***. In response to the decline in oil revenues and understanding the need for current spending containment and fiscal savings, the authorities adopted expenditure rationalization measures under several operating expenditure categories in 2016, which were supported by prior actions in the first operation of this series. The central government deficit declined to 3.6 percent of GDP in 2017, while the structural deficit declined to 1.9 percent. In 2018 it is estimated that the budget deficit declined to 3.1 percent of GDP, with an estimated structural deficit of 1.9 percent. The process of consolidation requires that targeted rationalization continue during 2019. A key area where spending containment measures are critical is the health sector. As part of the

[21] Estimates on the post conflict cost vary widely as there are many factors that come into play in those estimation. According to government estimates the most critical post-conflict related outlays will rise gradually to reach close to 1 percent of GDP over the medium term.
[22] Medium term fiscal framework 2018.

implementation of the Statutory Health Law, the government developed a strategy to increase the efficiency of available resources for procurement of Hepatitis C medicines, establishing the criteria for the centralized purchase of these medicines, and for the distribution, supply, and the follow up with patients. The Ministry of Health (MoH) also established the procedure and criteria to determine which imported medicines and medical devices will be subject to managed entry agreements (*puertas de entrada*). In addition, the MoH has taken a series of additional measures to improve the price regulation of medicines and increase efficiency. The government established the mechanisms for the classification of the therapeutic value of new drugs, as well as their economic evaluation, which may include cost-effectiveness and budget impact analysis. It also incorporated new drugs under direct price control and defined maximum prices of other medicines. These measures are complemented by efforts to impose additional spending controls through the budget process.

36. ***Substance of the Prior Action***. The 2019 Budget Law, approved in November 2018, mandates that in order to fill any vacancy, a certification of availability of budgetary resources for all personnel expenses for the fiscal year is required (Art 16). Finally, any request to modify personnel plans (*plantas de personal)* would require a justification, cost comparison between the existing and the proposed personnel plans, and estimations of the impact on overall spending, as well as approval by the Administrative Department of Personnel and Public Management (*Función Pública*). Article 81 of the 2019 Budget Law regulates the spending austerity plan, limiting services contracts, spending on publicity, printing, office upgrading, acquiring cars, changes of office location, acquisition of goods, receptions, and travel expenditures.

37. ***Expected results.*** In 2017, the central government expenditures on personnel and goods and services declined to 2.9 percent of GDP, from 3.1 percent of GDP in 2015, and if peace-related spending is excluded the decline was slightly more. It is expected that the measures supported by the DPF series will contribute to a reduction of the sum of central government personnel and goods and services expenditures from 3.1 percent of GDP in 2015 to 2.8 percent of GDP by 2019, even as a number of operating costs related to the peace process increase.

Tax policy and tax administration

38. **The implementation of the tax reform legislation, coupled with enhanced tax administration, is essential to ensuring fiscal sustainability.** The central government tax-to-GDP dropped from 14.5 percent of GDP in 2015 to an estimated 13.6 percent in 2016. This is below the 17.6 percent tax ratio for the Latin America and Caribbean region, and well below the 20.2 percent average for OECD countries. Non-oil tax revenues declined from 13.9 percent of GDP in 2015 to an estimated 13.6 percent of GDP in 2017, due to weaker-than-expected economic growth and the decline in the corporate tax burden. The Colombian tax system has been characterized by: (i) high marginal tax rates with large exempt income brackets and extensive deductions that erode the tax bases (especially for personal income tax); (ii) low VAT productivity[23] due among other things to special treatment of goods and sectors; (iii) limited progressivity; and (iv) high complexity leading to avoidance and evasion. The tax reform enacted in December 2016 and supported by the first operation of this programmatic series, moved the tax system forward in all these areas. Moving ahead, the implementation of the law, through a sound

[23] VAT revenues as a share of potential VAT collections if the standard VAT rate applied to the entire tax base and all revenues collected.

regulatory framework is critical to achieve the fiscal and job formalization objectives envisaged, and thus an essential component of the overall reform program. In addition, tax administration reforms are critical for lowering compliance costs, reducing evasion and increasing revenue mobilization.

DPL2 Prior Action #2: *The Borrower has issued the following decrees as part of the implementation of the 2016 tax reform regulating: (i) the tax treatment of dividends and shares, as well as the caps on total deductions and exemptions for personal income, as evidenced by government's Decree 2250 dated 29 of December 2017 and published in the Official Gazette 50461 on 29 of December 2017 to increase progressivity of the tax system; and (ii) the liquor and wine tax, as evidenced by the government's Decree 719 dated April 26 2018 and published in the Official Gazette 50576 on April 26 2018.*

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39. ***Rationale***. Inequality is still high in the country, with the Gini coefficient at 0.51in 2017. In this context, higher progressivity is an important objective of the 2016 tax reform in addition to the main goal of supporting fiscal sustainability. The taxation of dividends and the capping of the deductions are designed to increase the progressivity[24] of the personal income tax system. Another important objective of the reform was to generate revenues by increasing taxation of products that have negative externalities and generate increased public health spending, such as alcohol and tobacco. The government has issued Decree 1684 to regulate the implementation of the increase in the specific component of the cigarette and tobacco consumption tax, and to stipulate how the tax is determined and distributed for financing health insurance, establishing the procedures to calculate the additional tax revenues in the departments (*departamentos*) and the Capital District.

40. ***Substance of the Prior Action.*** With the issuance of Decrees 927, 2250 the government is advancing in the implementation of the Laws 1816 and 1819, enacted in December 2016, in the areas of simplification, progressivity, and taxing negative externalities, while increasing revenue to protect social spending and public investment. The implementation efforts supported by this operation are:

- *Regulating the Personal Income Tax, including taxation of dividends and shares, as well as a cap on total deductions and exemptions for personal income.* The Decree provides for the regulations applicable for the purposes of determining the income tax imposed on individuals and undistributed estates. The Decree regulates the tax treatment of dividends and unencumbered shares; income not taxed; special wealth comparison system for determining income; withholding at source for payments or installments in accounts in favor of natural persons without residence in Colombia or undistributed estates of individuals who were not residents in Colombia by the time they deceased; treatment of non-existent passive and of omitted assets and recovery of deductions; voluntary contributions made by the worker, the employer and the independent workers to private pension insurance and voluntary pension funds; withholding tax at the source as income tax for income from work and withholding at source as income tax for dividends or shares. The taxation of dividends (art. 1.2.1.10.3) is done at progressive rates, 5 percent for

[24] Only about 1.2 percent of GDP is collected in personal income tax (PIT), compared with 1.9 percent of GDP on average for Latin America and Caribbean countries and close to 9 percent of GDP for OECD countries. The low PIT revenue to GDP ratio is in part due to large deductions and exemptions with a relatively narrow tax base, and there is therefore scope to increase personal income taxation to increase the progressivity of the tax system.

dividend income above 600 UVT *(Unidad de Valor Tributario)* and at 20 UVT plus 10 percent for dividend income above 1,000 UVT. Total exemptions for labor income are capped at 40 percent or 5,040 UVT. For capital and non-labor income the limit is 10 percent or 1,000 UVT.

- *Regulating departmental taxes: the wine and liquor taxes.* Decree 719 regulates the tax levied on liquor and wine, and the measures aimed at improving departmental control of the production and distribution of liquor, and at strengthening efforts to fight smuggling and counterfeiting.

41. ***Expected results***. The tax reform measures supported by this DPF, which embeds several prior actions under the first and second operation in the series, are expected to support the mobilization of non-oil tax revenues of the central government over the medium term. The faster than expected pace of adjustment to the large oil income shock resulted in lower level of economic activity relative to that projected at the start of the DPF series, with the 2018 real GDP level estimated to be 0.7 percent lower. As a result of lower levels of economic activity, including lower import levels (0.4 percent of GDP as of 2018) and lower private consumption (0.2 percent of GDP as of 2018) non-oil tax collections are lower than projected at the start of the DPF series. Although VAT revenues as a share of GDP have increased by 0.3 percent of GDP since 2015, lower than expected final consumption and imports and slower progress in modernizing the tax administration caused VAT revenues to be 0.3 percentage points lower as a share of GDP than expected at the start of the series. Furthermore, international trade related tax revenues declined more than expected, down an estimated 0.2 percent of GDP since 2015. In addition, the phasing out of tax for equity surcharge (CREE) for corporations,[25] introduced as a temporary tax in 2014, and set to expire in 2019, together with the deceleration in economic activity, have resulted in a decline in non-oil CREE tax revenues of 1.5 percent of GDP since 2015. Additionally, revenues have also been affected by the gradual decline in the wealth tax rate (*Impuesto a la Riqueza para personas jurídicas)* and its elimination in 2018, as per the Law 1739 of 2014. This represented an additional revenue loss of 0.6 percent of GDP relative to 2015. Adjusting for temporary tax revenues, non-oil tax collections excluding CREE are expected to increase from 12.5 percent of GDP in 2015 to 13 percent of GDP by 2019. Measures supported by this DPF series have helped mobilize additional non-oil tax revenues, and their impact will strengthen with the recovery in economic activity over the medium term.

DPL2 Prior Action #3: *The Borrower has issued regulations for the national carbon tax and its operationalization, as evidenced by Decree No. 926 published in the Official Gazette on June 1, 2017, and Resolution No. 1447, issued by the Ministry of Environment and Sustainable Development, on August 1, 2018 and published in the Official Gazette on August 2, 2018.*

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42. ***Rationale***. Environmental taxes are a critical tool to address the negative externalities on the environment and public health imposed by carbon emissions and other pollution. The authorities, through the 2016 structural tax reform, introduced a carbon tax in line with their commitments to the Paris Agreement on Climate Change. Law 1819 of 2016 introduced a tax of COP15,000 per ton of CO_2 emissions to incentivize fuel efficiency and reduce greenhouse gas

[25] The surcharge for the income tax declined from 6 percent in 2017 to 4 percent in 2018 and will drop to 0 percent in 2019. The corporate income tax declined to 33 percent in 2018, from 34 percent in 2017. While the wealth tax dropped an estimated 0.2 percent of GDP in 2018.

emissions by incentivizing switching to cleaner fuels and renewable energy sources. The carbon tax is also expected to lead to higher tax collections. Tax revenues generated from the carbon tax are earmarked for the Fund for Sustainable Colombia, to manage coastal erosion, conservation of hydro sources and ecosystem protection, among other things, in accordance with the Ministry of Environment and Sustainable Development (MADS) guidelines.

43. ***Substance of the Prior Action***. The reform implementation that started with the adoption of Law 1819 of 2016 that introduces the carbon tax, was followed by regulations to define the implementation procedures, including Decree 926 issued in 2017. Decree 926, issued in 2017, defines the implementation procedures relating to the fiscal treatment of the national carbon tax, for the payment of the tax in conditions of zero tariff and non-causality, for control and information provision, for certification of carbon neutrality for the purposes of canceling the carbon tax, and control of carbon neutrality of tax payers, as well as reporting requirements of the MADS to Tax and National Customs Directorate (*Dirección de Impuestos y Aduana Nacional,* DIAN) for taxation and control purposes. In August 2018 the MADS issued the Resolution 1447 for the certification of carbon neutrality creating the conditions for operationalizing the carbon tax by putting in place a system for defining, measuring and monitoring Green House Gas emissions.

44. ***Expected results***. The tax reform measures supported by this DPF, which embeds several prior actions under the first and second operation in the series, are expected to support the mobilization of non-oil tax revenues of the central government over the medium term. Adjusting for these temporary tax revenues, non-oil tax collections excluding CREE are expected to increase from 12.5 percent of GDP in 2015 to 13 percent of GDP by 2019. Measures supported by this DPF series have helped mobilized additional non-oil tax revenues, and their impact will strengthen with the recovery in economic activity over the medium term.

DPL2 Prior Action #4: *The Borrower has issued the following regulations as part of the implementation of the 2016 tax reform: (i) regulation redefining qualification criteria for the not-for-profit entities' special tax regime, as evidenced by Decree No. 2150 published in the Official Gazette on December 20, 2017; (ii) regulation mandating the use of electronic invoicing by Large Taxpayers, as evidenced by Resolution No. 000010 issued by the National Tax and Customs Administration on February 6, 2018 and published in the Official Gazette on February 13, 2018; and (iii) regulation for the detailed reporting requirements for the new transfer pricing regime, as evidenced by Decree No. 2120 published in the Official Gazette on December 15, 2017.*

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45. ***Rationale.*** The special tax regime for not-for-profit organizations (*Entidades Sin Ánimo de Lucro*, ESAL) has several structural weaknesses, opening loopholes that allow taxpayers to use it as a preferential tax regime, thus avoiding or evading taxes and eroding the overall tax base. Among these weaknesses are a differentiated treatment of the three different categories of ESALs, lack of clear definition of their social objective, failure of many of them to serve the public interest or to provide access to communities, lack of a unified registry, which hampers the control and supervision by the government. Moreover, the lack of balance sheet control incentivizes accumulation of profits indefinitely, calling into question their social objective. Close to 50 percent of not-for-profit entities registered in the RUT (Single Tax Registry) are unclassified with respect to the economic activity, and in the case of social development programs there is significant discretionality as accreditation by a public entity is not required. To fight high levels of tax

evasion[26], the government is strengthening controls and closing loopholes in this special tax regime. Another tool to strengthen tax administration is the adoption of electronic invoicing, which is also expected to reduce tax compliance costs. In doing so, it can also help formalize and streamline commerce, and it is an important element of the government's efforts to reduce informality. A more extensive use of electronic invoices is also expected to increase the efficiency of the fiscal control through an optimal use of the information received, while reducing processing time and costs for companies. The pilot phase of the electronic invoice, supported by the first operation in this series, was concluded in November 2016 and has been successful, with all major tax payers participating on a voluntary basis. The government also established the declaration and payment mechanisms of VAT for Offshore Service Providers. The increasingly important role of multinational enterprises (MNEs) in the Colombia economy poses important challenges in terms of finding a balance between improving the business climate to reduce barriers to investment and, at the same time, protecting the country tax base. Colombia, as a new OECD member country and part of the Base Erosion and Profit Shifting (BEPS) Inclusive Framework, is committed to implement the international minimum standards of the Base Erosion and Profit Shifting project as a measure to fight tax evasion and avoidance.

46. ***Substance of the Prior Action.*** With the issuance of Decree 2150, the government is advancing in the implementation of the Laws 1816 and 1819 enacted in December 2016 with a view to reduce avoidance and evasion, while simplifying the tax system. The implementation efforts supported by this operation are the following:

- *Regulating not-for profit entities,* as a measure to fight evasion. Decree 2150 gives the DIAN broad oversight powers over not-for-profit organizations and stipulates that such entities by default pertain to the regular tax regime, and only by exception can they request to be admitted to the Special Tax Regime (STR), if they comply with the following requirements: (i) be constituted as a not-for-profit organization registered with the Chamber of Commerce; (ii) have a social objective of general interest by undertaking activities in at least one of the thirteen qualifying areas[27] defined by Art. 359 of the Tax Code, and providing access to the community; (iii) their contributions not be reimbursed and their surpluses not distributed even after dissolution or liquidation. The regulation requires making public the list of the Board of Directors, reinvests surpluses, and prohibits reimbursement of contributions or distribution of surpluses even after dissolution or liquidation of the not-for-profit organization. It also strengthens the mechanisms of control by both the DIAN and the civil society, making the process of admission to the STR public and allowing civil society to participate by providing comments and observations. Larger ESALs will be required to present to the DIAN an economic memorandum that presents a summary of its projects and financing; annual revenues, expenditure, and surpluses, detailing those not related to its social objective and their assignment to activities specified in Art. 359.

- *Regulation mandating the use of electronic invoice by large taxpayers,* as a measure to strengthen fiscal controls and reduce compliance costs. E-invoicing will also improve efficiency by streamlining the tax credit and refund process, benefiting taxpayers while

[26] Tax evasion on VAT and income tax is estimated at around 4 percent of GDP in the 2015 OECD Economic Survey for Colombia.
[27] Qualifying areas are health, education, culture, sport, etc.

reducing administrative costs. The roll-out of electronic invoicing of the VAT beyond large taxpayers became mandatory on January 1, 2019, with a detailed sectoral schedule.

- *Regulating the detailed reporting requirement for the new transfer pricing regime,* as a measure to fight tax evasion. Decree 2120 continues reforms towards the implementation of international tax standards, introducing the regulation for the implementation of Country by Country Reporting and Transfer Pricing Documentation, Action 13 BEPS minimum standards. The Decree sets out the detailed requirements for the new transfer pricing regime introduced as part of Law No. 1819 of 2016. The topics covered include: the content requirements for the Local report, Master report, and Country by Country reports and the relevant thresholds for preparation, as well as other transfer pricing provisions.

47. ***Expected results*:** The tax reform actions supported by this DPF, are expected to have a positive impact on non-oil tax revenues of the central government, and their impact is expected to strengthen over the medium term as economic growth accelerates. The government expects all businesses to be operating under the new system of electronic invoicing by February 2020. Strengthening the international tax framework and its effective implementation will contribute to improving mobilization of domestic tax resources and avoid base erosion. In a globalized world, international tax evasion and avoidance by multinationals, as well as financial crime, erode tax revenue bases and undermine the fairness and integrity of tax systems. By improving the effectiveness of the tax system to reduce tax evasion, avoidance and tax base erosion, Colombia will encourage tax compliance and improve equity, including ensuring that everyone pays their fair share of taxes in the country. In response to increased fiscal controls to avoid evasion 420,000 new income tax payers (*nuevos contribuyentes*) are expected for the 2016-2019 period. The government has made sustained efforts to contain tax evasion and avoidance, but the increase in the VAT rate from 16 to 19 percent may have contributed to an increase in evasion to 23.6 percent in 2017[28], even as VAT revenues increased from 5.2 percent of GDP in 2015 to 5.5 percent of GDP in 2017. While the higher VAT tax rate became effective in 2017, tax administration reform momentum has been slower than envisaged at the start of the DPF series which may have also contributed to the increase in the evasion rate. Furthermore, potential VAT revenues declined because of changes in the composition of GDP. Final consumption and imports declined relative to nominal GDP by 2.1 percentage points and 3.4 percentage points, respectively, while the difference between import to GDP and exports to GDP declined by 3.1 percentage points.[29] The effects are similar to the ones observed when economic growth decelerated sharply in the wake of the 2009 global financial crisis[30]. Various cross-country VAT tax evasion studies show that growth

[28] Kleven et al (2011) show that tax rate increases lead to increased evasion of the personal income tax in Denmark. Fisman & Wei (2004) show that higher import tariff rates lead to increased evasion of trade between Hong Kong and China.

[29] When the imports to GDP ratio is smaller than the exports to GDP ratio, the potential VAT revenues to GDP tends to become smaller, since potential VAT is estimated as the sum of import VAT plus domestic VAT calculated on domestic VA production minus zero-rated exports. (Fiscal Affairs Department IMF).

[30] Besley and Persson (2013) show that higher GDP per capita – both across countries and over time within a country – is correlated with higher tax compliance rates, and the current tax compliance literature is largely inspired by this work. Work by Jensen (2016) and Naritomi (2016) looks at some of the mechanism that drive increases in tax compliance with growth/development.

decelerations[31] and increases in VAT rates[32] result in higher VAT tax evasion, which has also been the case in Colombia, in a context in which the tax administration reforms have advanced at a slower than envisaged pace. Moreover, the full deductibility of VAT paid on capital goods has affected actual VAT revenues. The efforts made by DIAN to control internal evasion, as well as capital abroad, by allowing DIAN to request information from taxpayers resulted in the normalization of COP20 trillion in assets held abroad and in additional revenues of COP1 trillion. Measures supported by this DPF are expected to help contain and reverse the increase in evasion as measured by the VAT gap[33] from 23.6 percent in 2017 to 23.1 percent in 2019.

Pillar 2: Foster productivity and growth in non-extractive sectors by strengthening the policy framework for trade facilitation, business regulation, innovation and green growth.

48. **Addressing binding constraints to productivity growth requires policy reforms across various areas**. Over the period 2000-2016, annual TFP growth in Colombia averaged -0.2 percent, compared to 0.4 percent in Peru and 3.1 percent in China.[34] The poor productivity growth in Colombia can be decomposed into two components: (i) low average productivity growth at the firm level; and (ii) misallocation of resources between firms, where lower productivity firms employ a disproportionally large share of workers and capital, while higher productivity ones employ a disproportionately low share of workers and capital. Key binding constraints for productivity growth are multiple and need to be addressed in a systemic manner. First, it is important to improve incentives for firms to innovate and integrate into global markets, which are crucial in spurring average firm-level productivity growth. Second, burdensome regulations need to be simplified to improve efficient functioning of markets and address the constraints behind the current productivity misallocation.

[31] In particular, Gómez Sabaini & Morán (2016), Bellina Yrigoyen, Barrenechea & Martínez (2008), Sancak, Velloso & Xing (2010) y CASE (2013) show that for different groups of Latina American and European countries the VAT evasion rate could rise during economic deceleration periods, as incomes of households and firms decline, and they could perceive higher incentives to change to the informal sector.
[32] Similarly, the research of Corbacho, Fretes Cibils & Lora (2013), CASE (2013), Agha & Haughton (1996), Christie & Holzner (2006), Parra Jiménez & Patino (2010), Macías & Cortés (2004) y Steiner & Soto (1998) conclude that for different country groups (OECD, the EU, and Latin American countries) increases in the VAT rate could lead to higher evasion rates, which could be linked to cultural or economic factors that disincentivize taxpayers to comply, especially in countries with weaker revenue mobilization, lower tax paying culture, and high informality like Colombia.
[33] Defined as the difference between potential and actual VAT collections, expressed as a share of potential collections
[34] Total Economy Database, Original Dataset, Growth Accounting and Total Factor Productivity, 1950-2016, November 2017, The Conference Board.

Trade facilitation

***DPL2 Prior Action #5**: The Borrower has adopted a set of regulations to ensure legal certainty, improve risk management and implement paperless customs that include: (i) clarifying the role and responsibilities of public and private stakeholders along the trade logistics chain and fighting smuggling through a more efficient sanctions mechanisms; and (ii) simplifying sanitary and phytosanitary requirements for imports of food products and introducing a risk management system for food products with different level of risks, as evidenced, respectively by the Borrower's Decree No. 349 dated February 20th, 2018 issued by the Ministry of Finance; by the Decree No. 2478 issued by the Ministry of Health and dated December 28, 2018.*

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49. ***Rationale.*** Colombia trades below what its per capita income level would predict. Colombia's share of trade over GDP in 2016 was 34.7 percent, lower than the LAC average (39 percent) and well below the trade share of fast-growing Asia (75 percent).[35] Burdensome border procedures are a crucial obstacle limiting Colombia's trade integration. It takes 112 hours or 4.6 days to conduct border and documentary compliance procedures for imports in Colombia; versus 65 hours or 2.7 days on average in the LAC region or 9 hours on average in OECD countries.[36] More than 70 percent of this delay is due to clearances and inspections from border control public agencies.[37] The OECD Trade Facilitation Indicators confirm that Colombia is underperforming relative to LAC and upper-middle income countries on risk management. The 2018 Logistics Performance Index (LPI) also suggests that the inefficiency of customs and other border agencies is one of the major bottlenecks in Colombia's logistics chain. Indeed, some Colombian border control agencies currently inspect all traded products, instead of focusing on high-risk consignments and expediting the release of low-risk ones. Building on the new customs' regulatory framework, which was supported by the first operation in the series, and the implementation of which is supported by this operation, several border agencies started implementing risk management practices to improve the efficiency of inspections and reduce clearance and documentary compliance time. Considering that each day spent in transit is equivalent to an ad-valorem tariff ranging between 0.6 percent and 2.3 percent, and that delays due to clearance and inspections implemented by border agencies (other than customs) contribute as much as customs to the time to trade, these reforms are likely to lead to significant cost savings for importers.[38] The measures are also complementary to Colombia's trade agenda as they will allow the country to fully benefit from current preferential trade agreements with key trading partners (e.g., United

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[35] World Bank, 2015a.

[36] Doing Business, 2017. The Doing Business report measures import times from vessel arrival to merchandise clearance, covering all activities conducted by public and private actors along the logistics chain when importing a standardized shipment of 15 metric tons of containerized auto-parts from the Unites States through the port of Cartagena. GoC (DNP) import time indicator used in DPL1 monitors only the time between Customs (DIAN) acceptance of the declaration until merchandise clearance averaged across maritime, air and road transport modes; therefore, excluding time spend during port handling and other border/documentary compliance procedures needed before submitting the import declaration. GoC has recently made a time release study including the impact of other border agencies and logistics operators, following methodological recommendations from the World Customs Organization, including a detailed mapping of processes for imports and exports. GoC is weighing continuation of such type of studies.

[37] Doing Business, 2017.

[38] Hummels and Schaur (2013), Time as a Trade Barriers, American Economic Review, 103(7):2935-2959.

States, European Union and Canada) and to maximize the trade potential of regional partnerships such as the Pacific Alliance (which includes Colombia, Chile, Mexico and Peru).

50. ***Substance of the Prior Action.*** The reforms supported by the DPF promote the implementation of the customs' regulatory framework ("*regulación aduanera*"), in compliance with the WTO Trade Facilitation Agreement (TFA).[39] Specifically, the reforms ensure compliance with Article 7 of the TFA on the use of risk management for the release and clearance of goods, and Article 10 on formalities regulating import, export and transit. The Decree 349 dated February 20, 2018 issued by the Ministry of Finance, improves legal certainty about the role and responsibilities of public and private stakeholders along the trade logistics chain (i.e., operators by mode of transport, border control agents, trading firms). Additionally, it also improves the risk management system by allowing customs agents to perform a comprehensive risk analysis at the optimal step of the import process.[40] The Decree also reduces penalties for unintended errors while significantly strengthening them for smuggling. Decree 2478 from the Health Ministry and the National institute for Surveillance of Medicine and Food (*Instituto Nacional de Vigilancia de Medicamentos y Alimentos,* INVIMA) provides a new streamlined framework for import and export clearance of food products based on risk management. Specifically, it simplifies import procedures by: (i) eliminating the requirement of the certificate of free sales ("*certificado de venta libre"*) and substituting it with an auto-declaration for products with low levels of risk; and (ii) introducing mutual recognition of control and inspection systems with countries that have signed and ratified treaties or trade agreements with Colombia. The reforms supported by this program are complemented by additional reforms implemented during the same period. Specifically, ICA's automated risk profiling complements the previous reforms by: (i) introducing a risk management system for the selection of physical and documental inspections; (ii) creating a feedback mechanism that allows a continuous improvement of the risk assessment; (iii) organizing periodical meetings with the private sector to discuss control and enforcement activities; and (iv) allowing border post staff to focus on high-risk consignments only and expedite release of low-risk cargo. Additionally, Circular No. 003 dated January 18, 2017, updated by Circular 016 dated May 3, 2017 issued by the Ministry of Commerce, Industry, and Trade (*Ministerio de Comercio, Industria y Turismo*, MINCIT), allows exporting firms to register or modify their information electronically through the Single Window for Foreign Trade (VUCE) eliminating the requirement to register in person at the Antinarcotics Police office. This reform is particularly beneficial for exporting firms located in rural or remote areas. Finally, in compliance with Article 13 of the World Trade Organization Trade Facilitation Agreement, the government also set up a trade facilitation working group through the administrative act no. 2 of 2018, within the national committee on trade logistics, to coordinate between border control agencies, other public institutions, and private sector stakeholders, as well as monitor and evaluate reforms aimed at trade facilitation.[41]

[39] This agreement entered into force on February 22nd, 2017.

[40] Depending on the level of risk of the importer and products, whether it uses advanced declaration or post-audit procedures, the new regulations allow the Customs Authority to decide at which step of the import process physical or documentary inspections should be done (i.e. beginning, importer warehouse, etc.)

[41] Main functions of the trade facilitation committee include (i) proposing trade facilitation measures to all border control public agencies; (ii) analyzing best trade facilitation practices; (iii) identifying border clearance and other trade facilitation obstacles; (iv) proposing measures to improve coordination among different agencies in charge of border control; and (v) monitoring border clearance times.

51. ***Expected results.*** Customs clearance import times[42] (average across all modes of transport) will decrease by 19 percent from 23.85 hours in 2015 to 20 hours in 2019.[43] By the end of June 2018, the clearance import time was 22 hours.

Business regulation

52. The indicative trigger considered under this policy area in the first operation in the series has been expanded to reflect additional reforms to support the simplification of business registration.

DPL2 Prior Action #6: *The Borrower has adopted measures streamlining the registration of new firms, including, inter alia: (i) the simplification of the procedures through the establishment of a single window for registering new firms; and (ii) the establishment of a mechanism to identify and eliminate cumbersome regulations, as evidenced respectively in the Decree No. 1875 of 2017, dated and published on November 17, 2017 and Presidential Directive 07 of 2018, dated and published on October 1, 2018.*

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53. ***Rationale.*** Business environment indicators, as well as entry and density rates of new firms, indicate that Colombia continues to face challenges in promoting entrepreneurship. Young firms and startups play a crucial role in contributing to job creation and economic dynamism. Conditional on size, the average young firm in Colombia grows much faster, is more productive and creates more jobs than an average old firm.[44] However, the number of procedures and days it takes to register a business is well above the average of OECD countries. Barriers to entry are obstacles for the creation, operation, and expansion of new firms.[45] The literature also shows that there is a strong relationship between greater entrepreneurial dynamism and GDP per capita.[46] A key indicator of entrepreneurial dynamism is the new firms' density rate, defined as new firms formally registered throughout the year as a percentage of the active population (age 15-64). Colombia's new firm density rate in 2016 was 2.28 percent, while firm density in other Latin American economies like Peru and Chile was 3.63 and 8.93, respectively.[47] The highest entry rates—those above 15 percent—are found in industrial countries such as Australia and the United Kingdom, while the average in OECD countries is 6.29 percent. Entry rates also have a significantly negative relationship with the cost of starting a business and a significantly positive relationship with better governance.[48] To start addressing this challenge, promote economic dynamism and foster the creation of new firms, the government simplified the process of starting new businesses by issuing Decree 768 in mid-2016. This Decree electronically linked the databases of DIAN (tax authority) and the business registries housed at the chambers of commerce, so entrepreneurs no longer need to visit DIAN to register their businesses, as they can directly

[42] Data collected by Sinergia/DNP (www.sinergia.dnp.gov.co)
[43] Back of the envelope calculations for 2017 based on Hummels and Schaur (2013) suggest that this reduction in clearance time could lead to a 52 million cost-saving for importers. In addition is expected that the physical inspection rates from ICA will decrease from 100 percent in 2015 to 70 percent for products from animal origin and 80 percent for other agricultural products in 2019.
[44] Eslava and Haltiwanger (2013).
[45] Bruhn (2011).
[46] Klapper (2006).
[47] World Bank Group entrepreneurship data
[48] World Bank (2007).

obtain the RUT (Single Tax Registry) and NIT (Tax Identification Number) at the Chamber of Commerce. Further, Decree 768 eliminated the requirement for opening a bank account to register a new firm; this was burdensome for micro and small firms as well as young entrepreneurs who are often excluded from the formal financial system. Despite these improvements, businesses continue to face significant regulatory barriers and restrictions imposed by redundant and inefficient regulations. According to the National Planning Department (DNP, 2017), between 2000 and 2016, the executive branch of the Colombian government issued 94,748 regulations (9,222 in 2016 alone), many of which impose additional regulatory burdens on private businesses. Presidential Directive 07 of 2018 is an important step to consolidate efforts from the 2014 policy roadmap for regulatory improvement, which recommends ex-ante regulatory impact analysis (RIA) and appropriate public consultations through a web platform (SUCOP) to minimize the adverse impact of new regulations limiting market functioning.

54. ***Substance of the Prior Action.*** The government issued Decree 1875 of 2017 creating an electronic one-stop-shop (*Ventanilla Única Empresarial – VUE*) to register new companies merging most registration procedures under a single electronic entry point and simplifying current registration procedures and processes for new startups. The single window will not only reduce costs and save time, but it will also make procedural requirements more transparent. Furthermore, Decree 1875 of 2017 designated a coordinating agency to articulate future business simplification initiatives. In addition to simplifying business registration efforts, authorities issued Presidential Directive 07 of 2018 to help identify regulations and administrative procedures affecting citizens and firms to streamline or eliminate them. Presidential Directive 07 of 2018 sets a methodology to identify cumbersome regulations and administrative producers via public consultation and includes guidelines to classify and prioritize these barriers. This tool could play an important role in moving simplification efforts beyond the registration with the Chamber of Commerce and DIAN, expanding it to the registration of new firms with social security, labor risks, severance fund and pension agencies.

55. ***Expected results.*** The reforms supported by this DPF series are expected to increase the number of firms[49] registered online through the new single window from 0 in 2015 to 12,000 in 2018.[50] By the end of September 2019, the number of firms registered online through the new single window was already 9,371.[51]

Innovation

DPL2 Prior Action #7: *The Borrower improved the rules for the definition of priorities areas to be funded by the Royalties Fund for STI and improved the transparency and efficiency of the project selection process as evidenced by the Borrower's Decree No. 1467 dated and published on August 6, 2018.*

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[49] Including individual persons ("*personas naturales*") and legal entities ("*personas juridicas*").

[50] The Ministry of Commerce, Industry and Trade keeps electronic records of all business registrations at the electronic one-stop-shop (*Ventanilla Única Empresarial* – VUE).

[51] The original indicator only covered joint-stock companies and the team has decided to expand it for all firms due to the following reasons: i) most companies in Colombia are sole-proprietorship firms (in 2017, 255,255 sole-proprietorship firms were registered compared to 68,780 joint-stock companies); ii) informal entrepreneurs usually choose to register as sole proprietors once they decide to formalize their activities; and iii) lowering entry costs would have a disproportionate positive effect on smaller firms.

56. ***Rationale***. Not only is average productivity growth relatively low, but there are large differences in productivity levels across firms in Colombia, hinting at inefficiencies in the economy.[52] In the context of low commodity prices, unleashing productivity has become an essential priority, and a key channel to achieve this is through promoting innovation. Innovation is one of the key factors driving within-firm productivity and is influenced by the incentives set by the institutional and policy context. Since the pioneering work of Arrow (1962) and Nelson (1959), public intervention in supporting innovation has been justified by three key market failures: uncertainty, appropriability, and inseparability. Further, these market failures can be accentuated in contexts where markets are not fully developed, particularly in financial markets, which leads to the under-financing of innovation investments. Given complexity in diagnosing the exact market failures leading to under-investment in innovation, identifying the correct public interventions remains a challenge.[53][54] This problem is especially acute at the sub-national level, where diagnostic and implementation capacities are especially weak as shown by the ongoing analytical work assessing sub-national expenditures in science, technology, and innovation (STI). Government failures in identifying and implementing the correct interventions can lead to distortions in the national innovation system and misallocation of productive resources, which in turn can hamper productivity in some sectors and, through them, in the whole economy. In supporting innovation, the Colombian government faces two interconnected challenges. On one side, the level of investment in research and development (R&D) at 0.29 percent of GDP, lower than the 0.7 percent average in Latin America and significantly lower than the OECD average (2.38 percent).[55] On the other, the effectiveness of public investment in STI is limited, especially that of the sub-national investments funded through royalties (*regalias)*.[56]

57. ***Substance of the prior action.*** The government approved Decree No. 1467 of August 6, 2018. This reform implies two significant improvements. First, it mandates that local governments/departments (*departamentos*) follow a more open and effective process upstream, at the stage of identifying local challenges and priorities for STI investments. Second, once these priorities have been identified, it mandates that the process to select the most effective STI projects to address them should be open[57] and competitive through public calls (*convocatorias)*. This new system generates a "quasi-market" for the allocation of investments in STI with improved transparency and contestability. This reform complements previous measures enacted by the Government as part of a broader reform package. Specifically, the government also approved Decree 293 of February 22, 2017, which mandates that only the investments prioritized in the Strategic Departmental Plans for STI (*Planes y Acuerdos Estrategicos Departamentales*, PAED)

[52] A recent study found an 850 percent difference in productivity between manufacturing firms in the 90th vs. the 10th percentile of the productivity distribution, suggesting a higher level of productivity misallocation relative to the United States (Brown et al, 2015).
[53] World Bank, (2017).
[54] World Bank (2017). The Innovation Paradox: Developing Country Capabilities and the Unrealized Promise of Technological Catch-up.
[55] This refers to latest comparable R&D investment data from 2015 (Yearly Report on STI Indicators, Observatorio Colombiano de Ciencia y Tecnologia, 2017).
[56] For more details on these weaknesses see World Bank (2016). Public Expenditure Review of Science Technology and Innovation in Colombia, Project #153595; and World Bank (2018). Efficiency Analysis of Public Investment in Science, Technology and Innovation.
[57] The reform also expands the range of actors that can compete and propose STI projects, and it eliminates the separation between those actors who propose solutions and those who implement them, a situation which had led to significant inefficiencies.

can be financed through *regalias.* This represents a significant improvement in the quality of the investments as it introduces the rigorous requirement that local governments identify specific market failures for investments in STI in coordination with DNP and the Administrative Department of Science, Technology and Innovation (*Departamento Administrativo de Ciencia, Tecnología e Innovación,* COLCIENCIAS). In addition, the government approved Decree 584 of April 4, 2017, which regulates the Departmental Council for STI (*Consejos Departamentales de Ciencia, Tecnología e Innovación*, CODECTI), the body in charge of developing and revising the PAED. A key aspect of this reform is that it requires strong participation of local private sector representatives, as well as the presence of national authorities (i.e. COLCIENCIAS and DNP) to guarantee a stronger capacity to identify, develop and prioritize effective investments to promote innovation and reduce the risk of government failures (or local capture). Overall, these reforms contribute to improving institutional capacity at the local level. Until recently, institutional weaknesses affected the number of investments approved, leading to the accumulation of a significant unused balance in the STI fund.[58] Furthermore, the reforms are expected to improve the quality of investments significantly.[59]

58. ***Expected results.*** The total value of the projects that are registered in the PAED and that have been approved by OCAD (*Organismo Colegiado de Administración y Decisión*) will increase from COP 326.1 billion (2015) to COP 410 billion (2019).

Energy efficiency at the firm level

DPL2 Prior Action #8: *The Borrower has established guidelines to improve efficiency of energy management at the firm level by, inter alia, regulating the sale of surplus energy deriving from the auto-generation of energy at a small scale, as evidenced by the Borrower's Decree No. 348, dated and published on March 1, 2017 (that regulates Law No. 1715 of 2014).*

59. ***Rationale.*** The cost of electricity in Colombia accounts for 20 percent of the total cost of production in main sectors such as paper, cement, textiles, steel, glass ceramics and fertilizers. In 2015, electricity prices were approximately 11.98 cents per kilowatt-hour in Colombia.[60] This figure is higher than the ones of other countries such as Argentina (1.81 US$ cents/KWH), Peru (7.52 US$ cents/KWH), Brazil (8.68 US$ cents/KWH), Costa Rica (11.32 US$ cents/KWH) (Andi, 2015). In this context, policies aiming at improving efficiency of energy management at the firm level will improve firm competitiveness by lowering average costs of production and by reducing operation and maintenance costs.[61] The regulation of the processes and rules to allow firms to connect to the grid and to sell their energy surplus will also have a positive impact on production costs, by increasing the capacity of energy generation and guaranteeing enough supply of energy to the productive sectors during water shortage periods. From an environmental perspective, the promotion of higher levels of energy efficiency in production processes will help

[58] According to official Colciencias data, during the period 2012-2016 the STI fund had a balance of US$1.2 billion and approved a portfolio of regional projects worth only 720 US million, meaning that the rate of use hovered around 60 percent, leaving nearly US$480 million unused.
[59] This was confirmed by an audit that was performed by *Contraloría General de la Republica* in 2016, which confirmed that ITC investments lack of clear strategic objectives and were not necessarily related with innovation activities (see Informe De Auditoria Desempeño No. 145,2016)
[60] Here prices are computed for industries consuming more than 500.000 Kilowatt
[61] OECD and EIA, 2014.

Colombia to meet its international environmental commitments by potentially decreasing the amount of greenhouse gas emissions, which are directly related with climate change.[62] Empirical evidence also shows that environmentally friendly energy management is associated with lower energy intensity and with higher levels of firm productivity. Firms that adopt more such practices also engage in more R&D related to climate change.[63]

60. ***Substance of the prior action.*** Law No. 1715 of 2014 promotes the generation of electricity from non-conventional sources and the efficient use and management of energy with the expedition of a series of parameters on energy policy and technical regulation. In July 2018, the Government approved CONPES No. 3934 for Green Growth. CONPES sets an ambitious medium- to long-term national policy through 2030 that promotes the sustainable and efficient use of resources, with a special emphasis on economic activities that allow firms to produce "more with less", increase productivity and boost the competitiveness of the Colombian economy. In line with this policy, the government defined the policies related to the sale of surpluses deriving from energy auto-generation at a small scale in the interconnected national system. The provision to the national system of the energy surpluses coming from auto-generation and co-generation aims to decrease the uncertainty and price variation of energy provision, particularly in periods of scarcity of other main energy sources such as hydropower. The reform will improve firms' energy efficiency by increasing both the number of firms that are auto-generating energy, as well as the current amount of energy that can be auto-generated by each firm. The reform will also have a positive impact on firm competitiveness by reducing the costs of production for Colombian firms, especially for those that are in more energy-intensive sectors.

61. ***Expected results.*** The installed capacity of energy that is auto-generated and co-generated will increase from 86.6 MW in 2015 to 198.64 MW in 2019.[64] By the end of September 2018, the installed capacity of energy that was auto-generated and co-generated was already 198.64 MW.

Pillar 3: Support regularization and integration of migrants.

62. **Colombia is receiving a large inflow of Venezuelans, which is likely to result in increased demand for key basic services.** According to official data as of the end of February 2019 1,226,507 Venezuelans entered Colombia, including 589,445 regular migrants, 96,760 migrants within the authorized deadline, 74,578 holders of visa/foreign ID card, and 465,724 irregular migrants.[65] In addition, more than 300,000 Colombians had returned to Colombia as of end September 2018. Additionally, it is estimated that during the first 9 months of 2018, 724,036 Venezuelans have transited through Colombia and moved to other countries. Of the 1.6 million Venezuelans with a temporary mobility card, which allows them to temporarily enter the Colombian territory, 45,000 cross the border daily to purchase basic foodstuff, medicines or access health and education services.[66] The Government of Colombia has responded effectively and with

[62] IPPC (2007).
[63] Martin et al. (2012)
[64] It is important to note that although the expected result is ambitious in terms of increase from its baseline, the auto-generated and co-generated participation in the total energy market will remain small taking into account that the total energy installed capacity of the country in 2018 is 17.192 MW (XM. PARATEC. Parámetros Técnicos del SIM. Total Effective Capacity Net)
[65] Irregular migrants are considered those migrants that have entered through non-authorized checkpoints or are going beyond the limits of authorized human mobility, according to the Ministry of External Relations definition.
[66] Migración Colombia, Presentación Migración Venezolana en Colombia, September 2018.

solidarity to this migration (Box 3). Colombia has maintained a policy of open borders with Venezuela while putting in place a range of migration instruments that provide avenues to migrants to move in an organized manner, either in border areas (through mobility border cards), throughout the Colombian territory (with transit permits), or to stay in the country with a regular migratory status (through instruments like visas and the Special Permit of Permanence, PEP). It has also issued several policies granting access to emergency health care and education services to all migrants, as well as protection services to unaccompanied minors and vulnerable populations. The government has issued regulations that streamline and fast-track the process to regularize the status of irregular Venezuelan migrants through the PEP and has developed a medium-term National Policy (2019-2021) to develop a roadmap and strengthen institutional capacities for effective Venezuelan migrant integration. The Government provided guidelines to all relevant ministries and agencies to respond to the challenges emerging from this migration.

Box 3. The Government of Colombia response to migration

The Government's response can be grouped into four packages of measures. The first one was rolled out in 2015 to deal with the expulsion and return of 22,000 Colombians from Venezuela. These measures aimed at ensuring a more heightened institutional presence at the three main border points (La Guajira, Norte de Santander, and Arauca), through the deployment of control units with representatives from many national and local government entities. Furthermore, priority was given to providing humanitarian assistance to the migrants, by attending to health emergencies and births, constructing five shelters, and conducting health fairs (pediatrics and vaccination).[1] Law 1565 of 2012, which sets forth measures and incentives for promoting the return of Colombians residing abroad, was implemented to facilitate the return and reception of Colombian returnees. Lastly, authorities began to monitor the migratory flow from Venezuela.

The second response package was instituted in 2017 and included new measures for improving the management of the migrant population and enabling access to basic services. The Government developed two tools for regularizing the migratory flow in border areas. First, in order to facilitate pendulum migration, the Government created the border crossing permit (TMF), which allows access to Colombian territory for a maximum of seven days, restricting their access to the border areas. Second, with a view to granting migratory status to regular migrants who wish to become residents, the Government created the special residence permit (PEP), which allows migrants to work and have access to health, education and financial services. A total of 68,875 PEPs were issued as part of this second response package. In relation to access, the Colombian authorities provided emergency health care and education services for migrant children and made provisions to support infants, boys, girls, and adolescents.

In February of 2018, priority was given to three lines of action: (i) security and control at the border; (ii) solidarity and protection of human rights of migrants and returnees; and (iii) economic development and support for returnees. As part of measures to enhance border security and control, border checks were increased. Security operations were stepped up and the security presence at the border was strengthened, increasing to a total of 2,150 security personnel. Other measures included the tightening of controls on companies that hire migrants, the suspension of the TMF, and the strengthening of the technological capacity and staff of *Migración Colombia*. The Government established the *Grupo Especial Migratorio* - GEM (Special Group on Migration) to ensure more effective interinstitutional coordination on border control. The GEM is made up of the National Police, the *Instituto Colombiano de Bienestar Familiar* - ICBF (Colombian Family Welfare Institute), the *Departamento de Impuestos y Aduanas Nacionales* - DIAN (National Directorate of Taxes and Customs), and *Migración Colombia*. The role of the group is to monitor and ensure the appropriate use of migration tools such as the TMF and PEP, recover public spaces occupied by migrants and returnees living on the streets, control smuggling, and protect minors who have been abandoned or separated from their parents. Issuance of PEPs was resumed during the third phase, with 111,708 permits being granted. The *Registro Administrativo de Migrantes Venezolanos* - RAMV (Administrative Registry of Venezuelan Migrants) entered into operation, and as of June 8, 2018, 442,462 irregular Venezuelan migrants from 253,575 households had been registered. Lastly, in December 2018 the Government announced a series of additional measures. These include: The approval of CONPES 3950 providing guidelines for the response to the Venezuelan migration, and the launch of a series of migration instruments such as a fourth PEP regularizing by December 2018 an additional 110 migrants; the reactivation of the TMF issuing over 1 million cards by January 2019; and the creation of a transit permit targeting migrants whose destination is not Colombia.

***DPL2 Prior Action #9**: The Borrower has adopted measures to regularize the legal status of irregular Venezuelan migrants into the national economy, to facilitate their access to the labor market and basic services such as education and health, as evidenced by the Borrower's Decree No.1288, dated and published on July 25, 2018.*

63. ***Rationale.*** An adequate policy response to this unprecedented migration can mitigate negative impacts in the short term and maximize the potential for longer-term economic benefits for Colombia. Recent studies suggest that migrants can contribute positively to economic growth in receiving countries but that the extent to which this can be realized depends on the policy environment in these countries.[67] These effects operate through various channels. First, by facilitating access to the formal labor market for migrants, this can help limit increases in informal, lower productivity work, and more effectively take advantage of skills that migrants may bring with them.[68] Second, integration also serves to boost self-reliance and reduce the scope for criminal or anti-social behavior. Third, on the fiscal side, access to the formal labor market can help increase tax revenues and reduce the need for subsidized access to social services. In fact, while in the short-run migrants arrive with urgent health and education needs, in the long run, as confirmed by the evidence, migrants are net contributors to the receiving country in fiscal terms when one takes into account both taxes and transfers.[69] This is particularly true for populations with certain employability challenges, such as youth and women, and for demographic groups who face higher risks if excluded from basic services, which is the case of pregnant women. Finally, there is evidence that suggests that migration can also boost innovation due to a self-selection bias that associates the decision to migrate with personal attributes such as assertiveness and entrepreneurial spirit.[70]

64. ***Substance of the Prior Action.*** Decree 1288/2018 is a step towards an efficient integration process of the Venezuelan migrants. The measures introduced by the Decree help protect vulnerable migrants, including youth and women, and is expected to boost labor force dynamism, innovation and growth potential in the longer run. Specifically, the Decree modifies the eligibility requirements and the time frame to grant a PEP to irregular migrants that have been registered by the government in the Administrative Registry of Venezuelan Migrants (*Registro Adminstrativo de Venezolanos*, RAMV). The migrants that have been issued PEPs are able to work and access services legally, including the registration in the subsidized health care system. This will particularly benefit populations with high health risks, such as pregnant women. Furthermore, the Decree reduces regulatory barriers that affected immigrants' access to public services previously, such as the requirement of official educational attainment certificates for enrolling migrant children in public schools. Additionally, the Decree mandates the creation of a framework to equivalate higher education degrees.

[67] Clemens, Huang and Graham (2018) "The Economic and Fiscal Effects of Granting Refugees Formal Labor Market Access - Working Paper 496" October 2018.
[68] Clemens and Hunt (2017) analyzing the impact of multiple refugees' waves confirm that impact of immigration on average native-born workers is small and fails to substantiate claims of large detrimental impacts on workers with less than high school. Similarly, Peri (2012) shows long term positive effect of immigration on productivity in US, with no evidence that immigrants crowded out employment. Tabellini (2018) shows how immigration in US increased natives' employment and occupational standing and fostered industrial production in the US as effect of European immigration. Boubtane and Dumont (2013) document positive impact of human capital brought by migrants on economic growth in OECD countries**.**
[69] Dustmann and Frattini (2014) focusing on UK provides evidence of the positive fiscal effects of immigrants from EU to UK during the period 1995-2011.
[70] Hunt and Marjolaine (2010) shows the positive impact of immigrant college graduates' population on innovation (measured as patents per capita).

65. ***Expected Results.*** It is expected that the measures contribute to an increase in the number of Venezuelan migrants in the RAMV that have been issued a PEP, from zero in 2015 to 280,000 in 2019 (of which 125,000 women).[71]

DPL2 Prior Action #10*: The Borrower has approved a medium term National Policy (up to 2021) to, inter alia, develop a roadmap for the integration of migrants from Venezuela that includes health, education, water and sanitation, support for children, and housing services as well as, services to productively integrate them into labor markets, as evidenced by the CONPES No.3950, dated and published on November 23,2018.*[72]

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66. ***Rationale***. While the government has taken important actions to support the immediate needs of the migrants from Venezuela, such as guaranteeing emergency medical care and facilitating access to schooling on an expeditated basis, these actions have been short-term and of an emergency nature. As the crisis transitions from a response dominated by humanitarian needs to a longer-term developmental challenge, the government needs to develop concrete sector plans and effective institutional coordination to ensure that this vulnerable population can be supported. Such plans are needed not only to ensure effective support for the migrants, including refugees, but also for host communities directly affected by the crisis. They also should cater for the vulnerabilities experienced by specific demographic groups, including women and youth. The recently completed World Bank study on the impact of the migration crisis[73] provided various detailed recommendations in this regard.

67. ***Substance of the Prior Action.*** Building from the formalization process enacted through Decree No.1288, CONPES[74] No.3950 provides a broad framework for the government to respond to the developmental needs emerging from the Venezuelan migration over the medium-term (through 2021). The World Bank support, through this Development Policy Financing, focuses specifically and exclusively in the following areas: health, education, water and sanitation, labor, support for children, housing and labor. The CONPES diagnostic for these areas is fully aligned with that in the World Bank's study on the impact of the migration crisis.

68. ***Expected Results.*** It is expected that the number of migrants from Venezuela receiving services from the National Employment Agency will increase from zero in 2015 to 50,000 for the period 2016-2019, of which 25,000 are women.

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[71] Out of a total of 442,462 migrants that were registered as of June 8, 2018 when the registry closed.

[72] The World Bank, through this Development Policy Financing, will specifically and exclusively support the actions in CONPES No. 3950 that fall within the following areas of the mandate of development of the World Bank: health, education, water and sanitation, support for children, housing, and labor.

[73] "Migración desde Venezuela a Colombia: impactos y estrategia de respuesta en el corto y mediano plazo"; World Bank, 2018.

[74] A CONPES document contains a public policy that has been approved by the *Consejo Nacional de Politica Economica y Social* (CONPES). This council was created by Law No. 19 of 1958 and is the highest national planning authority of the country and acts as an advisory body to the Government in all aspects related to economic and social development. While not technically binding by law, currently all CONPES documents are built upon the commitment of the government agencies to execute actions and achieve specific and measurable goals with attached indicators that are regularly monitored by the National Planning Department.

Table 5. Prior Actions and Analytical Underpinnings

Prior actions	Analytical Underpinnings
Pillar 1: Support fiscal sustainability measures and improved contingent liabilities management	
Prior action #1: The Borrower has adopted measures to further reduce its Executive Branch's general operating expenditures (gastos generales) in the context of the 2019 National Budget, as evidenced by the National General Budget Law 1940 (art 81) dated November 2018, published in the Official Gazette on November 26, 2018.	Fiscal rule (2011), MTFF (2015, 2016, 2017, 2018) Comisión de Gastos e Inversión Pública.
Prior action #2: The Borrower has issued the following decrees as part of the implementation of the 2016 tax reform regulating: (i) the tax treatment of dividends and shares, as well as the caps on total deductions and exemptions for personal income, as evidenced by government's Decree 2250 dated 29 of December 2017 and published in the Official Gazette 50461 on 29 of December 2017 to increase progressivity of the tax system; and (ii) the liquor and wine tax, as evidenced by the government's Decree 719 dated April 26 2018 and published in the Official Gazette 50576 on April 26 2018.	Tax Commission Report (2016): Colombia's tax system generates relatively little revenue compared to its potential; does not contribute to a more equitable distribution of revenue; exhibits horizontal inequity between persons and companies; is complex and difficult to administer; and penalizes investment, employment and competitiveness. OECD (2015, 2017): The Colombian corporate tax system is highly complex and distortive. The effective tax burden on businesses is very high due to the combined effect of the corporate income tax, the corporate surtax (CREE), the net wealth tax on business assets and the value-added tax (VAT) on fixed assets. OECD (2017) Revisiting personal income tax in Latin America: Evolution and impact. CIAT (2017): Cincuenta años en el quehacer tributario de América Latina Andrea Yanira Rodriguez et al. 2016 – Impuestos al Tabaco, Papeles en Salud, No. 1, Colombia, Ministerio de Salud y Protección Social. Ley 1819 de 2016.
Prior action #3: The Borrower has issued regulations for the national carbon tax and its operationalization, as evidenced by Decree No. 926 published in the Official Gazette on June 1, 2017, and Resolution No. 1447, issued by the Ministry of Environment and Sustainable Development, on August 1, 2018 and published in the Official Gazette on August 2, 2018.	OECD (2015, 2017): Environmentally related tax revenues in Colombia, at 0.9 percent of GDP, are low compared to OECD (1.6 percent) and Latin American countries. Lower taxation of diesel than gasoline has environmental costs given that diesel has higher carbon emissions per liter of fuel used.
Prior action #4: The Borrower has issued the following regulations as part of the implementation of the 2016 tax reform: (i) regulation redefining qualification criteria for the not-for-profit entities' special tax regime, as evidenced by Decree No. 2150 published in the Official Gazette on December 20, 2017; (ii) regulation mandating the use of electronic invoicing by Large Taxpayers, as evidenced by Resolution No. 000010 issued by the National Tax and Customs Administration on February 6, 2018 and published in the Official Gazette on February 13, 2018; and (iii) regulation for	OECD (2017) IMF (2015): Legal changes, including stronger sanctions, are needed in many countries to enable administrations to better deter non-compliance. Tax Commission Report (2016): The adoption of the electronic invoice should be accelerated in order to strengthen control and reduce tax evasion.

Prior actions	Analytical Underpinnings
the detailed reporting requirements for the new transfer pricing regime, as evidenced by Decree No. 2120 published in the Official Gazette on December 15, 2017.	
Pillar 2: Foster productivity and growth in non-extractive sectors by strengthening the policy framework for trade facilitation, business regulation, innovation and green growth	
Prior action #5: The Borrower has adopted a set of regulations to ensure legal certainty, improve risk management and implement paperless customs that include: (i) clarifying the role and responsibilities of public and private stakeholders along the trade logistics chain and fighting smuggling through a more efficient sanctions mechanisms; (ii) simplifying sanitary and phytosanitary requirements for imports of food products and introducing a risk management system for food products with different level of risks, as evidenced, respectively by the Borrower's Decree No. 349 dated February 20th, 2018 issued by the Ministry of Finance; by the Decree No. 2478 issued by the Ministry of Health and dated December 28 2018.	World Bank (2015): Despite a wide array of public policies designed to foster trade openness and global insertion, Colombia is still far from fulfilling its trade potential given its development stage. Its export basket is highly concentrated and dependent on extractive industries. Hummels and Schaur (2013). Each day in transit is equivalent to an ad-valorem tariff equivalent ranging between 0.6 percent and 2.3 percent. Hillberry and Zhang (2015). Full implementation of the TFA has the potential to reduce time to import by over a day and a half (a 47 percent reduction) and time to export by almost two days (a 91 percent reduction). Governance and automation are the most time-saving reforms. Zaki (2014). A 50 percent reduction of the ad valorem equivalent of the time to export and import will increase imports and exports by approximately 10 percent in Latin American countries. WTO (2015). TFS implementation would increase the number of products between 8 and 10 percent for developing countries that are not part of the G20.
Prior action #6: The Borrower has adopted measures streamlining the registration of new firms, including, inter alia: (i) the simplification of the procedures through the establishment of a single window for registering new firms; (iii) the establishment of a mechanism to identify and eliminate cumbersome regulations, as evidenced respectively in the Decree No. 1875 of 2017, dated and published on November 17, 2017 and Presidential Directive 07 of 2018, dated and published on October 1, 2018.	Klaper, L., Laeven, L., Rajan, R. (2006): Costly regulations hamper the creation of new firms, especially in industries that should naturally have high entry. Djankov, S. (2002): Countries with heavier regulation of entry have higher corruption and larger unofficial economies, but not better quality of public or private goods. Bruhn, M. (2011:382). In Mexico a reform to facilitate business registration was introduced in different municipalities at different points in time. The reform increased the number of registered businesses by 5 percent and also increased wage employment by 2.2 percent. World Bank (2007): Automation can greatly reduce the barriers to starting a business. This finding makes a strong case for pursuing e-government initiatives to spur entrepreneurship. OECD Review of Regulatory Policy in Colombia (2013): Well-structured and implemented programs of regulatory reform can make a significant contribution to better economic performance and enhanced social welfare. In Colombia there is no single institution responsible for promoting regulatory reform across the administration,

Prior actions	Analytical Underpinnings
	which reflects the piecemeal approach to regulatory management. As a result, mobilization of the whole administration is still a challenge to overcome. WB Colombia Policy Notes (2014): Poor growth performance in Colombia is largely explained by lackluster productivity, associated to low innovation levels. Reforming the National Innovation System will be key to address this issue given its fragmented and inefficient governance. Brown et al (2015): There is a 850 percent difference in productivity between manufacturing firms in the 90th vs. 10th percentile and there is a high level of market misallocation relative to the United States.
Prior action #7: The Borrower improved the rules for the definition of priorities areas to be funded by the Royalties Fund for STI and improved the transparency and efficiency of the project selection process as evidenced by the Borrower's Decree No. 1467 dated and published on August 6, 2018.	Brown et al (2015): There is a 850 percent difference in productivity between manufacturing firms in the 90th vs. 10th percentile and there is a high level of market misallocation relative to the United States. Arrow (1962), Nelson (1959), World Bank (2017): In the area of innovation, market failures such as uncertainty, appropriability and inseparability can be accentuated in contexts where markets are not fully developed because of the existence asymmetric information and imperfect competition, which lead to under-financing of innovation investments and lower incentives to innovate.
Prior action #8: The Borrower has established guidelines to improve efficiency of energy management at the firm level by, inter alia, regulating the sale of surplus energy deriving from the auto-generation of energy at a small scale, as evidenced by the Borrower's Decree No. 348, dated and published on March 1, 2017 (that regulates Law No. 1715 of 2014).	Andi (2015): the costs of energy is one of the highest costs for Colombian firms. OECD/EIA (2014): Improved energy efficiency can deliver multiple benefits across the industry value chain, leading to enhanced competitiveness, more cost-efficient production, and reduced operation and maintenance costs. Jaffe and Stavins (1994) and DeCanio (1993): the failure of firms to adopt profitable, energy-saving innovations can be attributed to market failures and to managerial factors such as short-run optimizing behavior or the lack of managerial resources and attention for cost-cutting projects outside the scope of the firm's main business. Martin et al. (2012): empirical analysis based on a panel of interviewed managers of 190 randomly selected manufacturing plants in the UK shows that 'climate friendly' management practices are associated with lower energy intensity and higher TFP. Firms that adopt more such practices also engage in more R&D related to climate change.
Pillar 3: Support regularization and integration of migrants	
Prior Action #9: The Borrower has adopted measures to regularize the legal status of irregular Venezuelan migrants into the national economy, to facilitate their access to the labor market and basic services such as education and health, as evidenced by the Borrower's Decree No.1288, dated and published on July 25,	Clemens, MA. (2013): Foreign low-skill workers fill jobs that native workers will not, benefiting the economy and creating other positions for locals. Clemens, MA. and Hunt, J. (2017): The evidence from refugee waves shows that the impact of immigration on average native-born workers is small and fails to substantiate claims of large detrimental impacts on workers with less than high school.

Prior actions	Analytical Underpinnings
2018.	Peri, G. (2012): The paper finds no evidence that immigrants crowded out employment. In fact, it shows that immigration had a strong, positive association with total factor productivity. Tabellini, M. (2018): Immigration increased natives' employment and occupational standing and fostered industrial production and capital utilization. However, it triggered hostile political reactions, suggesting that diversity might be economically beneficial but politically hard to manage. Boubtane, E. and J.C. Dumont (2013): Identify a positive impact of the human capital brought by migrants on economic growth, but the net effect is small, including countries which have highly selective migration policies. Dustmann, C. and Frattini, T. (2014): The findings indicate that immigrants from the European Economic Area (EEA) have made a positive fiscal contribution, even during periods when the UK was running budget deficits, while Non-EEA immigrants, not dissimilar to natives, have made a negative contribution. Hunt, J. and Gauthier-Loiselle, M. (2010): Provide quantitative evidence to show that a 1 percentage point increase in immigrant college graduates' population share increases patents per capita by 9-18 percent.
Prior action #10: The Borrower has approved a medium term National Policy (up to 2021) to, inter alia, develop a roadmap for the integration of migrants from Venezuela that includes health, education, water and sanitation, support for children, and housing services as well as, services to productively integrate them into labor markets, as evidenced by the CONPES No.3950, dated and published on November 23,2018.[75]	World Bank (2016): The arrival of large numbers of people in specific locales can create opportunities, but it is key to help create conditions that enable the forcibly displaced to truly rebuild their lives. A comprehensive poverty reduction agenda must include special interventions for the forcibly displaced. World Bank (2018): Colombia is bearing the brunt of the Venezuelan crisis in terms of hosting a more than half of the Venezuelan migrants. Although there are multiple challenges to be addressed still, Colombia's response to integrate migrants can minimize negative short-term effects and generate the basis for more robust growth in the medium-long term.

[75] See paragraph 67.

4.3 LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

69. **The proposed DPF series is consistent with the World Bank Group's Country Partnership Framework (CPF) for FY2016-21.** The CPF, which was discussed by the Board in April 2016, is built on three pillars: (i) fostering balanced territorial development; (ii) enhancing social inclusion and mobility through improved service delivery; and (iii) supporting fiscal sustainability and productivity. Cutting across all pillars, the CPF aims to "Assist in Constructing the Peace" in response to Colombia's historic opportunity to reach a Peace Accord. The proposed DPF series is fully aligned with the third CPF pillar and supports two of its four objectives: improved fiscal management in support of fiscal consolidation; and improved business environment and innovation to boost productivity. It also contributes to the cross-cutting theme of peace-building considering that maintaining fiscal sustainability in the face of increased spending pressures will be critical. Furthermore, this DPF complements the reforms supported by the Territorial Development Policy Loan (P158520) supporting reforms to promote territorial development such as land management and territorial planning, which in turns fosters regional productivity as well as increased tax collections and investment prioritization at the subnational level. This operation also complements the Sustainable Development and Green Growth DPLs (P150475 and P161642) through key measures such as the implementation of a carbon tax and reforms to promote firms' energy efficiency.

70. **This operation is part of an envisaged multi-pronged package of World Bank support to the Government of Colombia to help address the impact of the Venezuelan migration**. First, the World Bank jointly prepared with the Colombian Government a study assessing the impact of the Venezuelan migration, and a multi-sectoral framework to support and mitigate the impacts on host communities. This study provided recommendations on ways to help integrate migrants and mitigate potential adverse impacts on host communities. Second, the WB is working to mobilize a Multi Donor Trust Fund (MTDF) that would support immediate-, short- and medium-term actions in the following four areas: (i) Policy and Institutional Framework for Response; (ii) Increasing the Resilience of Key Sectors and Host Areas; (iii) Supporting Highly Vulnerable Migrants; and (iv) Enabling Environment and Strategic Communication. Third, the WB is discussing with the Government of Colombia two complementary operations that could be prepared during the next 12-18 months: a Program-for-Results (PforR) operation, focused on social service provision to migrants and host communities; and an investment operation to support economic and basic infrastructure resilience, targeting host communities and migrants.

71. **The DPF series is supported by technical work under a range of instruments**. The reforms under Pillar 1 are linked to the activities conducted under the previous and ongoing programmatic knowledge services on fiscal issues, including on tax policy and contingent liabilities. Pillar 2 is closely linked to the following joint World Bank-IFC activities: (i) the programmatic knowledge services on innovation and competitiveness, including the Reimbursable Advisory Services (RAS) supporting the innovation public expenditure review and the RAS supporting the introduction of business environment reforms, including in areas covered by the Doing Business report; (ii) the Investment Policy and Promotion advisory project, which is in turn linked to the *Alianza del Pacifico* (AP) advisory project to increase investment and trade in services in the AP countries; and (iii) the Competition Policy advisory project for Latin America. The reforms under Pillar 3 were supported by a recent study of social, economic and sectorial impacts

of migration conducted by the World Bank: Migration from Venezuela to Colombia – Impacts and Short and Medium-Term Response Strategy.

4.4 CONSULTATIONS, COLLABORATION WITH DEVELOPMENT PARTNERS

72. **Many of the reforms supported by the DPF series were included in the NDP 2014–2018, which underwent extensive public consultations.** The NDP 2014–2018 was developed in consultation with the civil society and a wide range of governmental and nongovernmental agencies. 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. 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. Official consultations with minorities were concluded in mid-January 2015.

73. **Reforms supported by the DPF are closely aligned with the new NDP 2018-2022 currently being discussed in Congress**. While the formulation of the National Development Plan is exclusively a responsibility of the National Planning Department, the final document is the result of close collaboration with all the National Level Ministries, which contribute according to their topic of expertise, and a process of public consultation with ethnic minorities (including indigenous people and Afro-descendants). There is a broad set of jurisprudence to support the consultation process, with a cornerstone in Law 21 of 1991, and going as far as a ruling of the Supreme Court (C-461 2008) that specifically states that a National Development Plan cannot be implemented without such consultation. According to the legal framework, the consultation process for the current NDP took place between the second half of November 2018 and end of January 2019. Typically, this process involves the creation of separate discussion spaces for each interest group (*Mesa Nacional de Concertación con Pueblos Indígenas, la Comisión Consultiva de Alto Nivel de Comunidades Negras, y la Comisión Nacional de Diálogo con el Pueblo Gitano o Rrom*) where the government presents the aspects of the plan with the potential to affect specifically the lives of such communities.

74. **In addition, the reforms supported by this program followed Colombia's existing system for consultations on specific regulations.**[76] Colombia has several instruments that promote public consultation, as outlined in CONPES 3816 and Decrees No. 1595 and 1609 of August 2015. However, how these processes are carried out varies across different institutions and different reform proposals.[77] For example, Decree 2478 from the Ministry of Health was subject to the process of international notification to the WTO; additionally, it required the concept of the Superintendencia de Industria y Comercio, because it affects free competition, according to art.

[76] The government is currently working on a new Administrative Act that aims to establish a unique system for public consultation to strengthen the public consultation process. This reform will establish clear procedures and timelines to be followed in the process of consulting the public on new regulations.

[77] OECD (2014a).

2.1.2.1.9 of Decree 1609 of 2015. The process lasted 3 months and comments were received from Chile, Argentina, Unites States and Ecuador. The other reforms were subject to the usual public consultations processes which depend on the type of regulation, sector, organization, competencies, impacts on citizens or sector policy. Additionally, Presidential Directive 07 of 2018, dated and published on October 1, 2018, established a unique participatory process through both in person and online consultations to identify and eliminate cumbersome regulations.[78]

75. **During the process of preparing the DPF series, the World Bank collaborated with the IMF and the IFC.** Overall, the proposed DPF program is consistent with IMF policy advice, as outlined in the most recent Article IV staff report. Particularly, the Bank has collaborated with the IMF on the review of macroeconomic developments, including fiscal projections and the analysis of debt sustainability. Within the FCI (Finance, Competitiveness and Innovation) Global Practice, which is a joint WB-IFC Practice, the team received inputs both from the WB and the IFC arms of FCI. Several of the advisory projects related to the DPF are joint IFC-WB projects, including the Investment Policy and Promotion and the Competition Policy advisory projects.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1 POVERTY AND SOCIAL IMPACT

76. **Most prior actions supported by this operation are likely to have neutral or positive effects on poverty in the short term.** Moreover, the prior actions are expected to have some moderate positive effects on distributional outcomes over the medium to long-term from a stronger fiscal position, and the integration of migrants from Venezuela into society. All prior actions were screened for likely effects and a poverty and social impact analysis was conducted (included as Annex 5). Prior actions in the first pillar are designed to strengthen the fiscal position of the government of Colombia and enhance tax compliance, thus contributing to fiscal sustainability and supporting the provision of public services and investment through higher tax revenues. Policies associated with the reforms of the health system (such as public procurement of medicines) are aimed at supporting the financial sustainability of the system and guarantee an adequate provision of services. Thus positive but moderate effects on welfare in the medium and long run are expected.

77. **The prior actions under the first pillar are likely to have distributional impacts (either positive or marginally negative) in the short run but are expected to be beneficial in the medium term.** This operation supports a variety of reforms related to the implementation of the tax reform of 2016, including the lowering of corporate income tax rates, the introduction of tax incentives for investment, and the creation of excise taxes and green taxes. The policies supported by Prior Action #2 do not directly entail the creation of new taxes, the change of current tax rates or the increase of the tax base but are more closely related to facilitating the implementation of tax changes included as part of the tax reform. The policies supporting the implementation of the fiscal reform are expected to reduce disposable income in the short run across the income distribution, but also may have positive medium-run impacts on well-being by strengthening the fiscal position

[78] The methodology is described in detail in the document "*Estado Simple, Colombia Ágil*" (http://www.mincit.gov.co/colombiaagil/publicaciones/41676/asi_trabaja_el_gobierno_en_estado_simple_colombia_agil)

of the government, reducing geographical inequality and securing resources for public social spending.

78. **The policies in the second pillar aim to facilitate trade, ease entry and exit of firms in markets, and promote investment in science, technology, and innovation.** Although these policies would not have short-run impacts on welfare, they are expected to moderately promote growth, productivity, and stronger labor markets, potentially improving living conditions in the medium and long run. In addition, policies to improve and strengthen the regulatory and competition framework as well as the regulatory framework in specific network industries are expected to foster competitive markets in Colombia and may have positive indirect impacts on consumer welfare through lower prices, more competitive labor markets, and lower market barriers.

79. **In addition, the policies in the third pillar aim to facilitate the integration and inclusion of migrants, including refugees, from Venezuela into the society (e.g., give access to education, health and social protection services, as well as help them to integrate the labor force) may have some limited negative effects in the short run, although these could be outweighed by positive effects in the medium and long term.** Immigrants may in the short term put some downward pressure on real wages of low-skilled natives. However, regularizing their legal situation and strengthening institutional capacities that help migrants and refugees to integrate into the host communities could lead to an increase in growth, consumption, and investment, mainly via labor productivity growth which consequently could lead to positive effects on poverty reduction and shared prosperity.

5.2 ENVIRONMENTAL ASPECTS

80. **Prior Action 3 on the development of regulations for the carbon tax on non-liquid fossil fuels is likely to have significant positive effects on the environment.** In its Nationally Determined Contribution (NDC) under the Paris Agreement, the government committed itself to reducing its greenhouse gas emissions by 20 percent by 2030. The carbon tax on fossil fuels will help the government achieve this goal. Carbon taxes, along with cap and trade systems, are among the policy instruments that achieve the greatest reduction in greenhouse gas emissions at the lowest cost.[79]

81. **Prior Action 8 on improving energy efficiency and allowing the sale of non-conventional auto-generated electricity into the grid could have significant positive effects on the environment.** Providing incentives to generate electricity from non-conventional sources and promoting energy efficiency has the potential to increase the contribution of renewable energy in the grid mix, thereby lowering greenhouse gas emissions. Potential negative cumulative effects on the environment from construction of renewable energy facilities would be addressed through guidelines for the preparation of Compensation Plans for the Loss of Biodiversity and procedures for environmental benefit certification for new investments.[38]

82. **The remainder of the prior actions are unlikely to have significant effects on the environment.** The remaining prior actions are expected to have neutral or no significant environmental effects.

[79] OECD (2013).

5.3 PFM, DISBURSEMENT AND AUDITING ASPECTS

83. **Colombia's public financial management (PFM) systems are generally strong.** The national-level PFM systems show advanced levels of performance that are moving toward good international practices. A new Public Expenditure and Financial Accountability Assessment for Colombia was finalized in 2016;[80] Overall, Colombia's PFM system exhibits reasonable alignment with international best practices at the national government level. The policy-based fiscal strategy and budgeting has particularly noteworthy positive performance on the institutional capacity to establish a credible fiscal strategy and comply with it. The same can be said of management of assets and liabilities; with room to strengthen the fiscal risk reporting.

84. **Fiscal transparency is generally aligned with international best practices, except in the areas of budget classification and the inclusion of performance information in the budget allocated to the direct delivery of public services to the population**. The government is making efforts to address some of these issues. Practices regarding the predictability and control of budget execution have been adjusted to international standards in Treasury Management, and Internal Control Management; this has not been done for Payroll controls. The government of Colombia has also initiated actions to strengthen the instruments required to foster improvements in these processes, with an aim to consolidate them over the medium term.

85. **There are gaps with respect to international best practices and opportunities for improvements in performance in accounting and reporting and external scrutiny and audit.** If the ongoing reforms are pursued diligently, especially those aimed at strengthening the consolidation of government financial information on the National Balance Sheet and inter-agency coordination of regulators and oversight agencies, these shortcomings may be addressed over the medium term. 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,[81] and annual formulation reflects a mostly well-functioning policy-based system.[82] Execution of budgeted expenditures suggests a largely credible budget. The borrower has published its annual budget in a timely fashion.[83]
- **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.

[80] Public Expenditure and Financial Accountability Assessment (PEFA) 2015 of Colombia's Public Financial Management Systems, October 14, 2016

[81] 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.

[82] See PEFA 2015, IMF 2012 and the World Bank reviews 2013 for more information.

[83] Law 1873 of December 20, 2017.

- **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.

86. **The government is implementing an accounting and auditing reform agenda to adopt and implement international accounting (International Financial Reporting Standards and International Public-Sector Accounting Standards) and auditing standards (International Standards on Auditing).** In the last four years, there have been significant developments toward implementing this reform, including issuing the new regulation for public sector entities (October 2015) adopted in January 2018. The new accounting framework is used to consolidate the government public accounts for year ended December 31, 2018 and will facilitate enhance government's fiscal and financial reporting for decision-making. Going forward, there are still a few challenges for the government to overcome in the reform process.

87. **According to the recent Fiscal Transparency Evaluation (FTE) completed in 2018[84]; among practices rated "basic," the most salient ones relate to reporting and risk management:** (i) weaknesses in the fiscal reporting area stem from inconsistent classification systems, and the incomplete transition to international accounting standards. These impact the scoring on: (1) the credibility of data, which requires a full recognition of pension and public-private partnership (PPP)-related liabilities; and (2) the comparability between budget, outturn, and financial statements; (ii) Risk management's basic scores are partly due to lack of disclosure of otherwise internally available information on macroeconomic scenarios, long-term projections, and public corporations; and (iii) Basic scores in the forecasting and budgeting area are due to fragmentation (lack of budget unity), and gaps in the transparency and management of multiyear public investment projects, as well as weak practices such as public participation and performance indicators for service delivery. Other recent assessments seem to corroborate the FTE's findings, and suggest that Colombia could further enhance its transparency practices.

88. **Disbursement arrangements.** Once the DPF 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 in a commercial bank acceptable to the WB or alternatively 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 canceled from the loan.

[84] (https://www.imf.org/en/publications/cr/issues/2018/08/02/colombia-fiscal-transparency-evaluation-46148

89. **There is no evidence that the banking control environment into which the DPF proceeds would flow is inadequate.** This assessment is based on a review of the (i) 2017-2016 External Audit opinion on the Consolidated Financial Statements of Citigroup Inc.[85] and Subsidiaries; as well as on the effectiveness of the Company's internal control over financial reporting; (ii) the 2017 external audit report of the *Banco de la República;* and (iii) the 2018 IMF Article IV Consultation and the IMF Executive Board approval of a new two-year US$11.4 billion Flexible Credit Line to Colombia in May 2018; the IMF's assessment is that the country continues to meet the qualification criteria for access to FCL resources; focusing on an expedited review of the external audit mechanism of the Central Bank. 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.

5.4 MONITORING, EVALUATION AND ACCOUNTABILITY

90. **MHCP and DNP are responsible for collecting and monitoring information related to program implementation and progress towards the achievement of the results.** MHCP and DNP are responsible for coordinating necessary actions among the agencies involved in reform program supported by this DPF series, in particular, the National Planning Department, the Ministry of Health, the Ministry of Industry and Commerce, Superintendence of Industry and Commerce, the tax administration DIAN. The World Bank has worked closely with the two agencies in order to define results indicators that are clearly spelled out and measurable, giving preference to those that are collected on a regular basis in order to avoid an additional reporting burden. For example, several of the indicators are included in the NDP, which has a robust results framework that is closely monitored by DNP. Other indicators, such as those related to the annual Doing Business exercise, will be produced externally. The Bank will focus on monitoring progress towards the expected results of the program development objectives. The monitoring and evaluation of the operation will be also carried out through the ongoing policy dialogue during the preparation of any subsequent operations and the accompanying technical assistance projects.

91. **Grievance Redress**. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

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[85] The MHCP indicated its intention of requesting the disbursement of the loan into a Government's Bank account in the Citibank of New York, following the WB guidance and procedures.

6. SUMMARY OF RISKS AND MITIGATION

92. **The overall risk associated with the proposed DPF is assessed as moderate**. Many of the reforms supported by the proposed operation are part of the National Development Plan and therefore have strong backing from the government. Risks to the operations are primarily those related to social and stakeholder.

93. **The social risk associated with the proposed DPF is assessed as substantial**. **A surge in migration flows, if not adequately managed and without sufficient mitigation of the near to medium term adverse impact in host areas and on migrants, could translate into a range of risks in public health, security and stability.** The lack of access to sanitary services poses public health risks, as well as security risks for women and children, given the lack of privacy. Migration impacts in public services such as health, basic water and sanitation, and in poverty and employment, could lead to increased xenophobia and social exclusion. The multidimensional vulnerabilities of migrants have made them victims of forced recruitment by criminal organizations and armed groups, as well as of human trafficking and exploitation. There are several mitigating factors to these risks. The Government of Colombia and development partners have launched a number of actions to mitigate and manage these impacts. First, the government has granted access to basic services such as education and emergency health care to the migrant population, while mobilizing health units (i.e. pediatric services and immunizations, among others), expanding protection services to vulnerable groups and allocating additional resources to service provision in border areas, increasing their absorption capacity in the short term. Upon the regularization of migrants, it has also granted them the possibility of accessing health, education and social protection services through national systems. Also, it has created the *Grupo Especial Migratorio* (GEM) composed by the national police, DIAN, Migracion Colombia and the ICBF as to control specific issues emerging from this migration such as human trafficking and forced recruitment, smuggling and the occupation of public spaces. Finally, the Government has rapidly adapted its institutional and legal framework to respond to this migration by creating the Gerencia de Frontera and issuing a range of decrees and guidance notes, has greatly facilitated a coordinated, multi-sectoral response. Development partners such as UNHCR, IOM, WFP and international NGOs, with the financial support of Japan, the EU and the US, have launched a number of actions oriented to support host communities and migrants, including the provision of temporary shelter to migrants, emergency health and nutrition support and family reunification, as well as anti-xenophobia campaigns. These measures help mitigate the social risks.

94. **The stakeholder risk associated with the proposed DPF is assessed as substantial.** This is due to migration-related stakeholder risks as host areas have reported an increase in the perceived levels of crime, although evidence shows that crime has remained unchanged or even decreased in host areas. Yet, this perceived insecurity could lead to tensions between locals and migrants. The Colombian authorities are proactively addressing this risk by supporting host communities and municipalities most affected by the migration inflows with targeted investments and sensitization campaigns.

95. **The risk of impartiality in the application of the law is moderate**. In addition to the risks considered substantial, the Decree # 349 (Prior Action #5) triggered a risk assessment because, even if it is mainly related to customs activities, it modifies the sanctions applicable to

certain crimes (which include smuggling, among others). The risk assessment is discussed in the following paragraphs. First, it is important to note that Decree # 349 does not change the existing institutional framework in Colombia and therefore risks for biased use is the same as for any other existing legislation. Its implementation will occur in the context of existing institutional arrangements with DIAN as the main responsible actor for administrative penalties, in collaboration and interaction with other key state agencies such as The Office of the Attorney General (*Fiscalía General de la Nación*) and police forces in the case of criminal prosecution and Asset Forfeiture[86]. According to the World Justice Project, Colombia is positioned at the average level of the region and income group peers, with relatively better rankings on limited Government powers, civil and criminal justice and regulatory enforcement. Regarding the risks of using the law for political purposes, the fact that both Decrees # 349 and # 390 were subject to intensive debate and broad public consolations with business associations testifies the Government's genuine efforts to ensure the most comprehensive support and legitimacy across Customs services users, ensuring an informed and transparency law-making process. The OECD accession process, where the Government of Colombia will be subject to continuous Members oversight on matters related to trade procedures, is expected to act as an effective incentive for the Government to focus efforts in ensuring effective and impartial implementation of the law, as well as effectively communicating the applicability of the law to the business community and the public.

96. **Furthermore, the accession of Colombia to the OECD confirms that its institutional and regulatory capacity is considered and expected to meet OECD standards.** As part of its accession process, Colombia has been subject to in-depth reviews by 23 OECD Committees and has introduced major reforms to align its legislation, policies and practices to OECD standards[87]. The adoption of the new Customs Code (Decree # 390) supported by the first DPL in the series and complemented by the Decree # 349 supported by this operation, is central to the endeavor to improve the country's competitiveness by facilitating trade while improving the efficiency of border controls against smuggling and fraud. The Customs Code was greatly influenced by the need to emulate international best practice in shaping Customs and international trade procedures, among others with respect to the system of sanctions. The complementary Decree # 349 does not change the procedures to discriminate unintended errors versus smuggling, it only increases the fines for the later. The reforms introduced address some of the requirements for allowing Colombia's accession to the World Customs Organization Revised Kyoto Convention, including with respect to risk management, customs controls and appeal procedures. Therefore, there is limited risks of undue influence and improper prosecutions arising from the implementation of the Decree #349 related to the sanctions mechanism.

97. **Moreover, the country will be subject to continuous OECD members' oversight.** Following the Market Openness Review of Colombia, the Trade Committee concluded that "(…) Colombia's policies and practices are increasingly consistent with OECD best policies and practices in the area of trade"[88]. Additionally, the Trade Committee requested to Colombia to report back after accession on the implementation of its progress in achieving full implementation of the

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[86] The Office of the Attorney General exercises the criminal prosecution and Asset Forfeiture within the framework of the constitutional right to due process.
[87] OECD Council's Roadmap for Accession of Colombia and Market Openness Review of Colombia, among other performed reviews.
[88] OECD Accession of Colombia to the Organization: Formal Opinion of the Trade Committee, dated May 17th, 2018.

Trade Facilitation Agreement as well as of the provisions in the new Customs Code, to enable the Committee to undertake follow-up assessments following the date of its accession for two years.

98. **In terms of the institutional capacity of the implementing agency, as per the OECD Trade Facilitation Indicators, DIAN ranks among the top performers**. This is true both relative to regional and income-level peer agencies on governance and impartiality of Customs administrations (assessing Customs structures and functions, accountability and ethics policy) with an indicator of 1.8 over 2, close to the performance of OECD countries (1.9) and well above the Latin-American average (1.2).[89] This performance has substantially improved between 2015 and 2017. The area where Colombia has room for improvement is appeal procedures (i.e. the possibility and modalities to appeal administrative decisions by border agencies). The Customs Code provides for the possibility for users to lodge an appeal within 15 days from the contested Customs decision. DIAN also has an Office of the Ombudsman where complaints can be filled online[90]. In addition, in a case of legal irregularities or abuse of power, any individual can lodge a complaint against any public servant before the Office of the General Prosecutor (*Procuraduría General de la Nación, Procuraduría*).

Risk Categories	**Rating (H, S, M or L)**
1. Political and governance	M
2. Macroeconomic	M
3. Sector strategies and policies	M
4. Technical design of project or program	L
5. Institutional capacity for implementation and sustainability	M
6. Fiduciary	L
7. Environment and social	S
8. Stakeholders	S
9. Other	Not applicable
Overall	**M**

[89] http://www.oecd.org/trade/facilitation/indicators.htm
[90] http://www.defensoriadian.gov.co/. Such queries are protected by the constitutional right to petition and a recipient institution is obliged to respond, with the Director of the Department being held responsible.

ANNEX 1: POLICY AND RESULTS MATRIX

Prior actions (DPF1)	Prior actions (DPF2)	Results (2019)
Pillar 1: Support fiscal sustainability measures and improved contingent liabilities management		
PA#1: The government has adopted measures to reduce its Executive Branch's recurrent expenditures in the context of the 2016 national budget, including: (i) the implementation of cutbacks in general operating expenses (*gastos generales*) and communication costs; (iii) the establishment of a set of limitations for hiring new personnel, including a freeze in overall personnel numbers, as evidenced by Presidential Decree No. 1 dated February 10, 2016 and published in the Official Gazette on February 10, 2016.	PA#1: The Borrower has adopted measures to further reduce its Executive Branch's general operating expenditures (gastos generales) in the context of the 2019 National Budget, as evidenced by the National General Budget Law 1940 (art 81) dated November 2018, published in the Official Gazette on November 26, 2018.	Reduction in central government personnel expenditures and general operating expenditures (*gastos generales*[91]) as a share of GDP Baseline (2015): personnel expenditures and general operating expenditures of 3.1% of GDP Target (2019): personnel expenditures and general operating expenditures of 2.8% of GDP.
PA#2: The government has established a set of rules to improve the funding of public pension liabilities at the subnational level, including: (i) the requirement of registering public pension liabilities in FONPET on a regular basis and by administration sector; (ii) the procedure for transferring funds across said sectors to ensure adequate funding coverage; and (iii) the conditions for using any excess sectoral savings, as evidenced by Decree No. 630 issued by the Ministry of Finance and Public Credit dated April 18, 2016 and published in the Official Gazette on April 18, 2016.		Increase in the use of FONPET savings to finance subnational contributions to the subsidized health regime Baseline (2015): 0 Target (2016-2019): COP3.7 trillion
PA#3: The government has adopted a tax reform, which, inter alia, (i) increases the general VAT rate from 16% to 19%; (ii) establishes a single Corporate Income Tax, and lowers overall corporate tax rates;	PA#2: The Borrower has issued the following decrees as part of the implementation of the 2016 tax reform regulating: (i) the tax treatment of dividends and shares, as well as the caps on total deductions and exemptions for personal income, as	Non-oil central government tax revenue, excluding the equity tax and surcharge CREE

[91] General operating expenditure excluding post-conflict related expenditure.

Prior actions (DPF1)	Prior actions (DPF2)	Results (2019)
(iii) applies the Personal Income Tax to dividends; (iv) establishes a single tax (“*monotributo*”) for small traders; and (iv) increases the rates of the tobacco and liquor and wine taxes, as evidenced by Law No. 1816 dated December 19, 2016, and Law No. 1819 dated December 29, 2016, and published in the Official Gazette on December 19 and December 29, 2016, respectively. PA#4: The government has adopted the following environmental taxes: (i) a carbon tax on fossil fuels proportional to their CO2 emissions, and (ii) a tax on plastic bags, as evidenced by Law No. 1819, dated December 29, 2016 and published in the Official Gazette on December 29, 2016.	evidenced by government’s Decree 2250 dated 29 of December 2017 and published in the Official Gazette 50461 on 29 of December 2017 to increase progressivity of the tax system; and (ii) the liquor and wine tax, as evidenced by the government’s Decree 719 dated April 26 2018 and published in the Official Gazette 50576 on April 26 2018. *Reforms completed, published and documentation received.* PA #3: The Borrower has issued regulations for the national carbon tax and its operationalization, as evidenced by Decree No. 926 published in the Official Gazette on June 1, 2017, and Resolution No. 1447, issued by the Ministry of Environment and Sustainable Development, on August 1, 2018 and published in the Official Gazette on August 2, 2018. *Reforms completed, published and documentation received.*	Baseline (2015): 12.5% of GDP Target (2019): 13% of GDP
PA#5: The government has adopted measures for preventing, controlling and sanctioning contraband, money laundering and tax evasion, as evidenced by Law No. 1762 dated July 6, 2015 and published in the Official Gazette on July 6, 2015. PA#6: The government has established the regulatory framework which lays the foundations for the subsequent adoption and usage of electronic invoices, including, inter alia: (i) conditions and procedures for issuing, receiving and processing electronic invoices; and (ii) rules for their circulation as legal title, as evidenced, respectively, by Decree No. 2242 issued by the Ministry of Finance and Public Credit and dated November 24, 2015, published in the Official Gazette on November 24, 2015, and Decree No. 1349 issued by the Ministry of Commerce, Industry and Tourism dated August 22, 2016 and published in the Official Gazette	PA #4: The Borrower has issued the following regulations as part of the implementation of the 2016 tax reform: (i) regulation redefining qualification criteria for the not-for-profit entities’ special tax regime, as evidenced by Decree No. 2150 published in the Official Gazette on December 20, 2017; (ii) regulation mandating the use of electronic invoicing by Large Taxpayers, as evidenced by Resolution No. 000010 issued by the National Tax and Customs Administration on February 6, 2018 and published in the Official Gazette on February 13, 2018; and (iii) regulation for the detailed reporting requirements for the new transfer pricing regime, as evidenced by Decree No. 2120 published in the Official Gazette on December 15, 2017. *Reforms completed, published and documentation received.*	VAT evasion Baseline (2015): Estimated VAT gap[92] of 22.2% Target (2019): Estimated VAT gap of 23.1% Number of new income tax taxpayers Baseline (2015): 0 Target (2016-2019): 420,000 new taxpayers

[92] Defined as the difference between actual and potential collections, expressed as a share of potential collections.

Prior actions (DPF1)	Prior actions (DPF2)	Results (2019)
on August 22, 2016.		
Pillar 2: Foster productivity and growth in non-extractive sectors by strengthening the policy framework for trade facilitation, business regulation, innovation and green growth		
PA#7: The government has adopted: (i) a customs regulatory framework ("*regulación aduanera*") to, inter alia, improve risk management practices in connection with custom controls and establish standard procedures for the electronic processing of customs documents; (ii) procedures for using scanners to inspect goods transiting at the country's maritime terminal as evidenced, respectively, by Decree No. 390 issued by the Ministry of Finance and Public Credit and dated March 7, 2016, published in the Official Gazette on March 7, 2016 and the Resolution No. 84 issued by the Intersectoral Committee for the Implementation and Monitoring of Non-Intrusive Inspection Systems (*Comisión Intersectorial Para la Implementación y Seguimiento de Los Sistemas de Inspección No Intrusiva*) and dated July 31, 2015.	PA#5: The Borrower has adopted a set of regulations to ensure legal certainty, improve risk management and implement paperless customs that include: (i) clarifying the role and responsibilities of public and private stakeholders along the trade logistics chain and fighting smuggling through a more efficient sanctions mechanisms; (ii) simplifying sanitary and phytosanitary requirements for imports of food products and introducing a risk management system for food products with different level of risks, as evidenced, respectively by the Government's Decree No. 349 dated February 20th, 2018 issued by the Ministry of Finance; by the Decree No. 2478 issued by the Ministry of Health and dated December 28 2018. *Reforms completed, published and documentation received.*	Reduction of customs clearance import times (average across all modes of transport) Baseline (2015): 23.85 hours Target (2019): 20 hours
PA#8: The government has adopted measures to foster competition including, inter alia: (i) incentives to promote collaboration of cartel members in detecting and investigating anti-competitive agreements; and (ii) a fixed term and objective criteria for the selection and appointment of the director of the Superintendence of Industry and Commerce (*Superintendencia de Industria y Comercio*) whose responsibilities include, inter alia, the carrying out of competition oversight activities, as evidenced, respectively, by Decree No. 1523 issued by the Ministry of Commerce, Industry and Tourism and dated July 16, 2015, published in the Official Gazette on July 16, 2015, and Decree No. 1817 issued by the Administrative Department of the		Increase in the number of firms applying to the leniency program and collaborating with the competition authority in antitrust investigation. Baseline (2012-June 2015): 4 Target (July 2015-2019): 7

Public Function and dated September 15, 2015, published in the Official Gazette on September 15, 2015.		
	PA #6: The Borrower has adopted measures streamlining the registration of new firms, including, inter alia: (i) the simplification of the procedures through the establishment of a single window for registering new firms; (ii) the establishment of a mechanism to identify and eliminate cumbersome regulations, as evidenced respectively in the Decree No. 1875 of 2017, dated and published on November 17, 2017 and Presidential Directive 07 of 2018, dated and published on October 1, 2018. *Reforms completed, published and documentation received.*	Increase in the number of firms[93] registered online through the new electronic single window Baseline (2015): 0 Target (2018): 12,000 Number of regulations simplified or eliminated: Baseline (2015): 0 Target: (2019): 50
PA#9: The government has approved a national development policy for productivity development aimed to, inter alia, promote efficient use of public resources by recommending a number of measures, including: (i) a cost-benefit analysis for new projects; and (ii) a periodic review of public expenditures relating to projects in the areas of science, technology and innovation, as evidenced by CONPES No. 3866, dated, and published in the web page of DNP, on August 8, 2016	PA #7: The Borrower improved the rules for the definition of priorities areas to be funded by the Royalties Fund for STI and improved the transparency and efficiency of the project selection process as evidenced by the Government's Decree No. 1467 dated and published on August 6, 2018. *Reforms completed, published and documentation received.*	Total value of the projects that are registered in the PAED and that have been approved by OCAD (Organismo Colegiado de Administración y Decisión) Baseline (2015): 326.1 Billion Colombian Pesos Target (2019): 410 Billion Colombian Pesos
PA#10: The government has established the criteria and procedures for identifying projects entitled to access specific tax incentives under the existing fiscal legislation and within the established fiscal deductions' cap as evidenced by Decisions No. 13, 14 and 15 of the National Council of Tax Benefits for Science, Technology and Innovation (*Consejo Nacional de Beneficios Tributarios en Ciencia, Tecnología y*		Increase in the share of existing fiscal incentives granted by the National Council of Fiscal Incentives for STI to firms that come from sectors other than mining and energy Baseline (2015): 16% Target (2019): 24%

[93] Including individual persons ("*personas naturales*") and legal entities ("*personas juridicas*").

Innovación), dated, respectively, December 31, 2015, February 26, 2016 and March 22, 2016.		
	PA #8: The Borrower has established guidelines to improve efficiency of energy management at the firm level by, inter alia, regulating the sale of surplus energy deriving from the auto-generation of energy at a small scale, as evidenced by the Government's Decree No. 348, dated and published on March 1, 2017 (that regulates Law No. 1715 of 2014). *Reforms completed, published and documentation received*	Increase in the installed capacity of auto-generated (and co-generated) electricity. Baseline (2015): 86.60 MW Target (2019): 198.64 MW
Pillar 3: Support regularization and integration of migrants		
	PA#9: The Borrower has adopted measures to regularize the legal status of irregular Venezuelan migrants into the national economy, to facilitate their access to the labor market and basic services such as education and health, as evidenced by the Government's Decree No.1288, dated and published on July 25, 2018. *Reform completed, published and documentation received*	Number of Venezuelan migrants on the RAMV (Registro Adminstrativo de Venezolanos) as at June 8, 2018 that have been issued with a PEP. Baseline (2015): 0 Target (2019): 280,000 of which 125,000 women
	PA#10: The Borrower has approved a medium term National Policy (up to 2021) to, inter alia, develop a roadmap for the integration of migrants from Venezuela that includes health, education, water and sanitation, support for children, and housing services as well as, services to productively integrate them into labor markets, as evidenced by the CONPES No.3950, dated and published on November 23,2018.[94]	Number of migrants from Venezuela receiving services from the National Employment Agency. Baseline (2015): 0; Target (2016-2019): 50,000 of which 25,000 women (cumulative target 2016-2109)

[94] See paragraph 67.

ANNEX 2: LETTER OF DEVELOPMENT POLICY

El futuro es de todos | DNP Departamento Nacional de Planeación | El emprendimiento es de todos | Minhacienda

Bogotá D.C., 4 de abril de 2019

Señora
Kristalina Georgieva
Presidente Interina Grupo Banco Mundial
CEO Banco Mundial
Washington, D.C.

Asunto: Carta de Política. Second Fiscal Sustainability, Competitiveness and Migration Development Policy Financing

Estimada Sra. Georgieva:

Como ha sido conocido por el Grupo Banco Mundial, el Gobierno colombiano está firmemente comprometido con el manejo responsable de las finanzas públicas como una medida de política que permita robustecer los fundamentales macroeconómicos del país, permitiendo así generar las condiciones ideales para fortalecer la confianza inversionista, tanto de mercados locales como de los extranjeros, las instituciones y la democracia. El cumplimiento de este objetivo se enmarca en la implementación de un conjunto de políticas públicas como lo son la ley de la regla fiscal (Ley 1473 de 2011), la estabilidad de precios, un sistema de tasa de cambio flexible, la implementación de los estándares internacionales de regulación y supervisión, entre otros.

Gracias a este esfuerzo es que la economía colombiana ha mostrado resultados positivos en materia de crecimiento, inversión, generación de empleo formal y reducción de la pobreza. Entre 2010 y 2018 el crecimiento económico promedio anual se ubicó en 3,8 % y cerramos el 2018 con 2,7 %. Estos buenos resultados se ven reflejados en el crecimiento del PIB per cápita, ajustado por poder adquisitivo, el cual incrementó de USD 10.665 en 2010 a USD 15.021 en 2018. En esta misma línea, la tasa de desempleo se ha mantenido en niveles de un digito (9,4 % en promedio en 2018), inferior al promedio histórico desde 2001 (11,4 %) y la población ocupada continua una tendencia creciente (cerrando 2018 en 22,5 millones, uno de los niveles más altos de los últimos 10 años). Por su parte, los avances en materia de pobreza monetaria han sido significativos, al reducirse en más de 10 puntos porcentuales entre 2010 y 2017, pasando de 37,2 % a 26,9 %.

Los sólidos fundamentales le han permitido a la economía colombiana ajustarse al fuerte choque externo que experimentó durante 2014-2015, así como al choque migratorio de los últimos dos años. De los más de tres millones de venezolanos que han dejado su país, aproximadamente dos tercios lo han hecho a través de Colombia; a 31 de enero de 2019 estimamos que 1.202.408 de venezolanos estaban residiendo en nuestro país. No obstante, a pesar de las considerables presiones fiscales experimentadas recientemente, la disciplina fiscal del Gobierno nacional ha contribuido a salvaguardar la confianza de los inversionistas, la sostenibilidad de la deuda y el crecimiento económico.

Si bien el panorama macroeconómico es favorable y Colombia se destaca entre sus pares de la región, el Gobierno Colombiano reconoce la necesidad de continuar avanzando en la consecución de los objetivos de una política fiscal saludable con el fin de garantizar las condiciones deseables para un crecimiento sostenido en el mediano plazo.

En línea con estos objetivos, la segunda fase de este programa de créditos de apoyo a políticas con el Banco Internacional de Reconstrucción y Fomento se estructuró en tres pilares que consideramos esenciales para continuar avanzando en la consecución de los objetivos mencionados: i) sostenibilidad fiscal; ii) diversificación económica e incremento de la productividad y la competitividad; y iii) apoyo en la regularización e integración de migrantes.

Pilar I. Sostenibilidad fiscal:

Adoptamos medidas concretas para reducir el gasto público, fortalecer la estructura de ingresos tributarios nacionales y subnacionales, mejorar la fiscalización y reducir la evasión.

i. Incorporamos medidas para estricta austeridad del gasto en el Presupuesto General de la Nación.
ii. Reglamentamos el impuesto a los dividendos, así como los límites a las deducciones y exenciones de impuestos de personas naturales.
iii. Reglamentamos el impuesto a los licores para fortalecer la estructura de ingresos tributarios territoriales.
iv. Definimos unos criterios más estrictos para el régimen tributario de las entidades sin ánimo de lucro.
v. Regulamos el reporte detallado del nuevo régimen de precios de transferencia.
vi. Avanzamos en la reglamentación para masificar el uso de la factura electrónica.

Adicionalmente, avanzamos en nuestra agenda de desarrollo sostenible y compromiso con el medio ambiente, reglamentando el uso del impuesto al carbono.

Finalmente, nuestro compromiso con la sostenibilidad fiscal no cesa, razón por la cual recientemente hemos continuado adoptando medidas para fortalecer nuestro marco tributario adaptándolo mejor a la dinámica de nuestra economía, promoviendo mayor equidad entre los contribuyentes e introduciendo mecanismos para mejorar y facilitar la interacción con la ciudadanía en materia de impuestos, así como para modernizar la institucionalidad de nuestra Dirección de Impuestos y Aduanas Nacionales.

Pilar II Diversificación económica e incremento de la productividad y la competitividad:

Somos conscientes de que tenemos que complementar los esfuerzos fiscales antes descritos con acciones que promuevan la diversificación de nuestra economía e incrementen la productividad, procurando reducir de manera progresiva y sostenible nuestra dependencia de las industrias extractivas. Por eso aprobamos recientemente una Ley de Financiamiento (Ley 1943 de 2018) en virtud de la cual, entre otras, redujimos la carga tributaria de las empresas, redujimos el costo de inversión en bienes de capital y generamos incentivos para promover el desarrollo de nuevos negocios y emprendimientos en lo que hemos denominado economía naranja (industrias creativas, innovación, turismo, tecnología, entre otras).

Según cálculos del Departamento Nacional de Planeación, con datos de *The Conference Board* (2018), la productividad (medida como productividad total de factores) restó 0,2 puntos porcentuales al crecimiento promedio de la economía colombiana (4 %) entre 2000 y 2016, esta cifra contrasta con los 1,8 puntos porcentuales que le aportó la productividad al crecimiento promedio de las economías asiáticas durante el mismo periodo.

Por lo anterior, en virtud de este DPF logramos avanzar en los siguientes frentes:

i. Expedimos regulación para generar mayor seguridad jurídica, mejorar la gestión del riesgo y reducir trámites. De esta manera, clarificamos el rol y las responsabilidades de los agentes públicos y privados a lo largo de la cadena logística de comercio, combatiendo el contrabando a través de mecanismos sancionatorios más eficientes. Además, simplificamos los requerimientos sanitarios y fitosanitarios para importación de alimentos e introdujimos un sistema de riesgos para productos alimentarios.
ii. Adoptamos medidas para facilitar el registro de nuevas empresas.
iii. En el ámbito subnacional, mejoramos las reglas para priorizar y mejorar la transparencia y efectividad la asignación de recursos susceptibles de ser financiados por el Fondo de Ciencia, Tecnología e Innovación del Sistema General de Regalías.
iv. Establecimos lineamientos para mejorar la eficiencia del manejo de energía a nivel empresarial, en consideración a que este representa uno de los mayores costos para las empresas colombianas. Por esta razón, regulamos la venta de excedentes de la autogeneración de energía eléctrica a pequeña escala.

Pilar III Apoyo en la regularización e integración de migrantes:

Finalmente, y como ha sido explícitamente manifiesto por el Gobierno de Colombia, hemos adoptado medidas concretas para enfrentar con una política de solidaridad y puertas abiertas los grandes flujos migratorios provenientes de Venezuela, en consideración a la crisis económica, social y política de ese país. A pesar del importante choque fiscal de corto plazo que este fenómeno ha representado para Colombia, presionando al alza y de manera importante el gasto público nacional y territorial, estamos convencidos del beneficio potencial que esta situación traerá consigo en el mediano y largo para nuestro país en materia de crecimiento económico, generación de empleo, mejoramiento de la calidad de vida y fortalecimiento de las dinámicas sociales en las zonas fronterizas, entre otros.

En consecuencia, con esta operación de crédito y con el apoyo decidido de la comunidad internacional (i) adoptamos medidas para regular el estatus legal de migrantes venezolanos irregulares en la economía nacional y así facilitar su acceso al mercado laboral y a servicios básicos como la educación y la salud; y (ii) diseñamos y adoptamos una política nacional a mediano plazo (hasta el 2021) para, entre otros, desarrollar un mapa de ruta para la integración de migrantes desde Venezuela, a través del documento CONPES No.3950 de noviembre de 2018.

Las anteriores medidas dan cuenta de los logros que hemos alcanzado gracias al apoyo y acompañamiento técnico del Banco Mundial. Para Colombia es fundamental poder acceder a mecanismos como los préstamos de políticas bajo la modalidad DPF con el fin de avanzar en su agenda de reformas estructurales bajo los mejores estándares y prácticas internacionales. Sea entonces esta la oportunidad para agradecer una vez más al Grupo Banco Mundial por su permanente apoyo y disposición para que nuestro país desarrolle e implemente de manera seria y decidida su agenda de desarrollo económico sostenible hoy denominada "Pacto por Colombia, Pacto por la Equidad".

Agradeciendo su atención, reciba un cordial saludo,

Alberto Carrasquilla Barrera
Ministro
Ministerio de Hacienda y Crédito Público

Gloria Alonso Másmela
Directora General
Departamento Nacional de Planeación

TRANSLATED VERSION: LETTER OF DEVELOPMENT POLICY

Bogota D.C., April 4, 2019

Ms.
Kristalina Georgieva
Acting President World Bank Group
CEO World Bank Group
Washington, D.C.

Ref: Politic Letter. Second Fiscal Sustainability, Competitiveness and Migration Development Policy Financing

Dear Ms. Georgieva:

As it has been known by the World Bank Group, the Colombian Government is firmly committed to the responsible management of public finances as a policy measure that allows strengthening the macroeconomic fundamentals of the country, thus enabling ideal conditions to strengthen confidence of investors, both local and foreign, institutions and democracy. The fulfillment of this objective is part of the implementation of a set of public policies such as the law of the fiscal rule (Law 1473 of 2011). price stability, a flexible exchange rate system, implementation of international standards of regulation and supervision, among others.

Thanks to this effort, the Colombian economy has shown positive results in terms of growth, investment, generation of formal employment and reduction of poverty. Between 2010 and 2018 the average annual economic growth stood at 3.8% and it closed 2018 with 2.7%. These good results are reflected in GDP growth per capita, adjusted for purchasing power, which has increased from 10,665 in 2010 to 15,021 in 2018. Along same line, unemployment rate has remained at one-digit level. (9.4% on average in 2018), lower than the historical average since 2001 (11.4%) and employed population continues a growing trend (closing 2018 in 22.5 million, one of the highest levels in the last 10 years). On the other hand, advances in terms of monetary poverty have been significant, since they have fallen by more than 10 percentage points between 2010 and 2017, from 37.2% to 26.9%.

These solid fundamentals have allowed the Colombian economy to adjust to the strong external shock that it experienced during 2014-2015, as well as the migratory shock of the last two years with more than three million of Venezuelans who have left their country, approximately two thirds have passed through Colombia; as of January 31, 2019, we estimate that 1,202,408 Venezuelans were residing in our country. However, despite the considerable fiscal pressures experienced recently, the fiscal discipline of the national government has helped to safeguard investor confidence, debt sustainability and economic growth.

Although, the macroeconomic landscape is favorable and Colombia stands out among its peers in the region, the Colombian Government recognizes the need to continue advancing in the achievement of the objectives of a healthy fiscal policy in order to guarantee the desirable conditions for sustained growth in the medium term.

In line with these objectives, the second phase of this policy support credit program with the International Bank for Reconstruction and Development was structured in three pillars that we consider essential to continue advancing in the attainment of the aforementioned objectives: i) fiscal sustainability; ii) economic diversification and increase in productivity and competitiveness; and iii) support in the regularization and integration of migrants.

Pillar I. Fiscal Sustainability:

We adopted concrete measures to reduce public spending, strengthen the structure of national and subnational tax revenues, improve oversight, and reduce evasion.

i. We incorporate measures for strict austerity of spending in the General Budget of the Nation.
ii. We regulate the tax on dividends, as well as the limits on deductions and exemptions from taxes for natural persons.
iii. We regulate the liquor tax to strengthen the revenue structure of local taxes.
iv. We define more stringent criteria for the tax regime of non-profit organizations.
v. We regulate the detailed report of the new transfer pricing regime.
vi. We advance in the regulation to massively expand the use of the electronic invoice.

Additionally, we move forward in our agenda of sustainable development and commitment to the environment, regulating the use of the carbon tax.

Finally, our commitment to fiscal sustainability does not cease, which is why we have recently continued to adopt measures to strengthen our tax framework, adapting it better to the dynamics of our economy, promoting greater equity among taxpayers and introducing mechanisms to improve and facilitate taxation and interaction with citizens on tax matters, as well as to modernize the institutional capacity of our National Department of Taxes and Customs.

Pillar II Economic diversification and increase in productivity and competitiveness

We are aware that we must complement the fiscal efforts described above with actions that promote the diversification of our economy and increase productivity, seeking to progressively and sustainably reduce our dependence on extractive industries. That is why we recently approved a Financing Law (Law 1943 of 2018) under which, among others, we reduced the tax burden of companies, reduced the cost of investment in capital goods and generated incentives to promote the development of new businesses. and undertakings in what we have called the orange economy (creative industries, innovation, tourism, technology, among others).

According to calculations of the National Planning Department, with data from The Conference Board (2018), productivity (measured as total factor productivity) reduced by 0.2 percentage points the average growth of the Colombian economy (4%) between 2000 and 2016. This figure contrasts with the 1.8 percentage points that productivity contributed to the average growth of the Asian economies during the same period.

Given the above, under this DPF we managed to advance in the following fronts:

i. We issue regulations to generate greater legal security, improve risk management and reduce paperwork. In this way, we clarify the role and responsibilities of public and private agents along the trade logistics chain, combatting smuggling by using more efficient sanctioning mechanisms. In addition, we simplified sanitary and phytosanitary requirements for food imports and introduced a risk based system for food products.
ii. We take measures to facilitate the registration of new companies.
iii. In the subnational area, we improve the rules to prioritize and improve the transparency and effectiveness of the allocation of resources that may be financed by the Science, Technology and Innovation Fund of the General Royalty System.
iv. We established guidelines to improve the efficiency of energy management at the business level, considering that this represents one of the greatest costs for Colombian companies. For this reason, we regulate the small-scale sale of self-generated electricity surplus.

Pillar III Support in the regularization and integration of migrants:

Finally, as it has been explicitly stated by the Government of Colombia, we have adopted concrete measures to address the large migratory flows coming from Venezuela with a policy of solidarity and open doors, in consideration of the economic, social and political crisis of that country. Despite the important short-term fiscal shock that this situation has represented for Colombia, significantly increasing national and local public spending, we are convinced of the potential benefit that this situation will bring in the medium and long term for our country, in terms of economic growth, employment generation, improvement of quality of life and strengthening of social dynamics in border areas, among others.

Consequently, with this credit operation and with the firm support of the international community (i) we adopted measures to regulate the legal status of irregular Venezuelan migrants in the national economy and thus facilitate their access to the labor market and basic services such as education and health; and (ii) we designed and adopted a medium-term national policy (until 2021) to, among others, develop a road map for the integration of migrants from Venezuela, through document CONPES No. 3950 of November 2018.

The previous measures give an account of the achievements we have achieved thanks to the support and technical assistance of the World Bank. For Colombia it is fundamental to be able to access mechanisms such as policy loans under the DPF modality to advance in its agenda of structural reforms under the best international standards and practices. Let this be the opportunity to once again thank the World Bank Group for its permanent support and willingness for our country to develop and implement in a serious and determined way its sustainable economic development agenda today called "Pact for Colombia, Pact for Equity".

Thank you for your attention.

Sincerely,

Alberto Carrasquilla Barrera	Gloria Alonso Masmela
Minister	Director
Ministry of Finance and Public Credit	National Planning Department

ANNEX 3: FUND RELATIONS ANNEX

Colombia—Assessment Letter For The World Bank
December 12, 2018

1. **Colombia successfully adjusted to large external shocks guided by its very strong economic policy framework and timely policy actions.** The flexible exchange rate, combined with an inflation-targeting regime, effective financial sector supervision and regulation, and a fiscal rule, allowed the country to smooth the impact of a large permanent terms of trade deterioration from a substantial decline in oil prices in late 2014. Economic growth subsequently turned a corner in mid-2017, supported by accommodative fiscal and monetary policy, and inflation has been broadly in line with the central bank's target since early 2018.

2. **Economic activity will accelerate further in 2019.** Real GDP growth is forecast to reach 2.8 percent this year, a marked increase from 1.7 percent in 2017, supported primarily by higher consumption growth and a slight rebound in both investment and export growth. In 2019, supported by more dynamic exports and a recovery in investment—following the resolution of electoral uncertainty and an acceleration in 4G infrastructure execution—GDP growth should pick up further to 3.6 percent, leading to a narrowing in the output gap. The current account deficit has appreciably narrowed in recent years to 2.4 percent of GDP in 2018 (projected) and staff expects it to remain broadly stable around those levels and to be fully financed by FDI. Headline and core inflation are expected to end 2018 very close to the Central Bank's 3 percent target and inflation expectations remain broadly anchored. Absent the materialization of risks, monetary accommodation can begin to be withdrawn in 2019. The financial system solvency and liquidity has remained strong amid less favorable external financing conditions, sectoral credit issues, and changes in local funding conditions. The banking system's capital adequacy ratio stood at 18.6 percent at end-2017, significantly above the regulatory limit. The Conglomerates Law that follows FSAP recommendations (IMF Country Report No. 16/129), passed in September 2017 and will come into effect in February 2019. The Law will improve the regulatory and supervisory framework including the management of corporate and overseas risks.

3. **But risks are tilted to the downside**. Growth in 2018 and 2019 could disappoint if the weaker-than-expected growth in exports and investment seen in 18Q3 persists. Recent falls in oil prices also pose significant downside risks to staff's growth forecast and large migration flows from Venezuela, now in excess of one million migrants, could significantly increase fiscal costs. Colombia has weathered market volatility in 2018 relatively well. With larger foreign participation in the local government debt market, however, Colombia's vulnerability to a sharp tightening in global financial conditions may have increased. A flexible exchange rate and adequate international reserves and resources available through the IMF's Flexible Credit Line (FCL), represent key buffers against downside risks. On the domestic front, a lack of political consensus could pose risks to the timely implementation of planned public investment and structural reform agenda, whilst local elections in 2019 may accelerate local expenditure plans.

4. **The authorities plan to strengthen reserve adequacy to further enhance the economy's resilience to external shocks.** External reserves at end-2017 remained adequate at 116 percent of the IMF's reserve adequacy (ARA) metric (including a buffer for oil prices; 133 percent excluding the buffer). Banco de la Republica (BanRep) announced in September its intention to accumulate additional reserves to enhance the economy's resilience to external shocks as part of the authorities' efforts to prepare for a gradual exit from the FCL. To minimize pressure on the spot exchange rate and the monetary transmission mechanism, BanRep will sell U.S. dollar put options.

5. **The authorities' fiscal plans seek to maintain fiscal credibility whilst protecting key government spending plans, in line with previous staff advice.** Meeting the headline deficit consistent with the Medium Term Fiscal Framework's fiscal rule requires budgetary effort in coming years. The Ley de Financiamiento or Financing Law, (currently being discussed in Congress) aims to raise additional tax revenue (currently standing at around 0.7 percent of GDP for 2019) to create space for a higher level of public investment and to protect key social programs, while at the same time adhering to the headline budget target implied by the fiscal rule (-2.4 percent of GDP for 2019) as set out in the 2018 Medium Term Fiscal Outlook. Adhering to the fiscal rule targets is needed to firmly place public debt (as a percent of GDP) on a declining path. The passage of the Financing Law has thus far proved to be challenging and that any dilution of tax proposals would require a corresponding scaling back of planned public investment to meet the deficit target implied by the fiscal rule.

6. **Structural reforms should target strategic priorities to enhance medium-term inclusive growth.** Colombia officially became an OECD member in 2018, capping a series of reforms undertaken during the admissions process. Nevertheless, several reform priorities remain, such as promoting infrastructure investment, lowering barriers to international trade, tackling labor-market informality and reforming the pension system. Enacting a broad reform agenda will allow Colombia to raise potential growth and reduce poverty and inequality as envisioned in the draft pillars of the 2018–22 national development plan.

7. ***The latest Executive Board assessment of Colombia is presented in Press Release No. 18/196 for the Approval of the Arrangement under the Flexible Credit Line.*** On May 25, 2018, the IMF Executive Board approved a two-year Flexible Credit Line arrangement for SDR 7.848 billion (US$11.4 billion). The staff report (IMF Country Report No. 18/150) was published.

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant environmental effects	Significant poverty, social or distributional effects
Prior action #1: The Borrower has adopted measures to further reduce its Executive Branch's general operating expenditures (gastos generales) in the context of the 2019 National Budget, as evidenced by the National General Budget Law 1940 (art 81) dated November 2018, published in the Official Gazette on November 26, 2018.	*No significant environmental effects are likely.*	*No significant effects are expected on poverty or promotion of shared prosperity.*
Prior action #2: The Borrower has issued the following decrees as part of the implementation of the 2016 tax reform regulating: (i) the tax treatment of dividends and shares, as well as the caps on total deductions and exemptions for personal income, as evidenced by government's Decree 2250 dated 29 of December 2017 and published in the Official Gazette 50461 on 29 of December 2017 to increase progressivity of the tax system; and (ii) the liquor and wine tax, as evidenced by the government's Decree 719 dated April 26 2018 and published in the Official Gazette 50576 on April 26 2018.	*No significant environmental effects are likely.*	*Overall, the policies in this prior action are expected to reduce disposable income in the short-run, although they may have positive medium-run impacts in wellbeing by strengthening the fiscal position of the government, reducing geographical inequality and securing resources for social public spending.*
Prior action #3: The Borrower has issued regulations for the national carbon tax and its operationalization, as evidenced by Decree No. 926 published in the Official Gazette on June 1, 2017, and Resolution No. 1447, issued by the Ministry of Environment and Sustainable Development, on August 1, 2018 and published in the Official Gazette on August 2, 2018.	*Significant positive environmental effects are likely*	*Moderate impacts effects on wellbeing in the short-run, although in the medium-run impact could be positive based on the allocation of additional tax revenues.*
Prior action #4: The Borrower has issued the following regulations as part of the implementation of the 2016 tax reform: (i) regulation redefining qualification criteria for the not-for-profit entities' special tax regime, as evidenced by Decree No. 2150 published in the Official Gazette on December 20, 2017; (ii) regulation mandating the use of electronic invoicing by Large Taxpayers, as evidenced by Resolution No. 000010 issued by the National Tax and Customs Administration on February 6, 2018 and published in the Official Gazette on February 13, 2018; and (iii) regulation for the detailed reporting requirements for the new transfer pricing regime, as evidenced by Decree No. 2120 published in the Official Gazette on December 15, 2017.	*No significant environmental effects are likely.*	*Policies supported by this Prior Action are not expected to have direct impacts on the reduction of poverty or promotion of shared prosperity.*

Prior Actions	Significant environmental effects	Significant poverty, social or distributional effects
Prior action #5: The Borrower has adopted a set of regulations to ensure legal certainty, improve risk management and implement paperless customs that include: (i) clarifying the role and responsibilities of public and private stakeholders along the trade logistics chain and fighting smuggling through a more efficient sanctions mechanisms; (ii) simplifying sanitary and phytosanitary requirements for imports of food products and introducing a risk management system for food products with different level of risks, as evidenced, respectively by the Borrower's Decree No. 349 dated February 20th, 2018 issued by the Ministry of Finance; by the Decree No. 2478 issued by the Ministry of Health and dated December 28 2018.	*Environmental effects are expected to be broadly neutral. Any resulting shift in the composition of Colombia's exports is likely to shift environmental burdens toward those sectors that experience increased growth as a result of the trade facilitation.*	*The simplification of administrative procedures and improved risk management are not expected to have direct effects on poverty or inequality.*
Prior action #6: The Borrower has adopted measures streamlining the registration of new firms, including, inter alia: (i) the simplification of the procedures through the establishment of a single window for registering new firms; (iii) the establishment of a mechanism to identify and eliminate cumbersome regulations, as evidenced respectively in the Decree No. 1875 of 2017, dated and published on November 17, 2017 and Presidential Directive 07 of 2018, dated and published on October 1, 2018.	*No significant environmental effects are likely.*	*Policies simplifying the registration of new firms are not expected to generate significant lasting effects on wellbeing.*
Prior action #7: The Borrower improved the rules for the definition of priorities areas to be funded by the Royalties Fund for STI and improved the transparency and efficiency of the project selection process as evidenced by the Borrower's Decree No. 1467 dated and published on August 6, 2018.	*The impact on the environment is likely to be neutral.*	*Policies in prior action 7 are not expected to have a significant direct impact in poverty reduction in the short-run but may foster productivity and economic growth in the medium and long-run.*
Prior action #8: The Borrower has established guidelines to improve efficiency of energy management at the firm level by, inter alia, regulating the sale of surplus energy deriving from the auto-generation of energy at a small scale, as evidenced by the Borrower's Decree No. 348, dated and published on March 1, 2017 (that regulates Law No. 1715 of 2014).	*The impact on the environment is likely to be positive.*	*Policies supporting efficiency in energy management are not expected to have a direct impact on consumer wellbeing in the short run.*
Prior Action #9: The Borrower has adopted measures to regularize the legal status of irregular Venezuelan migrants into the national economy, to facilitate their access to the labor market and basic services such as education and health, as evidenced by the Borrower's Decree No.1288, dated and published on July 25, 2018.	*No significant environmental effects are likely.*	*In general, the policies supported by this prior action 9 are expected to have positive effects in the medium and long-run that would outweigh the negative effects in the short-run on poverty and shared prosperity.*

Prior Actions	Significant environmental effects	Significant poverty, social or distributional effects
Prior action #10: The Borrower has approved a medium term National Policy (up to 2021) to, inter alia, develop a roadmap for the integration of migrants from Venezuela that includes health, education, water and sanitation, support for children, and housing services as well as, services to productively integrate them into labor markets, as evidenced by the CONPES No.3950, dated and published on November 23,2018.[95]	*No significant environmental effects are likely.*	*In the short term, there is a concentration of migration costs that would impact negatively the wellbeing of host communities, with the potential benefits of migration emerging in the medium term.*

[95] See paragraph 67.

ANNEX 5: POVERTY AND SOCIAL IMPACT ANALYSIS

1. **The prior actions supported by this operation are expected to have neutral or positive effects on poverty in the short term except for those focused on helping to address the Venezuelan migration crisis. Moreover, it is expected to have some moderate positive effects on distributional outcomes over the medium to long term from a stronger fiscal position of the government, and the integration of migrants from Venezuela into society.** This assessment[96] follows the Bank guidelines and provides an analysis of the potential distributional effects of the government's program focusing on poverty and shared prosperity, while also assessing other welfare outcomes such as household income and expenditures, employment and prices. The reforms supported by this operation such as the implementation of the structural tax reform, fiscal consolidation and contingent liabilities reduction measures, are expected to strengthen the fiscal position of the government and positively impact economic growth over the medium term. Although in the short-run the implementation of the fiscal reform could marginally affect disposable income across the income distribution, the consolidation measures are designed to help protect critical social spending and are expected to create fiscal space for the implementation of the peace agreement, including measures to reduce geographical inequalities. Similarly, the reforms related to health are expected to strengthen the fiscal sustainability of the system. In addition, the prior actions which main purpose is to facilitate the integration of migrants from Venezuela into the labor market are expected to have positive effects on the medium and long-run that would outweigh the negative effects in the short-run. Furthermore, strengthening the regulatory and competition framework in Colombia could have positive indirect impacts on consumer welfare in the medium and long-run through lower prices, more competitive labor markets and lower market barriers. The expected effects are based on quantitative analysis, the review of academic literature and additional information gathered during the preparation of the operation.

2. **The prior actions under Pillar 1 supporting fiscal consolidation measures and improved contingent liabilities management are not expected to have significant poverty or distributional effects in the short run.** The prior actions supported under the first pillar are designed to strengthen the fiscal position of the Government of Colombia and enhance tax compliance, thus contributing to the sustainability of the fiscal stance. Higher tax revenues are expected to help protect public investment and social spending. The reduction of general operating expenditures is not expected to affect social programs or public employment, and thus is not expected to have significant impacts on welfare. The policies associated with the reforms of the health system (such as the public procurement of medicines) are aimed at supporting the fiscal sustainability of the system and guarantee the adequate and effective provision of services, thus positive moderate effects on welfare in the medium and long-run are expected.

3. **The implementation of the structural tax reform supported under Pillar 1 is expected to have broadly neutral impacts on poverty/social outcomes.** Although they could marginally reduce disposable income across the whole distribution in the short-run, to the extent that new revenues create space for protecting and/or increasing social spending, the actions could also benefit the poor directly. Medium-run impacts on wellbeing are expected to be positive on account of a stronger fiscal position of the government, reduction in geographical inequality, and protection of

[96] This PSIA was produced by Sergio Olivieri (GPV04), Eduardo A. Malásquez (GPV05), and Julieth Pico (GPV04) with contributions from Mariana Vijil (GGE) and Oliver Masetti (GFCLC)

social public spending. First, the implementation of the single-tax (*monotributo*) for small traders is expected to generate incentives, at the margin, for firm formalization, with potential positive impacts on workers of firms that formalize. The revamping in the taxation of the non-profit entities (*Entidades Sin Ánimo de Lucro*, ESAL) is expected to reduce tax avoidance and evasion boosting government tax revenues. Meanwhile, implementing both the national carbon tax is expected to have moderate impacts on wellbeing in the short-run, although in the medium-run the impact could be positive based on the allocation of additional tax revenues. Finally, the policies to facilitate the reforms on excise taxes on tobacco and liquor consumption are not expected to have significant direct effects on poverty in the short-run. The overall expected effect of these policies (including the simplification of corporate taxation, the introduction of tax incentives for investment, and the creation of excise taxes and green taxes) in the medium and long-run is to increase tax revenues for the Government of Colombia to support the financing of the post-conflict social spending as well as to protect key social and infrastructure spending, while ensuring compliance with the medium-term deficit reduction required by the fiscal rule.

4. **Policies under Pillar 2 are aimed at promoting economic growth, competitive markets and boosting productivity, and are not expected to have significant direct effects on poverty or on the distribution of incomes.** However, some of these policies may, through indirect mechanisms, contribute positively to overall welfare. While policy actions related to trade facilitation could reduce time and costs associated with international commerce they are not expected to have significant direct impacts on poverty or inequality. Nevertheless, some positive indirect effects could occur, if they contribute to reducing consumer prices. In addition, policies to facilitate entry and exit of firms to promote firm formalization are not expected to have significant direct effects in labor markets in the medium to long run. Similarly, guidelines for investment in science, technology and innovation are expected to foster growth and competitiveness in the medium and long-run but would not have significant direct impacts in poverty reduction in the short-run. Moreover, policies supporting efficiency in energy management are not expected to have a direct impact on consumer wellbeing in the short run, and any negative impact in the long-run could be mitigated by an adequate tariff regulation of the energy sector.

5. **Pillar 3 incorporates policies to facilitate the integration of migrants from Venezuela into society (access to education, health and social protection services, as well as labor force) are expected to have positive effects in the medium and long-run that would outweigh the negative effects in the short-run on poverty and shared prosperity.** In the short term, there is a concentration of migration costs that would impact negatively host communities' wellbeing. As quickly as the migrants from Venezuelan could integrate into host communities, the potential benefits of migration will emerge and positive effects on poverty and share prosperity will come. In one hand, regulation that extent the grant of the Special Permission to Reside (PET for the acronym in Spanish) to migrants from Venezuela is expected to give them access to the formal labor market and help accelerate the integration process, increasing labor productivity. In the long run positive effects are expected on growth, consumption and long-term investment.

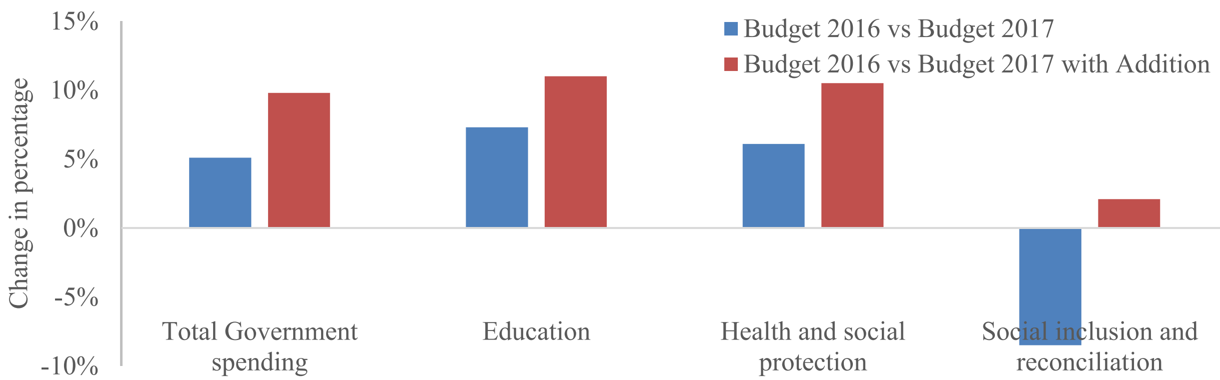
PILLAR 1: SUPPORT FISCAL SUSTAINABILITY MEASURES AND IMPROVED CONTINGENT LIABILITIES MANAGEMENT

Public expenditure and contingent liabilities

Prior Action 1: *The Borrower has adopted measures to further reduce its Executive Branch's general operating expenditures (gastos generales) in the context of the 2019 National Budget, as evidenced by the National General Budget Law 1940 (art 81) dated November 2018, published in the Official Gazette on November 26, 2018.*

6. **Lower general operating expenditures are not expected to have direct negative impacts on welfare as it is not expected to translate into lower public spending on social programs or reduce government employment.** Despite that modeling the distributional impacts of reduction in government expenditure typically require understanding of the transmission channels (Essama-Nssah, 2006),[97] the potential reduction on operating expenditures is not expected have a significant impact on growth and poverty. Key categories of social spending such as Education, and Health and Social Protection increase faster than total government expenditure in 2017 (Figure 8) (excluding debt servicing).[98] In addition, given the composition of the proposed additions to the 2017 budget, Education, Health and Social Protection, and Social inclusion and reconciliation, will exceed their 2016 levels. Public employment is not expected to be affected.[99] The team will request detailed information on Colombian budget breakdown by categories in order to identify which were the operating expenditures more affected by the fiscal consolidation.

Figure 8. Changes in Government Spending in Colombia 2016-2017



Source: Ministerio de Hacienda y Crédito Público de Colombia (March 2017).

[97] Essama-Nssah, B. (2006) "Macroeconomic shocks and policies" in Analyzing the Distributional Impacts of Reforms. *A practitioner's guide to pension, health, labor markets, public sector downsizing, taxation, descentralization, and macroeconomic modelling*. Eds. Aline Coudouel and Stefano Paternostro. Vol. 2. The World Bank, Washington, D.C.

[98] In spite that the government budget only provides a raw number for social expenditure categories, it does indicate that we should not expect an important reduction in aggregate categories that are key for social development.

[99] Since the freeze does not involve direct public employment reduction, the typical framework to analyze the distributional effects of public sector downsizing (see Coudouel and Paternoso, 2006; Rama, 1999; or Haltiwanger and Singh, 1999) in multiple stakeholders such as public workers, one company-towns or communities, providers of services to state firms and taxpayers would not be adequate to analyze the impacts of this prior action.

Tax administration and tax policy

Prior Action 2: *The Borrower has issued the following decrees as part of the implementation of the 2016 tax reform regulating: (i) the tax treatment of dividends and shares, as well as the caps on total deductions and exemptions for personal income, as evidenced by government's Decree 2250 dated 29 of December 2017 and published in the Official Gazette 50461 on 29 of December 2017 to increase progressivity of the tax system; and (ii) the liquor and wine tax, as evidenced by the government's Decree 719 dated April 26 2018 and published in the Official Gazette 50576 on April 26 2018.*

7. **The policies supported by Prior Action 2 are expected to help the implementation of policies to increase tax revenue, thus they are expected to reduce disposable income in the short-run. However, they might have positive medium-run impacts in wellbeing since they help raise tax revenues and strengthen the fiscal position of the government securing resources for social public spending.** This Prior action supports a variety of reforms aimed at enhancing the implementation of the fiscal reform of 2016 including the simplification of corporate taxation, the introduction of tax incentives for investment, and the creation of excise taxes and green taxes. The overall objective of these policies is to increase tax revenues to support the financing of post-conflict related spending and protect key social and infrastructure investments, while ensuring compliance with the medium-term deficit reduction required by the fiscal rule. The poor are expected to benefit in general terms over the medium term to the extent that in the future new resources or cost savings are used to increase coverage of basic services and provide more benefits to the poor. Stronger growth in the medium and long term could contribute to poverty reduction and improve multi-dimensional welfare.

8. **The policies to facilitate the reforms on excise taxes on liquor consumption are not expected to have significant direct effects on poverty in the short-run.** The excise taxes on Liquors are expected to have short-term regressive effects, although these effects are expected to be rather moderate, and might be mitigated by positive impacts in welfare due to health improvements and lower health-related expenditures in the long-run. It is important to mention that excise taxes on alcoholic beverages in Colombia such as *aguardiente* (a popular local alcoholic beverage), wines and spirits, alcoholic appetizers and others are not expected to have a significant impact on poverty and inequality in the short run, since the tax modification does not affect the beer industry, which has more than 90 percent of market share of alcoholic beverages according to Zapata and Sabogal (2012).[100]

9. **However, the relative incidence effects of the modification to the indirect taxes on liquor are expected to be moderate and slightly regressive in the short-run.** In the case of the indirect taxes on liquor, a similar microsimulation exercise suggests that welfare losses from higher tax rates to liquors seem to be modest along the expenditure distribution. Table 1 shows that the relative share of expenditure in alcoholic beverages is relatively low and most of this consumption corresponds to beer). However, positive effects from higher tax revenues are expected due to the strengthen municipal finances, to balance the tax burden between local and international liquor

[100] Zapata, J. G., and Sabogal, A. (2012). "Una estimación de la adulteración y la falsificación de bebidas alcohólicas en Colombia." Document from FEDESARROLLO. Elaborated in November 15, 2012. Available at: http://www.repository.fedesarrollo.org.co/bitstream/11445/209/3/Adulteracion_bebidas_alcoholicas_27oct2012.pdf

producers, to have a more transparent tax framework thus reducing the incentives for contraband, and to promote the development of a sector with higher growth potential. In addition, the policy reform is expected to support the implementation of Law 1816 of 2016 modifying liquor taxes, in particular to help allocate the revenues associated to liquor taxes to finance health, education and sport promotion, potentially mitigating short-run negative effects from higher tax rates.[101]

Table 1. Share of expenditure in each consumption category by expenditure decile (%)

	D1	D2	D3	D4	D5	D6	D7	D8	D9	D10	All
Food and beverage (non-alcoholic)	**38.0**	**37.8**	**34.4**	**31.2**	**27.5**	**24.2**	**21.1**	**17.5**	**12.7**	**5.3**	**12.3**
High-risk food	13.8	15.6	14.9	13.9	12.7	11.4	10.0	8.2	6.2	2.5	5.7
Meat derivatives, fish and fishery products, and egg products	9.3	10.7	10.2	9.6	8.7	7.7	6.9	5.5	4.1	1.6	3.8
Milk and milk derivatives	4.5	4.8	4.6	4.3	4.0	3.6	3.2	2.7	2.1	0.9	1.9
Low-risk food	22.1	20.1	17.5	15.4	13.0	11.3	9.7	8.0	5.6	2.4	5.8
Non-alcoholic beverage	2.1	2.1	2.0	1.9	1.7	1.6	1.4	1.2	0.9	0.4	0.8
Alcoholic beverages, tobacco and drugs	**0.9**	**0.9**	**0.8**	**0.9**	**0.9**	**0.7**	**0.7**	**0.7**	**0.9**	**0.7**	**0.8**
Alcoholic beverages	0.6	0.6	0.6	0.7	0.7	0.5	0.6	0.6	0.8	0.7	0.7
Tobacco	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.0	0.1
Drugs	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Clothes and shoes	6.2	6.5	7.5	7.7	8.0	8.8	9.8	10.7	11.3	9.5	9.7
Rent, water, electricity, gas and other services	**19.5**	**19.8**	**21.0**	**22.5**	**24.0**	**24.6**	**24.1**	**24.2**	**23.5**	**24.7**	**24.2**
Furniture and decorations, gardens, others	**6.3**	**4.6**	**4.3**	**4.3**	**4.1**	**4.2**	**4.4**	**4.5**	**4.9**	**5.2**	**4.9**
Health	**2.2**	**1.6**	**1.6**	**1.9**	**1.9**	**2.0**	**2.3**	**2.6**	**2.9**	**4.8**	**3.7**
Transport	**8.0**	**9.4**	**9.8**	**9.5**	**10.1**	**10.1**	**9.7**	**9.7**	**10.3**	**13.1**	**11.6**
Communications	**2.4**	**2.8**	**3.4**	**3.6**	**4.6**	**4.8**	**5.7**	**6.5**	**8.0**	**8.2**	**7.2**
Recreation and culture	**3.3**	**3.1**	**3.1**	**2.9**	**2.9**	**3.0**	**3.2**	**3.0**	**3.4**	**4.4**	**3.8**
Education	**0.1**	**0.4**	**0.6**	**0.7**	**1.0**	**1.3**	**1.7**	**2.2**	**3.1**	**4.7**	**3.4**
Restaurants and hotels	**3.4**	**5.0**	**5.8**	**7.1**	**7.6**	**8.7**	**9.1**	**9.4**	**9.5**	**6.9**	**7.7**
Diverse goods and services	**9.6**	**8.2**	**7.7**	**7.5**	**7.5**	**7.6**	**8.0**	**9.1**	**9.6**	**12.5**	**10.7**

Note: High risk products for human consumption are the products derived from livestock production, which are within the group of milk and milk derivatives, meat derivatives; fish and fishery products, and egg products.
Source: Own calculations based on DANE's welfare aggregate (ENPH 2016-2017)

Prior action #3: *The Borrower has issued regulations for the national carbon tax and its operationalization, as evidenced by Decree No. 926 published in the Official Gazette on June 1, 2017, and Resolution No. 1447, issued by the Ministry of Environment and Sustainable Development, on August 1, 2018 and published in the Official Gazette on August 2, 2018.*

[101] Article 16. "Tax revenues allocation". Law 1816 of 2016.

10. **Implementing the national carbon tax is expected to have moderate impacts on wellbeing in the short-run, although in the medium-run impact could be positive based on the allocation of additional tax revenues.** In general, tax policies to promote green growth generate mixed results from the distributional stand-point.[102] In particular, the economic literature finds that distributional effects depend on the use of the additional revenues obtained from green growth taxation, with more progressive results found when the revenue was used to fund monetary transfers for the poor or the finance of the provision of public goods.[103] The reforms supported by these policies could be associated with positive distributional effects since the Decree establishes the procedures to calculate the additional revenues generated by the tax increase in the departments and the Capital District, while maintaining the earmarking. According to the tax reform Law 1819 of 2016, the tax revenues from the carbon tax will be used to finance the Fund for the Environmental Sustainability and Sustainable Rural Development in the Areas Affected by the Conflict in Colombia.[104] Earmarking these resources to provide aid in areas affected by the Colombian conflict could bolster the progressiveness of the impacts of this tax.

Prior Action 4: *The Borrower has issued the following regulations as part of the implementation of the 2016 tax reform: (i) regulation redefining qualification criteria for the not-for-profit entities' special tax regime, as evidenced by Decree No. 2150 published in the Official Gazette on December 20, 2017; (ii) regulation mandating the use of electronic invoicing by Large Taxpayers, as evidenced by Resolution No. 000010 issued by the National Tax and Customs Administration on February 6, 2018 and published in the Official Gazette on February 13, 2018; and (iii) regulation for the detailed reporting requirements for the new transfer pricing regime, as evidenced by Decree No. 2120 published in the Official Gazette on December 15, 2017.*

11. **The policies promoted by Prior Action 4 are not expected to have direct impacts on the reduction of poverty or the promotion of shared prosperity.** On one hand, the policies supported by Prior Action 4 are expected to facilitate the implementation of electronic invoices, thus contributing to the reduction of costs faced by firms in paying taxes, for instance by diminishing spending on paper and storage of physical records. In addition, the use of electronic invoice fosters the digitalization of other documents, promoting efficiency and cost savings in other areas of the companies. These costs are expected to be especially significant among smaller firms for whom tax registration and administration could be costly and complex procedures. Some additional potential benefits of the implementation of the electronic invoice include being environmentally friendly due to the reduction in the use of paper, facilitation of the traceability and security of operations, and generally improving the competitiveness of the country (Valenti, 2011). On the other hand, although the impact of the implementation of electronic invoices on government revenues is not immediately clear and these additional revenues are not earmarked to social

[102] Feng, K., Hubacek, K., Guan, D., Contestabile, M., Minx, J., & Barrett, J. (2010). Distributional effects of climate change taxation: the case of the UK. Environmental science & technology, 44(10), 3670-3676.
[103] Yusuf, A. A., & Resosudarmo, B. (2007). On the distributional effect of carbon tax in developing countries: the case of Indonesia. Papers No. EEN0706, Economics and Environment Network, the Australian National University, 70.
[104] Article 223 of Law 1819 of 2016 on the allocation of revenues from carbon taxes indicates that "El recaudo del impuesto nacional al carbono se destinará al Fondo para la Sostenibilidad Ambiental y Desarrollo Rural Sostenible en Zonas Afectadas por el conflicto ("Fondo para una Colombia Sostenible") de que trata el artículo 116 de la ley 1769 de 2015. Estos recursos se presupuestarán en la sección del Ministerio de Hacienda y Crédito Público."

programs, additional resources due to higher tax compliance could be used to finance government social spending.

12. **The use of electronic invoices could help to enhance firms' tax compliance.** According to the economic literature, some of the most important elements for tax compliance are the income levels of taxpayers, the knowledge of tax due, the frequency of audit, the probability of detection by tax authorities and the severity of punishment if caught. Valenti (2011) argues that the use of electronic invoices is one of the tax procedures with positive impacts on the government capacity to enforce tax obligations since they allow to improve oversight and simplify tax compliance. In addition, the World Bank (2015) identifies cumbersome tax regulations as one important regulatory burden limiting private sector competition and contributing to the misallocation of resources among firms. By simplifying and reducing the cost of tax compliance, through the implementation of electronic invoices, the tax authorities would help especially smaller firms, which compared to larger ones, have more limited resources to allocate in administrative costs involved with complying with tax regulations. For instance, Nabei and Sirigni (2011) assess the impact of use of Electronic Tax Registers (ETRs) on Value Added Tax (VAT) compliance among private firms in Kenya finding that use of ETR has a significant impact on VAT compliance in Kenya. In Rwanda, Eissa et al. (2014)[105] conduct the study on the impact of the adoption of Electronic Billing Machines (EBM) finding an increase in firms' VAT payments by 5.4 percent on average, although impacts varied substantially by sector and firm size.

13. **Additional government revenues due to higher compliance could help finance government social spending.** Even under the assumption that electronic invoicing enhances government tax revenues, the effect of Prior Action 4 on welfare will depend on the government use of any additional government resources due to higher tax compliance. Although, it is not clear how potential additional resources would be allocated, potential additional government resources could be used to increase government public spending in social programs, thus helping alleviate poverty and inequality.

14. **Finally, the update in the tax of the non-profit entities (*Entidades Sin Ánimo de Lucro, ESAL*) is expected to reduce tax avoidance and evasion boosting government tax revenues which have no impact on poverty reduction.** The tax reform is seeking to strengthen this special tax regime and eliminate behavior that seek to take advantage of the ESAL special tax regime since it suffers from several weaknesses which hampers the control and supervision by the government. In particular, this policy aims to eliminate abuses in the use of ESALs as vehicles to accede to a preferential tax regime, in harsh contrast with their "non-profit" objective. For instance, the reform considers as an indirect distribution of profits the hiring of relatives or acquaintances at wages above market price. In general, policies aimed at promoting clear tax rules and reduced discretion in the application of tax regimes tends to help curb down tax evasion and promote a better allocation of resources (Stiglitz and Rosengard, 2015),[106] fostering growth in the long-run. As a consequence,

[105] Eissa, N., Zeitlin, A., Karpe, S., & Murray, S. (2014). Incidence and Impact of Electronic Billing Machines for VAT in Rwanda.

[106] In particular, according to Stiglitz and Rosengard (2015:778) complexity in the tax system "(…) *increases administrative costs for the government and compliance costs for the taxpayer; it creates uncertainty in calculating tax liabilities (…); it reduces revenue by creating opportunities for tax avoidance (…); and it decreases transparency and increases perceptions of inequities, undermining incentives for voluntary compliance.*"

this policy is expected to help increase government tax revenues, but it is not expected to have a direct impact on poverty or inequality.

PILLAR 2: FOSTER PRODUCTIVITY AND GROWTH IN NON-EXTRACTIVE SECTORS BY STRENGTHENING THE POLICY FRAMEWORK FOR TRADE FACILITATION, BUSINESS REGULATION, INNOVATION AND GREEN GROWTH

Trade facilitation

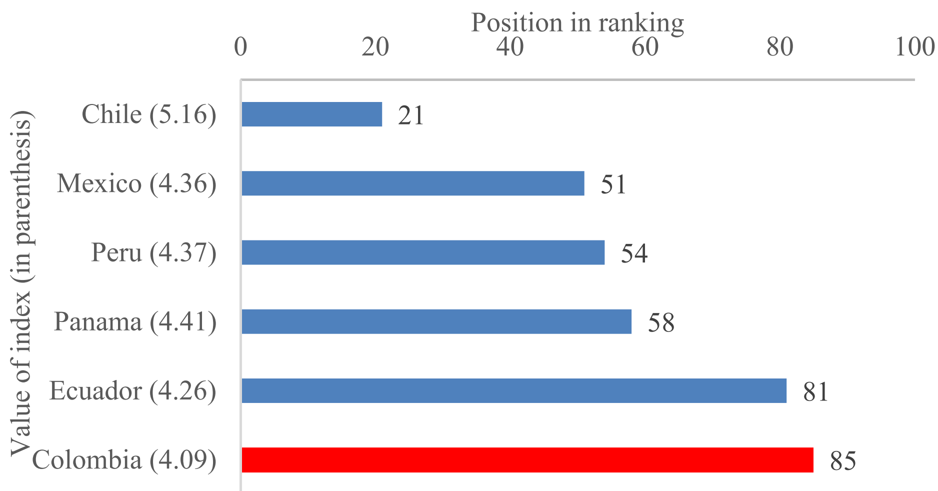
Prior Action 5: *The Borrower has adopted a set of regulations to ensure legal certainty, improve risk management and implement paperless customs that include: (i) clarifying the role and responsibilities of public and private stakeholders along the trade logistics chain and fighting smuggling through a more efficient sanctions mechanisms; (ii) simplifying sanitary and phytosanitary requirements for imports of food products and introducing a risk management system for food products with different level of risks, as evidenced, respectively by the Borrower's Decree No. 349 dated February 20th, 2018 issued by the Ministry of Finance; by the Decree No. 2478 issued by the Ministry of Health and dated December 28 2018.*

15. **The policies promoted by Prior Action 5 are expected to facilitate trade by simplifying administrative procedures and improving risk management but are not expected to have a direct impact on poverty or inequality.** Colombia substantially lags behind neighboring countries in terms of trade facilitation (Figure 9). A particular burden for firms trading across borders are cumbersome customs and other public border control procedures. According to DNP (2017), these procedures account for almost 60 percent of the total time in the logistics chain. Border compliance times and costs for imports and exports are well above regional peers[107] and represent a substantial burden for international trade. The specific policies supported by Prior Action 5 aim at reducing these impediments for trade by improving the efficiency of border control procedures. The combination of improved risk management systems stipulated in the Decree # 349 from the Ministry of Finance, the Decree # 2478 issued by the Ministry of Health and the resolution # 00008071 issued by ICA aim to improve import procedures for a wide range of products. Simplified sanitary requirements under the Ministry of Health Decree and optimized assessment of zoosanitary and phytosanitary risks through the ICA's automated import risk profiling, both measures that specifically target food and agricultural imports which account for around 12 percent of total imports, are likely to significantly reduce the time to import while improving the risk assessment efficiency.[108] Potential welfare effects of the policies under Prior Action 5 are most likely to be indirect and come from the impact of simplified procedures on lower import prices, in particular for food and agricultural products, which in turn would reduce consumer prices. These results are under the assumption that there is no import-market concentration or that there is competition in domestic markets for these products[109]. As milk and milk derivatives products (affected by the

[107] Doing Business (2017)
[108] UNCTAD, Trade Statistics.
[109] Whether wholesale services are characterized by intense competition remains an open question, as Colombia grants preferential import quotas for selected food and agricultural products to firms importing from trade agreements partners. Depending on how these quotas are allocated among importers and whether maximum quantities are easily met (some

Ministry of Health reform article on mutual recognition of control and inspection systems) account for around 4.7 percent of total expenditures of the bottom 20 percent of the income distribution - compared to around 1.5 percent of the top-20 percent[110] - lower food prices would particularly benefit the lower part of the consumption distribution. That said, back-of-the-envelope estimations and the economic literature presented below suggest that the impact of the policy measures on consumer prices is likely to be relatively modest. They are thus expected to have only a modest positive effect of welfare, if any, via reduced consumer prices, and potentially an indirect but positive second order effect on poverty reduction through economic growth.

Figure 9. Trade Facilitation index



Source: DNP (2017) and World Economic Forum.

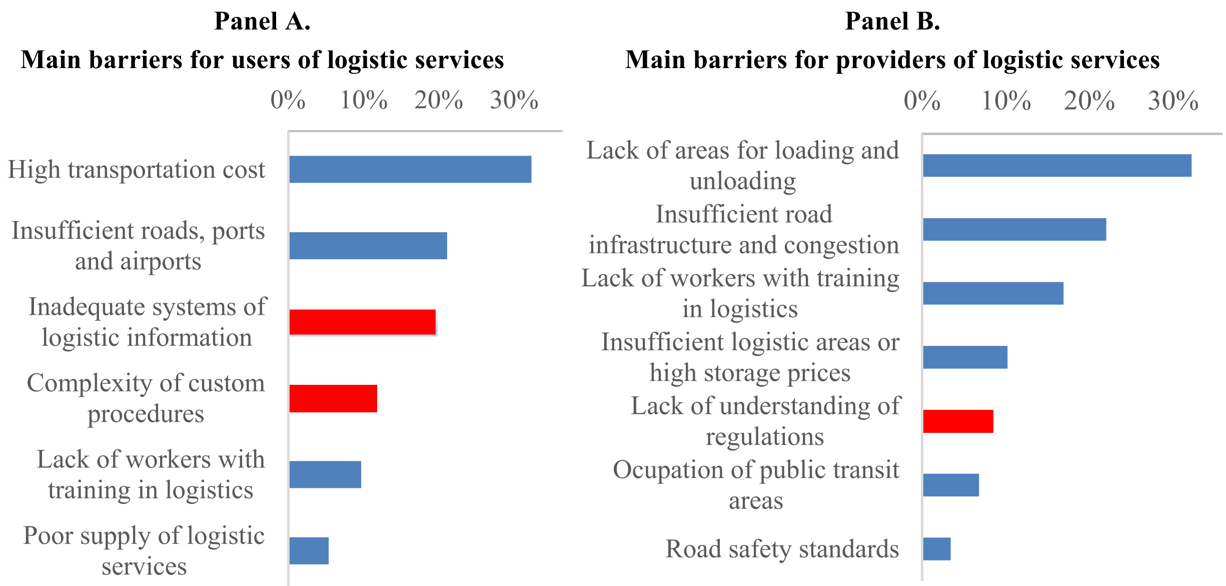
16. **The trade facilitation policies in Prior action 5 aim to reduce some of the main barriers for logistic services, which could have an impact on trade costs and ultimately on consumer prices.** According to information from DNP (2017), logistic costs represent on average 15 percent of sales prices, although about 60 percent of these costs correspond to the components of transport, distribution and storage, and less than 20 percent are associated with administrative procedures such as processing customers' orders and reverse logistics. However, the users of logistic services identify the complexity of custom procedures and inadequate systems of logistic information among the main barriers for logistic activities (Figure 10- panel A). On the other hand, the providers of logistic services indicate that poor understanding of regulations is among the main barriers for these activities (Figure 10 – panel B). In addition, DNP (2017) also identifies the poor coordination among government institutions as the main challenge to implement trade facilitation policies (which

quotas on dairy, rice, maize and other food products have already been filled at 95 percent in October 2018), anti-competitive practices could arise in wholesale services, therefore limiting the transmission of lower import costs into lower wholesale prices. Likewise, as seen in Mexico (Atkin et al., 2018) competition in retail services fostered by global retail stores can lead to reductions in consumer prices; yet Colombia has a relatively low penetration rate of supermarkets in food retail (Competition Policy International, 2015). The list of products where import quotas have been filled at 95 percent can be found here: https://muisca.dian.gov.co/WebArancel/DefMenuControlCupo.faces

[110] See Table 3. Share of expenditure in each consumption category by expenditure decile (percent)

the Government of Colombia is planning to tackle with the creation of the *Comité Nacional de Facilitación del Comercio*). A back of the envelope calculation suggests that a 10 percent reduction in logistics costs would reduce the average sale price of imported goods by approximately 0.3 percent if the whole cost reduction is passed on to consumers through lower prices (already a very generous assumption). Similarly, following the international evidence on the impact of import variety on domestic prices and welfare (Broda and Weinstein, 2006; Chen and Ma, 2012), an increase in import variety following the reduction in fixed costs to import high-risk food products could lead to 1.2 percentage points reduction per year in consumption prices for goods that weight relatively more on the expenditure basket of the poor[111].

Figure 10. Barriers for Logistic Services



Source: *DNP (2017).*

17. **The net welfare effect of trade facilitation policies would depend on consumers and producers' effects, as well as on which groups are the main beneficiaries of the additional economic growth.** The link between trade reforms and poverty outcomes tend to be case specific and complex, with similar trade policies having widely varying impacts on poverty in different countries (Coudouel and Paternostro, 2006[112]; and Vijil et al. 2018[113]). The economic literature on the effects of trade discuss at least three pathways on how trade policies affect income distribution and poverty: (i) the prices of goods; (ii) returns to factors of production; and (iii) the government revenues and expenditures. Even though most of the literature discusses the role of tariff as trade barriers, recently there is a recognition that non-tariff measures are also important obstacles

[111] Broda and Weinstein (2006), Globalization and the gains from variety, The Quarterly Journal of Economics. Fixed import costs will fall through the recognition of the national quality infrastructure system of the exporter instead of a firm by firm approach.
[112] Coudouel, A., and Paternostro, S. (2006:xii-xiv). "Introduction" in Analyzing the Distributional Impacts of Reforms. A practitioner's guide to pension, health, labor markets, public sector downsizing, taxation, decentralization, and macroeconomic modelling. Eds. Aline Coudouel and Stefano Paternostro. Vol. 2. The World Bank, Washington, D.C.
[113] Vijil, M., V. Amorim, M. Dutz and P. Olinto. 2018. Productivity, Competition and Shared Prosperity, mimeo.

Márquez-Ramos et al., 2012; Cali et al. 2015;[114] and Nguyen-Viet, 2013[115]). Trade facilitation measures could put downward pressure on import costs. Depending on the elasticities of domestic prices to changes in import costs, these measures could lead to lower consumer prices and have positive second-order effects on poverty reduction through expenditure gains. However, the distributional effects of trade facilitation from the producer side are more ambiguous. Tambunan (2013) finds that the benefits from trade facilitation measures are maximized by larger firms in Indonesia. In Colombia, increased import competition following the Ministry of Health Decree that opens the possibility for mutual recognition of control and inspection systems for high-risk food products could put pressure on the dairy value chain. At short term, this measure should not have consequences on poverty as about 44 percent of the national milk production is marketed in raw form through informal channels, mainly in departments that suffer from a lack of infrastructure and armed conflict (imported dairy products are less likely to be highly substitutable to informal raw milk and its derivates)[116]. At medium term, import competition could lead to a restructuring of the value chain in favor of more productive actors. Reduction in import prices for agricultural inputs, especially following ICA measure, could also increase producers' productivity gains. The net welfare effect should be positive and inclusive as consumer gains are likely to be higher and more widespread across the population (including among the bottom 40 percent), relative to concentrated potential producer losses. In the long term, trade facilitation could also reduce poverty by boosting economic growth, since it allows each country to use its resources more efficiently by specializing in the production of goods and services that it can produce more cheaply, by giving access to more advanced technological inputs, by enhancing incentives to innovate through increased competition, by raising employment and wages (McCulloch et al., 2001)[117][118] and by expanding the export sectors (World Bank and WTO, 2015).

Business regulation

Prior Action 6: *The Borrower has adopted measures streamlining the registration of new firms, including, inter alia: (i) the simplification of the procedures through the establishment of a single window for registering new firms; (iii) the establishment of a mechanism to identify and eliminate cumbersome regulations, as evidenced respectively in the Decree No. 1875 of 2017, dated and published on November 17, 2017 and Presidential Directive 07 of 2018, dated and published on October 1, 2018.*

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[114] Cali, M. Hollweg, C.H., and Ruppert-Bullmer, E. (2015). "Seeking shared prosperity through trade." *Policy Research Working Paper*; No. WPS 7314. Washington, D.C.: World Bank Group. Available at: http://documents.worldbank.org/curated/en/2015/06/24649967/seeking-shared-prosperity-through-trade

[115] Nguyen-Viet, C. (2013:3). "Poverty, inequality and trade reduction: Literature review and framework", Chapter 3 in "*Impacts of trade facilitation measures on poverty and inclusive growth: Case studies from Asia*". A Study by the Asia-Pacific Research and Training Network (ARTNet). Edited by Ravi Tarnayake, Rajan Sudesh Tarna, Martina Francesca Ferracane and Yann Duval. United Nations Publications. 2013.

[116] Superintendencia de Industria y Comercio, 2015. Market Analysis of Milk and Dairy Products in Colombia 2008-2012; Colombia.

[117] The "trade" approach is based on the idea that factors are in fixed supply. Consequently, an increase in the demand for a factor increases it wages (real return). The "Development" approach by contrast assumes that one factor – labour – is in perfectly elastic supply, that is, any amount of labor can be obtained

[118] McCulloch, N., A. Winters, and X. Cirera. (2001). "Trade Liberalization and Poverty: A Handbook." London: Centre for Economic Policy Research.

18. **Policies supported by Prior Actions 6 aim at facilitating entry and exit of firms from markets in order to promote firm formalization are not expected to have significant direct effects in labor markets in the medium to long-run.** The increased flexibility for entry promoted by the reforms aims to boost competition and reduce barriers for otherwise informal firms to enter the formal sector, thereby potentially having moderate positive indirect impacts on welfare through its effects in labor markets. The decrease in resources allocated to cumbersome administrative process would allow firms to assign resources into additional economical and productive activities, potentially promoting economic growth. Because of the simplification of procedures and the implementation of the single-window to register new firms, the number of newly registered formal firms is expected to increase and, assuming that formal registration is positively associated with providing formal employment benefits, the labor market conditions are expected to improve. Moreover, the benefits (exemption of payment of the *matrícula mercantil* during the first two years of registration) associated with the formal registration of young small firms[119] is expected to support formalization especially among young entrepreneurs, given the elimination of registration fees for this group.

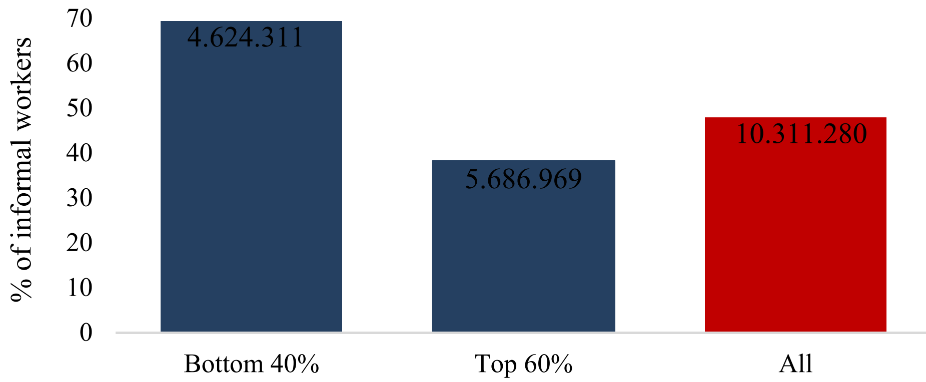
19. **Non-causal empirical evidence suggests that regulations on firm entry and exit are inversely correlated with productivity and firm creation, with stronger effects in sectors that tend to have higher turnover rates.** Cross-country correlations indicate that countries with more burdensome entry regulations have larger informal sectors, and that costly entry regulations are associated with lower creation of limited-liability firms. Recent evidence for Mexico indicates that easing entry requirements helped increase business registration and employment. Moreover, the reforms contribute to more institutional development (i.e. to low entry and exit barriers, well-defined property rights, and effective contract enforcement) that is conducive to competition and private commercial transactions, which helps alleviate smaller firms' growth constraints (especially for SMEs), leveling the playing field between firms of different sizes (OECD, 2012). The report Doing Business 2005[120] shows that once regulation is relaxed and administrative processes simplified, the number of formal businesses increases, for example, the rate of formal registration on Ethiopia, France, Morocco, Slovakia and Turkey grows 2 to 4 times the rate of other countries, since its reform on 2003.

20. **The policy reforms in Prior Action 6 intend to support the creation of more opportunities for workers to enter the formal sector either as entrepreneurs or as employees of small firms, in particular for younger cohorts.** The policies in Prior Action 6 for young small firms include the exemption of payment of the *matrícula mercantil* during the first two years of registration of young small firms. This could be beneficial for workers in the lower 40 percent of the income distribution (bottom 40) who are more likely to be employed informally (Figure 11). Nonetheless, the impacts are expected to operate on the margin and the effects on overall levels of formality may arise from the synergies of the entire package of policies proposed.

[119] According to Article 2.2.2.41.5.2. of Law 1780 of 2016 a young small firm is one with 50 or less workers, with total assets valued in less than 5,000 minimum wages, and where the owner (or 51 percent of share owners) are 35 years old or younger.

[120] Business, D. (2005). Removing obstacles to growth. *Retrieved from Doing Business Web Page: http://www. doingbusiness. org/Downloads*.

Figure 11. Informality rates by income distribution



Notes: *The number inside the bar corresponds to the number of informal workers. Informality refers to a productivity definition of it.*
Source: *Own elaboration based on GEIH (2017).*

21. **However, recent experimental evidence for Colombia suggest that the impact of the policies removing fixed costs of formalization may not have lasting effects.** Experimental evidence suggests that reducing barriers to firms' entry and exit per se may play a small role in the decision of whether or not to formalize. In particular, Galiani et al. (2015) present evidence from an experiment[121] designed to induce formalization in Colombia with similar characteristics to those proposed by Prior Action 6. The results of the experiment suggest that assistance through the bureaucratic process and the removal of fixed costs of formalizing increase the likelihood of formalization, however these effects did not persist over time. After a year experimenting with formal operation the firms decide to opt out of formality suggesting that they did not find advantages in continuing operating as a formal sector enterprise. One interpretation of this result is that a reduction in the fixed costs of operating formally does not play a defining role in a firm's decision to whether or not formalize, since that reduction had no enduring effect on the decision to operate in the formal sector.

22. **Evidence from other developing countries suggests that entry costs to enter formality are not the main drivers of firm informality.** Empirical studies by De Mel et al. (2008, 2013) evaluate the influence of different types of interventions on a firm's decision to operate informality in Sri Lanka. The authors find that when actual payments are made, in addition to the provision of information and the reimbursement of registration costs, firms were more likely to decide to formalize. However, solely proving information about the formal registration process and the possibility of obtaining reimbursements for direct registration costs did not have any effect on the formalization decision. Moreover, Andrade et al. (2014) implement a field study in Belo Horizonte (Brazil) to test the effect of alternative government interventions to encourage informal firms to register. The authors find that information and free cost treatments have zero or negative impact in formalization (similarly to the results from De Mel et al. 2013 and Galiani et al. 2015), while

[121] The natural experiment discussed in Galiani et al. (2015) is somehow unique in that it not only entails the virtual elimination of formalization costs but also provides firms with the opportunity to experiment with formality at no costs for an entire year while, simultaneously, not incurring in any tax liabilities for two years.

inspections have a small but positive effect in formalization. These results show that most informal firms will not formalize unless forced to do so, suggesting that these firms perceived the benefits of operating formally to be negligible. Thus, joint evidence from De Mel et al. (2008, 2013), Andrade et al. (2014) and Galiani et al. (2015) seems to suggest that informal firms remain operating in the informal sector because they perceive the benefits of formality to be modest, not because burdensome entry costs deter them from operating formally (De Mel et al., 2013). If this is true, we would not expect to observe significant lasting effects of the simplification in the registration of enterprises, and elimination of some bureaucratic procedures in firm formality, labor market outcomes or poverty.

Innovation

Prior Action 7: *The Borrower improved the rules for the definition of priorities areas to be funded by the Royalties Fund for STI and improved the transparency and efficiency of the project selection process as evidenced by the Borrower's Decree No. 1467 dated and published on August 6, 2018.*

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23. **Policies promoted by Prior Action 7 are expected to foster science, technology and innovation promoting growth and competitiveness in the medium and long-run but are not expected to have a significant direct impact in poverty reduction in the short-run**. Recent empirical evidence from assessments in Colombia (Arbeláez and Parra, 2011) and the Latin America region (Crespi and Zuniga, 2012; Crespi et al., 2014) suggests that investments in scientific, technological and innovation projects increases firms' productivity and sales, with the potential to boost economic growth in the medium-run. For instance, in Colombia Arbeláez and Parra (2011) find strong evidence that innovation increases firm sales and efficiency, which in turn leads to potential job creation and the enhancement of economic activity.[122] At a regional level, several authors find a strong association between innovation and productivity (Crespi and Zuniga, 2012),[123] as well as improvements in production processes and labor productivity (Crespi et al., 2014).[124]

24. **Economic theory has largely acknowledged the importance of investment in human capital, innovation and knowledge for economic growth to enhance the development of new technologies and promote a more efficient production.** Innovation is an important engine for development of modern economies and is a distinguishing feature of emerging countries that exceed poverty traps and pass the threshold to progress. Innovation applies to multiple economic activities, extends to different linkages, and has the potential to translate into growth, quality jobs and greater prosperity.[125] In particular, the endogenous growth theory (Romer, 1990) argues that technological

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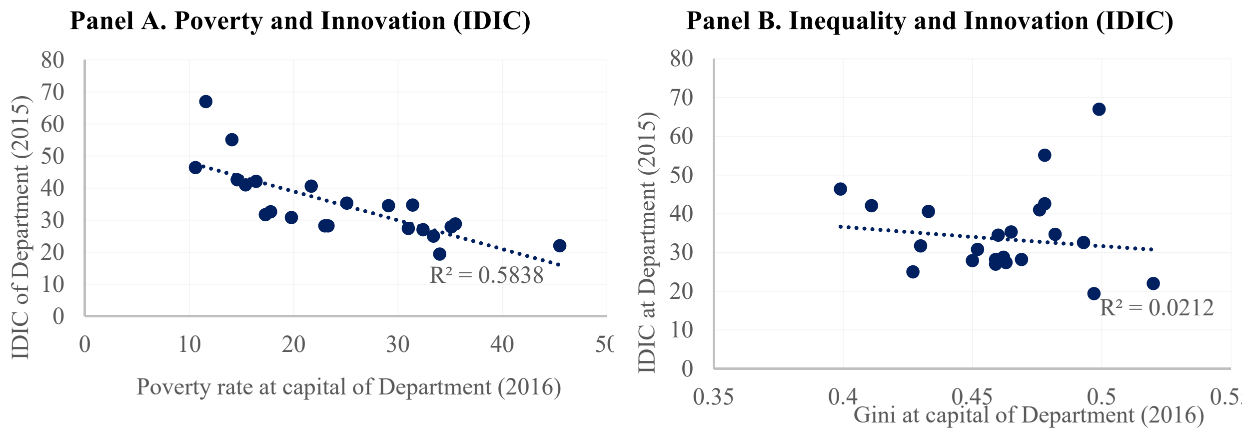
[122] Arbeláez, M. and Parra, M. (2011). "Innovation, R&D Investment and Productivity in Colombian Firms". Inter-American Development Bank.
[123] Crespi, G. and Zuniga, P. (2012:273-274,283). "Innovation and Productivity: Evidence from Six Latin American Countries." *World Development*. Vol. 40, No. 2, pp. 273-290, 2012.
[124] Crespi, G., Tacsir, E. and Vargas, F. (2014:4-6). "Innovation and Productivity in Services: Empirical Evidence from Latin America." *Technical Note No. IDB-TN-690*. Competitiveness and Innovation Division. Institutions for Development Sector. Inter-American Development Bank. Available at: http://publications.iadb.org/handle/11319/6592
[125] Gomez, H.J., Mitchel, D. (2014:7). "Innovación y emprendimiento en Colombia - Balance, perspectivas y recomendaciones de política: 2014-2018". *Cuadernos de FEDESARROLLO*. March, 2014. Available at: http://hdl.handle.net/11445/149

change is a response to economic incentives that can be influenced by the government or the private sector,[126] and investment in research and development (R&D), leading to innovation in science and technology, is a key driver for technological change and economic growth. Additionally, a competitive and open process to decide the project and the executor can foster competition and may exert downward pressure on prices face by local governments. As a consequence, this policy is expected to help cut back local government expenditures per project.

Figure 12. Relationship between Innovation, Poverty and Inequality in Colombia



Source: Own elaboration based on DNP (2015) and DANE (2016).

25. **An adequate prioritization of investment in science, technology and innovation to foster technological development and competitiveness can increase earnings by improving firms' productivity promoting economic growth.** The Government of Colombia is promoting reforms to identify and prioritize investments in science, technology and innovation at the subnational level through the Regional Strategic Plans of Science, Technology and Innovation (*Planes y Acuerdos Estratégicos Departamentales en Ciencia, Tecnología e Innovación*, PAED). The policies in Prior Action 7 aim at effectively promoting innovation across the territory, thus are expected to have a positive impact on economic growth and firm's productivity in the medium to long-run and help to reduce the regional inequality of the country, which could lead to positive impacts on incomes, a more balanced economic growth and to the reduction of poverty. For instance, in 2-Panel A shows that in Colombia, moderate monetary poverty has a strong negative correlation with innovation, measured through the *Índice Departamental de Innovación* (IDIC). However, note that inequality and innovation does not seem to be significantly correlated -Figure 12 Panel B (if any, the relationship is slightly negative, although hardly different from zero). A note of caution regarding Figure 122 is necessary, according to the National Planning Department of Colombia (DNP) the IDIC is estimated based on information at the Department level while [127] both measures of monetary poverty and inequality are estimated by the Colombian statistics office (*Departamento Administrativo Nacional de Estadísticas, DANE)* at the capital of the Department level. Thus, the correlations showed in Figure 122 are merely indicative.

[126] Romer, P.M. (1990). "Endogenous Technological Change." *Journal of Political Economy* 98, S71-102.
[127] DNP (2016). Índice Departamental de Innovación para Colombia (IDIC), 2015. Available at: https://colaboracion.dnp.gov.co/CDT/Prensa/Publicaciones/%C3%8Dndice%20de%20Innovaci%C3%B3n%20Departamental%20para%20Colombia.pdf

26. **Despite the importance of innovation for productivity and growth, fiscal resources have an opportunity cost, thus the importance of prioritizing investment in science and technology.** Even though the theoretical grounds and empirical evidence supporting the importance of investment in science, technology and innovation to raise productivity and achieve economic growth in the medium and long-run, the recent evidence (Becker, 2015)[128] suggest that there are positive effects of tax credits in investment in research and innovation, shifting away from earlier findings suggesting that public subsidies often crowd-out private investment (see Bloom et al., 2002;[129] and, Cappelen et al. 2011[130]), towards results that indicate that subsidies typically stimulate private R&D. This positive effect seems to be particularly prevalent in small firms, more likely to experience financial constraints, and important creators of jobs in developing countries. However, a comprehensive impact analysis of these policies would require evaluating the opportunity cost for the resources allocated for the specific tax incentives.

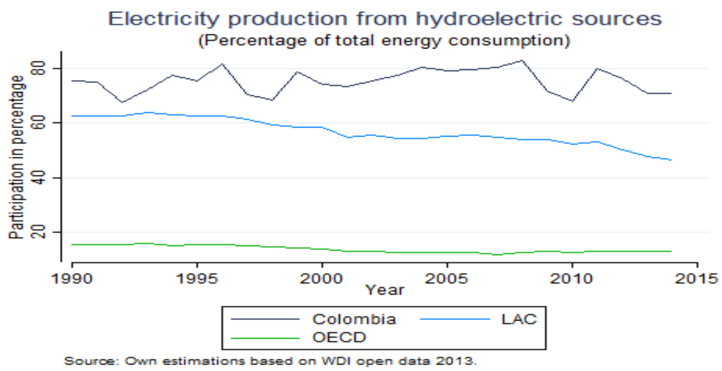
Energy efficiency at the firm level

Prior Action 8: *The Borrower has established guidelines to improve efficiency of energy management at the firm level by, inter alia, regulating the sale of surplus energy deriving from the auto-generation of energy at a small scale, as evidenced by the Borrower's Decree No. 348, dated and published on March 1, 2017 (that regulates Law No. 1715 of 2014).*

27. **The policies supporting efficiency in energy management are not expected to have a direct impact on consumer wellbeing in the short run.** The policies promoted by Prior Action 8 are expected to support the efficient provision of energy by expanding the back-up capacity of the electric system in Colombia. As shown by Figure 3, Colombia's energy matrix relies heavily on hydroelectric power generation to provide electricity to the population and to the Colombian industrial sector, significantly more than the average country in the LAC region or than OECD countries, raising concerns about the vulnerability and reliability of service provision. In particular, production of energy from renewable sources depends greatly on climatic conditions, which may be impacted in the future due to global climate change. For instance, in a study discussing the case of electricity generation using hydropower in Brazil, De Lucena et al. (2012) find increasing energy vulnerability of the poorest regions of the country to global climate change. Thus, improving energy management through the regulation of sales of surplus energy from auto-generation is a positive step to guarantee the continuous provision of the service even under droughts or long-run changes in climate. The reduction in the risk of the provision of the service fostered by the higher grid reliability could have a positive impact on overall productivity by reducing uncertainty in the grid system. These potential positive effects on growth could also be indirectly reflected in the reduction of poverty rates, although hard to quantify the magnitude of the effect would be expected to be moderate.

[128] Becker, B. (2015). "Public R&D Policies and Private R&D Investment: A Survey of the Empirical Evidence." *Journal of Economic Surveys* (2015), Vol. 29, No. 5, pp. 917-942.
[129] Bloom, N., Griffith, R., and Van Reenen, J. (2002:1). "Do R&D tax credits work? Evidence from a panel of countries 1979-1997". *Journal of Public Economics*. Volume 85, Issue 1, July 2002, pp.1-31.
[130] Cappelen, A., Raknerud, A., and Rybalka, M. (2012:334). "The effects of R&D tax credits on patenting and innovations". *Research Policy*, Vol. 41, Issue 2, March 2012, pp. 334-345.

Figure 13. Share of Hydropower Electric Generation



28. **In the medium to long-run the increasing adoption of auto-generating energy alternatives could trigger increases in electricity charges and raise inequity issues.** A distributional concern of promoting the auto-generation of energy in the long-run is the trigger of the so-called 'death spiral' (Kind, 2013) and, in the medium-run, the increase in electricity charges for low-income households who are not able to afford auto-generating energy solutions and have to make up for netted costs of auto-generating owners (Eid et al, 2014). Historically, the death spiral was related to price increases resulting from radically higher utility costs. The death spiral in the present context refers to retail customers migrating from full-requirements utility service to the combination of self-generation and partial-requirements service. Under this scenario, advances in renewable energy will permit consumers to generate more of their own power (at least for those who can afford the new auto-generating alternatives), allowing them to leave the grid or just keep it as a back-up electric energy source (Costello and Hempfill, 2014). As more customers leave the network, companies will be forced to raise rates to cover fixed costs--like power-transmission infrastructure—generating unintended negative externalities for the users who remain in the grid and potentially forcing even more people away.

29. **The World Bank will discuss with the Government of Colombia the implementation of mitigation mechanisms to avoid sharp increases for users who remain relying on the electricity grid as source of energy.** Among the financial risks created by a massive adoption of auto-generation of energy include declining utility revenues, increasing costs, and lower profitability potential, particularly over the long term.[131] However, revising utility tariff structures, particularly in contexts with potential for high auto-generation adoption, to mitigate (or eliminate) cross-subsidies and provide proper customer price signals will support economic implementation of auto-generation alternatives while limiting stress on users relying solely in the grid and utility finances. In this sense, the 'death spiral' is not necessarily a result of disruptive competition from resources at the customer side of the meter, but from the inherent design of rate structures (Felder and Athawale, 2014). In this sense, the World Bank will discuss with Colombian authorities the possibility of updating their tariff structures to avoid equality issues in the medium to long-run.

[131] See Kind (2013) for more details on the concerns related with the "death spiral" and auto-generated energy sources.

PILLAR 3: SUPPORT REGULARIZATION AND INTEGRATION MIGRANTS.

Prior Action 9: *The Borrower has adopted measures to regularize the legal status of irregular Venezuelan migrants into the national economy, to facilitate their access to the labor market and basic services such as education and health, as evidenced by the Borrower's Decree No.1288, dated and published on July 25, 2018.*

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30. **The extension of the law granting Special Permission to Reside (PET for the acronym in Spanish) to Venezuelan migrants is expected to have positive effects in the medium and long-run that would outweigh the negative effects in the short-run on poverty and shared prosperity.** The main objective of the policies supported by Prior Action 9 is to grant a temporary permit that gives access to education and health services, as well as work permission to Venezuelan migrants. In principle, this policy fosters the participation of migrants into the formal labor market. The integration of migrants in society and the labor market plays an important role on moving towards achieving positive outcomes on growth and poverty reduction. Although hard to quantify, the short-run effects of this policy on poverty and inequality are expected to be negative. Initial evidence on the impacts of Venezuelan migration on host communities has been identified through a rapid assessment report (World Bank, 2018 [132]). The document finds that the migration from Venezuela could be affecting the reduction of poverty and extreme poverty in Colombia in the short-run. Some preliminary results show that for each 1 percent increase in recent immigration rates, national poverty would increase by 2 percentage points. The decrease in the rate of poverty reduction of last year could be explained mainly by the inability of local labor markets to adjust to the influx of migrants in the short-run. For instance, estimations for Colombia finds that an increase of 1 percent in the migration rate during the last 12 months induces a reduction of 2 percentage points in employment rates. In addition, the informal labor market, as well as the underemployment rate is expected to grow in the short-run. The report also finds that real wages in Colombia have decreased between 3 to 6 percent due to the increase of migration.[133] However, those negative effects are expected to be outweighed by the positive effects in the medium and long run.

31. **The increase in the number of granted Special Permissions to Reside is expected to facilitate the introduction of migrants in the formal labor market, although the magnitude of the impacts on the labor market is hard to quantify.** In particular, Aleksynska and Trirtah (2015)[134] analyze the impact of immigration on the decomposed factors of production: physical capital, human capital, total factor productivity, and also on employment rates in a sample of 20 OECD members countries between 1960 and 2005 finding a negative short-term effect that are outweighed by larger positive effects in the medium term. The authors find that, on the aggregate, there is an overall positive impact of immigration on the host countries' income and labor productivity, which works primarily through TFP, and mostly in the medium run. A closer look

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[132] World Bank (2018), Migración desde Venezuela a Colombia: impactos y estrategia de respuesta en el corto y mediano plazo – forthcoming, Washington, D.C.

[133] An important caveat from this report is that the data used for estimating labor market impacts is not representative of the Venezuelan population, therefore results should be taken with caution.

[134] Aleksynska, M., & Tritah, A. (2015). The Heterogeneity of Immigrants, Host Countries' Income and Productivity: A Channel Accounting Approach. Economic Inquiry, 53(1), 150-172.

across different age groups and at the components of income and productivity suggests that the impact of immigration works through complementarities between immigrants and natives.

32. **An increase in the number of formal migrants is expected to have positive impacts in economic growth on the medium and long run.** Economic literature finds only a limited effect of migration on the average wages and employment of native workers (see Peri 2014[135]). However, some other studies find a negative impact on the wages of low-skilled workers (e.g., Borjas 2003[136], Card 2001[137]). Nevertheless, when looking the effects on the GDP per capita on the long run, the literature found that in cases where migrants are integrated in the labor market and are employed productively, migration can boost GDP per capita. Ortega and Peri, 2014[138] and Alesina et al, 2016[139] found that immigration has a large effect on both income per capita and productivity. More recently, Jaumotte et al. 2016[140] argued that one percentage point increase in the share of migrants in the adult population can raise GDP per capita by up to 2 percent in the long run, the effect is mainly drive by an increase in labor productivity (by increasing the diversity of skills and ideas, fostering skill complementarity and specialization, and encouraging the upgrading of natives' skills). Furthermore, Jaumotte et al. 2016 found that both high- and low-skill migrants raise labor productivity. There is no evidence of major physical or human capital dilution, as investment adjusts over time to the larger pool of workers, and migrants are increasingly high-skilled.

33. **It is often considered that immigrants can increase poverty through the creation of protracted economic and social costs for the host country. Nevertheless, long-run diversification of workers' skills could lead to positive effects on poverty reduction through an increase in labor productivity.** For instance, Jaumotte et al. 2016 looking at developed economies find that the positive effects of migration are distributed among the population. The authors found that the gains from immigration are broadly shared across the population. Migration increases the average income per capita of both the bottom 90 percent and the top 10 percent of earners, even though high-skilled migration benefits more top earners. Moreover, the Gini coefficient is not affected by the migrant share. Some other research on south to south migration find that the aggregate effect of migration on wages is very small both in the short and long run (Ratha and Saw, 2007141). Nevertheless, it is important to highlight that one condition that must to be satisfied to those positives effects to happen is the integration of the migrants into the society and specially into the labor market142.

135 Peri, G (2014) "Do immigrant workers depress the wages of native workers?", IZA World of Labor.
136 Borjas, G J (2003) "The labor demand curve is downward sloping: Reexamining the impact of immigration on the labor market", Quarterly Journal of Economics, 118(4): 1335–74.
137 Card, D (2001) "Immigrant inflows, native outflows, and the local market impacts of higher immigration", Journal of Labor Economics, 19(1): 22–64.
138 Ortega, F and G Peri (2014) "Openness and income: The role of trade and migration", Journal of International Economics, 92(2): 231–51.
139 Alesina, A, J Harnoss and H Rapoport (2016) "Birthplace diversity and economic prosperity", Journal of Economic Growth, 21(2): 101–38.
140 Jaumotte, F, K Koloskova and S Saxena (2016) "Impact of migration on income levels in advanced economies", IMF Spillover Note, Issue 8, October.
141 Ratha, D., & Shaw, W. (2007). *South-South migration and remittances*. The World Bank.
142 Ratha, D., Mohapatra, S., & Scheja, E. (2011). *Impact of migration on economic and social development: A review of evidence and emerging issues*. The World Bank.

Prior Action 10: *The Borrower has approved a medium term National Policy (up to 2021) to, inter alia, develop a roadmap for the integration of migrants from Venezuela that includes health, education, water and sanitation, support for children, and housing services as well as, services to productively integrate them into labor markets, as evidenced by the CONPES No.3950, dated and published on November 23,2018[143].*

34. **Policies in prior action 10 aim at developing a roadmap to effectively integrate migrants from Venezuela. In the short term, there is a concentration of migration costs that would impact negatively the wellbeing, with the potential benefits of migration emerging in the medium term.** In the analysis of impacts[144] of migrants from Venezuela in Colombia, the World Bank (2018), shows that in the short term there is an overflow in the demand of most sectors (education, health, employment, etc.). A critical feature to be considered is the geographical concentration of migrants from Venezuela in Colombia, especially in a number of areas where the challenges for host communities already existed before the influx of migrants from Venezuela, what makes more difficult the integration of the migrants into the host community. Furthermore, as mentioned by the World Bank (2016), just 27 percent of exited refugee return to their place of origin, what makes migration a long-term phenomenon. However, the early overflow does not necessarily imply that migration has a negative impact on the country's growth in the medium term. Colombia could achieve a greater economic growth as a result of migration, benefiting from an increase in investment and in consumption, subject to the rate with which migrants and returnees enter the labor market. Nevertheless, the possibility of taking advantage of the flow of migrants depends on the capacity of the recipient country governmental institutionality to successfully integrate this population (Center for Global Development (CGD)[145], 2018, McKinsey Global Institute, 2016[146]).

35. **The increase of migrants has forced the territorial entities, governorates and mayors to respond not only to existing problems, but to new financial pressures, attention capacity, among others.** As mentioned by DNP (2018), there are different important challenges related to the response and articulation of the Colombian Government given the increase of the Venezuelan migration. In the first place, it is found that there are high costs of identification of the irregular migrant population. Secondly, the provision of public services to a large migrant population generates fiscal pressures on the social security, education and protection systems of the ICBF. Third, coordination costs between the national, regional and local levels for the attention of the migrant population could be important. Finally, one of the most complex challenges is to maintain an environment of openness from the local population.

36. **Coordination among local and national government entities and private organizations is a key element to ensure positive effects in the medium term, not just for migrants, but also for host communities.** For instance, as noted by the Center for Global Development (2018) in Guinea, the government and donors cooperated to create an integrated health system that led to

[143] See paragraph 67 of the main text.
[144] The impact calculations included here are mere estimates. The calculations were made using existing information and specific parameters, which implies that they are subject to a considerable margin of error.
[145] Center for Global Development. (2018). Migration is What You Make It: Seven Policy Decisions that Turned Challenges into Opportunities
[146] McKinsey & Co. (2018). Propuestas iniciales para gestionar la integración de los migrantes en Colombia

improved health outcomes for all. In contrast in Zaire, an uncoordinated response led to a deterioration of the local health system[147]. In a series of cross-country reviews, the studies by Hynes et al. (2002, 2012)[148] found that integration help to either generate improved health outcomes or support burdened health systems in Cameroon, Uganda, and Lebanon. Clearly, policy decisions and implementation play a major role in determining the impact that immigrants have on service quality. If systems adapt to immigrant inflows, they will offer immigrants with the services they need while improving outcomes for hosts. Integration of migrants into society could help to reduce fiscal pressures. For example, as mentioned by the DNP (2018), the average per-capita cost of health services (for people who is part of the Colombia health system) in 2018 was 830,523 Colombian pesos. While the average cost of the most common treatments for migrants from Venezuela (out of the health system) were more than 1 million Colombian pesos.

37. **The increase of migrants is expected to have positive effects on the long run that outweigh the negative effects in the short-run on poverty and shared prosperity.** According to estimates of the Directorate of Economic Studies of the National Planning Department (DNP, 2018) the average growth of the Colombian economy is expected to be between 0.2 and 0.9 percentage points between 2018 and 202 if the fiscal costs of serving the migrant population from Venezuela are not considered. Consumption would increase between 0.3 and 1.1 percentage points. The investment would only grow between 0.2 and 0.6 percentage points compared to the scenario where there is no migration. The positive effects will be reduced by the fiscal impact of serving the population. Therefore, the average growth of the economy will be between 0.1 and 0.5 percentage points. Consumption would have grown between 0.2 percent and 0.5 percent. Nevertheless, in order to obtain the greatest possible benefit from migration, it is essential to have policies that encourage rapid population linkage (CGD, 2018).

[147] Center for Global Development. (2018). Migration is What You Make It: Seven Policy Decisions that Turned Challenges into Opportunities.
[148] Hynes, Michelle, Ouahiba Sakani, Paul Spiegel, and Nadine Cornier (2012), "A Study of Refugee Maternal Mortality in 10 Countries, 2008—2010," *International Perspectives on Sexual and Reproductive Health,* 38 (4): 205-213. Hynes Michelle, Mani Sheik, Hoyt G. Wilson, and Paul Spiegel (2002), "Reproductive Health Indicators and Outcomes Among Refugee and Internally Displaced Persons in Post-emergency Phase Camps," *The Journal of the American Medical Association*, 288 (5): 595–603. Agha, A., & Haughton, J. (1996). Designing VAT systems: Some efficiency considerations. The Review of Economics and Statistics, 303-308.

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