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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT

FOR A

PROPOSED SOCIAL SECTOR ADJUSTMENT LOAN

IN THE AMOUNT OF US$155 MILLION

TO

THE REPUBLIC OF COLOMBIA

June 18, 2002

Human Development Department
Colombia, Mexico and Venezuela Country Management Unit
Latin America and the Caribbean Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective October 25, 2001)
Currency Unit = Colombian Pesos (COP)
Colombian Peso $2,340.00 = US$1.00
US$0.00042735 = 1 Colombian Peso

FISCAL YEAR

January 1 - December 31

ABBREVIATIONS AND ACRONYMS

ARS	*Administradora del Régimen Subsidiado*	INS	National Institute of Health
AUC	*Autodefensas Unidas de Colombia*	INURBE	National Institute of Social Interest Housing and Urban Reform
BTOR	Back-to-Office Report	IPS	*Institución Prestadora de Salud*
CAIP	Centers of Integrated Attention for Pre-School Children	ISA	International Standards on AUDITING
CAS	Country Assistance Strategy	ISS	Social Security Institute
CAS-PR	Country Assistance Strategy – Progress Report	LAC	Latin America and the Caribbean Region
CFAA	Country Financial Accountability Assessment	LDP	Letter of Development Policy
CMU	Country Management Unit	MEN	Ministry of Education
CONPES	*Consejo Nacional de PolíticaEconómica y Social*	MOF	Ministry of Finance
CPAR	Country Procurement Assessment Report	MOH	Ministry of Health
CRECE	*Centro de Estudios Regionales Cafeteros y Empresariales*	NFPS	Non Financial Public Sector
DANE	*Departamento Administrativo Nacional de Estadística*	OPV	*Organizaciones Privadas Voluntarias*
DNP	Department of National Planning	PAC	*Plan Anual de Caja*
DTP3	Diphtheria-Tetanus-Pertussis Vaccine	PACES	Program for Expanding Coverage of Secondary Education
ELN	*Ejército de Liberación Nacional*	PAHO	Panamerican Health Organization
EN	*Escuela Nueva*	PFMP	Public Financial Management Project
EPI/PAI	Expanded Immunization Program	QAG	Quality Assurance Group
EPS	*Empresas Promotoras de Salud*	QER	Quality Enhancement Review
FARC	*Fuerzas Armadas Revolucionarias de Colombia*	RAS	*Red de Apoyo Social*
FEC	*Fondo de Compensación*	RSS	*Red de Solidaridad Social*
FINDETER	*Financiera de Desarrollo Territorial*	SABER	National Evaluation System for the Quality of Education
FOGAFIN	Banking Superintendency and Financial Guarantee	SAT	*Sistema de Aprendizaje Tutorial*
FOSYGA	*Fondo de Solidaridad y Garantía*	SDR	Special Drawing Rights
FSAL	Financial Sector Adjustment Loan	SECAL	Social Sector Adjustment Loan
GDP	Gross Domestic Product	SENA	*Servicio Nacional de Aprendizaje*
GOC	Government of Colombia	SFAL	Structural Fiscal Adjustment Loan
IBRD	International Bank for Reconstruction and Development	SGP	*Sistema General de Participaciones*
ICBF	Colombian Institute for Family Welfare	SIIF	Integrated Financial Management System
IDB	Inter-American Development Bank	SINERGIA	National System for Evaluation of Results of Public Sector Performance
IDF	Institutional Development Facility	SISBEN	*Sistema de Selección de Beneficiarios*
IDP	Internally Displaced Population	SNSSS	National System of Social Security in Health
IFI	International Finance Institutions	UNESCO/ OREALC	United Nations Educational, Scientific and Cultural Organization
IMF	International Monetary Fund	WBG	World Bank Group

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LOAN AND PROGRAM SUMMARY

REPUBLIC OF COLOMBIA
SOCIAL SECTOR ADJUSTMENT LOAN (SECAL)

Borrower: Republic of Colombia

Amount and Terms: US$155 million fixed-spread loan, with automatic interest rate fixing whenever disbursements reach an aggregate of US$155 million; final repayment maturity of 15 years with level repayments of principal, each equivalent to 5 percent of the loan amount. Commitment charge: 0.85 percent p.a. for the first four years, and 0.75 percent p.a. thereafter. Front-end fee: 1 percent of the loan amount, to be paid by the Government out of its own finances.

Implementing Agency: Ministry of Finance (Public Credit)

Description: The proposed SECAL, a one tranche loan intended to be completed before the end of the current Administration on August 7, 2002, is the Bank's response to the current government's demonstrated commitment to social sector reforms. The loan would: (i) encourage and enable the current Administration's momentum on several key social reforms that have been developed with active Bank support; (ii) provide an opportunity to influence the social sector agenda of the next Administration; and (iii) help sustain the Government's fiscal program during this calendar year.

The operation supports the medium term strategic framework laid out in Table 4.1 and includes among others the following core set of legally binding actions: (i) the introduction of a system of periodic impact/performance evaluation and public monitoring of the Government of Colombia's (GOC) main social sector programs to improve their transparency and citizens' oversight; (ii) the development of a comprehensive Social Risk Management System, improvements in ICBF child assistance programs, and formulation of a time-bound action plan to eliminate barriers to internally displaced population's access to social programs; (iii) the expansion of the subsidized health insurance coverage of the poor, issuance of regulations to implement the new methodology for allocating health transfers to territorial entities, strengthening of the Health Superintendency, and the revitalization of the country's Expanded Immunization Program; and (iv) improvement of the public education regulatory framework (including issuance of regulations to implement a new methodology for allocating education transfers to territorial entities and guiding contracts between public education entities and private providers), establishment of performance and monitoring agreements between the national and selected local governments/Education Secretariats, and more effective dissemination of information regarding education methodologies to improve the education of the poor.

The above social strengthening program is the product of sustained collaboration among GOC, the Bank and the IDB – and is financed in parallel by the IDB's Social Sector Project.

Risks and Benefits: The actions supported by the operation are likely to lead to improvements in people's well-being in various ways, particularly among the children and the poor. These would include among others: (i) increased health status and reduction of financial risks from illness through the expansion of health insurance coverage, improved managed competition, and the revitalization of the immunization program; (ii) greater access to better child care programs through incombe-based cost recovery and efficiencies from the decentralization of ICBF programs; and (iii) improved educational status of children through increased efficiency and equity in the allocation of resources.

The timing of the loan is an issue posing some risks. Given the upcoming change of government, questions have been raised about the wisdom of presenting the Board with a one-tranche loan to be disbursed by the end of the current Administration's term. The principal concern has been that the new Administration might fail to support or might even reverse the various reform initiatives embodied in the SECAL. This risk factor has been weighed against the benefits of approving the proposed loan under the current Administration. The conclusion is that the expected benefits outweigh the risk for reasons elaborated in Section 4B. Two reasons are noteworthy in this regard. First, various programs supported by the operation (e.g. the expansion of the number of poor people affiliated with the subsidized health insurance regime) are now under implementation and are already providing substantial benefits to their target population. These benefits are unlikely to be reversed. Second, the social strengthening program supported by this loan has strong backing from a wide spectrum of stakeholders, including the incoming Administration which has indicated its agreement to the presentation of the proposed loan to the Board before the change of government.

Schedule of Disbursement: Single tranche.

INTRODUCTION

i. I submit for your approval the following report and recommendation on a proposed Social Sector Adjustment Loan (SECAL) to the Republic of Colombia for US$155 million in support of the government's social sector development program. The loan will be fixed spread in US Dollars with 15 years maturity including 5 years of grace with a Libor-based variable interest rate.

ii. The proposed SECAL is a one tranche loan to be completed before the end of the current Administration on August 7, 2002. The loan would: (i) support key social reforms that the current administration has developed with active Bank support; (ii) provide an opportunity to influence the social sector agenda of the next Administration; and (iii) help sustain the Government's fiscal program during this calendar year.

iii. This SECAL is important to the Bank's country assistance strategy as well as the GOC's short term financial needs and social goals. The proposed SECAL supports the GOC's strong commitment to sound fiscal management and helps provide a financial cushion, the need for which has become even more pressing as a result of recent developments: the breakdown of the peace process, weak economic growth, and unfavorable financial markets – factors that have combined to increase GOC's financial needs and raise the price of borrowing from private financial markets. The proposed SECAL also ensures fiscal space for social protection to enhance the sustainability of the fiscal reforms supported by the recently-approved Bank-supported Structural Fiscal Adjustment Loan (SFAL), a need underscored by the Board in recent discussions on the SFAL. On the social front, the SECAL supports the GOC's ongoing efforts to establish enabling regulations for the implementation of the health and education reforms mandated by the recently approved Law 715. In this regard, the CAS Update recently discussed with the Board confirmed the strategic importance of this SECAL.

iv. The proposed SECAL represents the culmination of the Bank's program of social sector strengthening activities initiated with the GOC three years ago. This program consists primarily of three lending operations and two sector studies aimed at improving social protection, human capital development and poverty reduction. Of the three lending operations planned in 1998 for Bank and IDB financing, two investment loans – the Community Works and Employment Project and Human Capital Protection Project that are part of the *Red de Apoyo Social* (RAS) emergency safety net program -- are currently under implementation; the third one, intended as an adjustment operation from the start, is the current proposal.[1] The analytical work consists of the recently completed *Colombia Social Safety Net Assessment* and the *Colombia Poverty Report*. These studies have not only informed this proposed operation, but have also stimulated discussions of social sector reform issues within and outside government circles (see Annex F on consultations).

[1] These lending operations are complemented by other human capital investment projects, notably the Youth Development LIL, Rural Education, and Decentralization Education Management Projects, which support institutional strengthening and experimentation with innovative approaches for dealing with issues of violence and the education of poor children, including children in isolated areas.

v. While the SECAL marks the completion of the above-mentioned package of social sector strengthening activities, it also acts as a bridge to the future. The medium-term policy framework supported by this loan identifies follow up activities for the incoming Administration that the Bank deems important for the coming years. These activities are summarized in the Policy Matrix (Table 4.1) and the Letter of Development Policy (Annex D). They are further elaborated in Annex E, which lays out the Bank's Colombia Social Sector Strategy for the medium-term. Dialogues with various stakeholders, including the technical teams of leading presidential candidates, indicate strong and broad political support for the operation and its medium-term policy framework.

vi. Undertaking this loan in the face of an upcoming change of Administration clearly entails considerable risks. The main concern is the sustainability of the measures supported by the operation, due to the timing of the loan. Various measures have been taken to address those risks, including confirming broad-based support for the measures backed by the loan (see Section 4) and obtaining agreement from the incoming Administration. On balance, signaling the value of sustained cooperation and of continued focus on the social sector reform issues being addressed by the adjustment loan outweighs the risks of approving the proposed loan.

vii. This operation, like the loans supporting the Red de Apoyo Social (RAS) safety net program and the recent analytical work, is the product of sustained collaboration among the GOC, the Bank and the IDB. In fact, the proposed SECAL and IDB's Social Sector Project are financing in parallel the GOC's social sector adjustment program.

1. THE ECONOMIC CONTEXT

A. Poverty, Economic Setback and Conflict

1. **Achievements in growth and poverty reduction.** Colombia has benefited from stable growth and low economic volatility. Steady GDP per capita growth averaging 1.8% annually between 1978-1995 brought significant improvements in overall poverty rates (Table 1.1), although growing inequality affected the distribution of the benefits.[2]

TABLE 1.1. Income Inequality and Poverty Indicators, 1978-1999

	1978	*1988*	*1995*	*1999*
National				
Poverty rate	80%	65%	60%	64%
Poverty gap	46%	32%	29%	34%
FGT P(2)[1]	32%	20%	17%	22%
Extreme poverty rate	45%	29%	21%	23%
US$ 2 per day poverty[2]	54%	15%	11%	13%
Mean income per capita[3]	112	183	216	210
Average annual growth rate	NA	5.0%*	3.6%**	-1.4%***
GDP growth rate	4.1%[4]	4.1%	5.2%	-4.3%
Income inequality (Gini)	53%	54%	56%	57%

Source: Colombia Poverty Report (Velez et al., 2001).
[1] Foster-Greer-Thorbecke index.
[2] Based on Purchasing Power Parity Converters from WDI database.
[3] Thousand 1999 pesos, based on monthly household income.
* 1978-1988
** 1988-1995
*** 1995-1999
[4] 1980 figure

2. In the last 70 years, the country experienced only one economic downturn. A recent cross-country study has shown that the probability of the Colombian economy entering episodes of "high volatility" in the last 30 years was close to zero.[3] Steady economic growth afforded Colombia poverty reduction as well as marked improvements in health and education (see Section 2 below).

3. At the heart of this remarkable performance was Colombia's prudent economic management that allowed it to steadily accumulate and mobilize human and physical capital, resulting in high productivity and employment. Colombia's simultaneous support of employment and GDP growth was crucial to poverty reduction.[4]

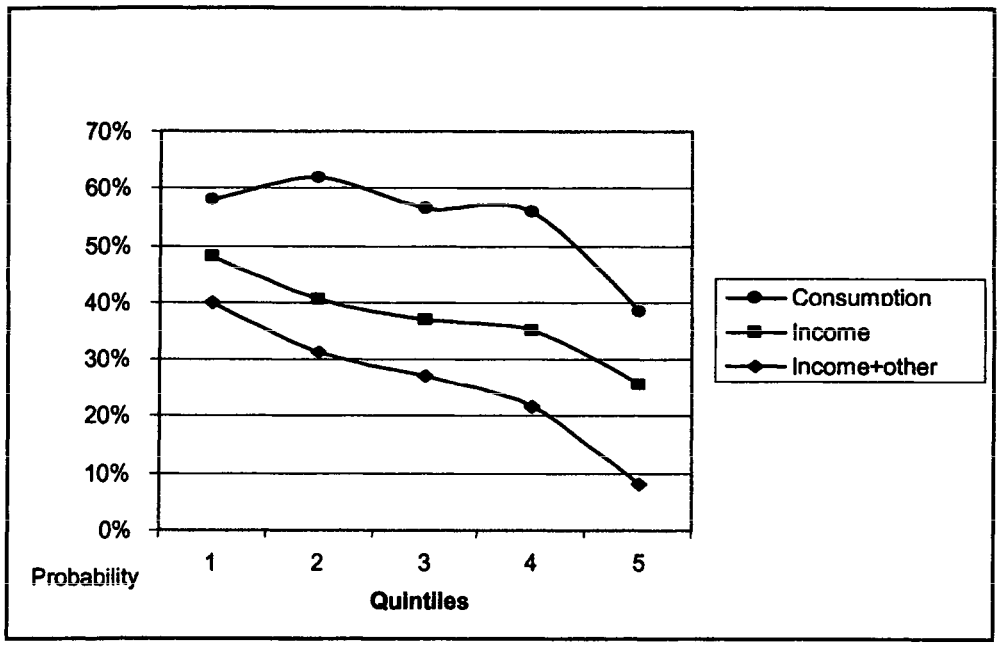
[2] The tight connection between GDP growth and poverty in Colombia is documented in Annex C of the SFAL.
[3] Rodrik, D. "Why is there so much Economic Insecurity in Latin America?" World Bank mimeo, October 1999.
[4] The critical relationship between growth, unemployment and poverty is indicated by the enormous effect of household head's unemployment on poverty. In urban areas poverty is 25 percentage points higher if the head used to work and is presently unemployed (the nexus between poverty and employment/income growth is discussed in Annex D of World Bank SFAL, 2001).

4. **Economic setbacks and their consequences.** In 1999 Colombia experienced its most severe recession in 70 years, marked by a decline of 4.3% in GDP and accompanied by a growing deficit, with the combined public sector balance reaching 5.5% of GDP. This shock had its origin in several factors discussed below that resulted in the deterioration of key social indicators. The downturn in economic growth, the high unemployment rate, and the continued widening of income inequality combined to dramatically reverse the reduction in poverty achieved over the past two decades, as shown in Table 1.1. Between 1995 and 1999, poverty rates rose four percentage points and extreme poverty rates rose by two percentage points. This reversal is disappointing, considering that even at its lowest in the mid-nineties 60% of the population remained poor. The severity of poverty increased as well, particularly in urban areas, where the poverty gap rose from 19% to 26% from 1995 to 1999.[5]

5. The recent crisis did not leave rural areas unaffected. Even though the rural poverty headcount measure remained relatively stable, this masks the deterioration in the depth of poverty as marked by the increase in the poverty gap from 40% to 44% between 1995 and 1999.

6. A closer look at the impact of the economic downturn, using results of a 1999 survey, when the economic recession was strongest, indicates that while 37% of the households in the sample registered a negative income shock, 54% modified their consumption habits in varying degrees, depending on their savings/wealth and access to credit.[6] It was found also that poor households are more vulnerable, in that they are more likely to be affected by negative income or consumption shocks (Figure 1.1).

FIGURE: 1.1 Probability of a Reduction in Economic Well-being by Quintile



Source: Gaviria, 2000.

[5] The severity of poverty is measured by the poverty gap which indicates how far the poor are below the poverty line representing the cost of acquiring the minimum caloric intake plus an allowance for basic non-food necessities.
[6] See Gaviria 2000 for results of the *Encuesta Social* survey conducted in Colombia's 4 main cities in 1999. Twenty-one percent (21%) of randomly sampled households reported having savings available to draw upon in the face of income reductions and 17% acquired some type of debt.

One reason is that poorer households are less likely to have access to savings and credit, as indicated by the 'income + other' line denoting the probability of an income shock by poverty quintile for households with access to savings and/or credit.

7. As illustrated in Figure 1.1, the probability of a reduction in consumption is approximately 20 percentage points higher for the four lowest quintiles as compared to the wealthiest quintile. The same survey further found that the probability of a household member dropping out of school is 8 percentage points higher in those households that reported a negative income shock that in those that did not. This result underscores one of the negative human development impacts of the recent economic setbacks. Section 2 further discusses how the weakening of the economy has affected the education, health care, and nutrition status of the population.

8. **Structural weakening**. There are various reasons for the economic reversal. Part of the explanation is that Colombia's notable economic record in the past masked important structural problems, which in conjunction with external shocks and the emergence of forces undermining prudent fiscal and financial management, eventually produced a sharp deterioration in the economy.

9. Starting in the mid-1990s, Colombia entered a path of fiscal and financial imbalance. On the fiscal side, key determinants of the imbalance include the progressive weakening of fiscal discipline brought about by unbridled sub-national spending, the substitution of current for capital expenditures and rising inefficiency in the delivery of social services. The financial imbalance, on the other hand, was caused by weaknesses in the banking sector.

10. With those critical structural weaknesses in the government accounts and the financial sector, the country was vulnerable to the 1998-1999 economic recession triggered by a combination of a sharp deterioration in the country's terms of trade, the effect of the East Asia and Russia crises, and a weakening of private investor confidence due to stepped-up violence and internal conflict.

11. **Increasing violence and transaction costs**. Complicating the investment climate and poverty reduction effort is the intensification of the internal conflict. This governance problem has contributed to the deterioration of the investment climate and to the disruption of the lives of many families. It has also made delivery of social and development assistance difficult and dangerous to the above-mentioned areas, calling for the implementation of creative solutions for reaching the civilian population in affected areas.

12. The increase in violence, deaths, kidnappings, extortion and displacement due to the rise of the guerrillas' and paramilitaries' economic and military strength has carried a heavy toll, especially among the rural civilian population. There is no reliable figure on the number of displaced population. The GOC estimates that there are currently 400,000 displaced people. Other estimates put it at a much higher level. This population has been evicted from areas where they have been engaged in productive economic activities and relocated in urban slums where economic prospects are limited.

B. Macroeconomic Perspective

13. One of the principal internal sources of Colombia's structural weakening can be traced back to changes introduced in the 1991 Constitution. One key change involved an emphasis on decentralization, with territorial transfers to finance decentralization dependent on the government's current fiscal revenues which were volatile during the 1990's due to fluctuations in economic activity. An asymmetry between increases and decreases in expenditures resulted, and revenue transfers below anticipated trends were not sufficient to cover the asymmetry, creating additional financial obligations for the central government. Other important changes introduced by the 1991 Constitution involved reforms in social security and a

renewed emphasis on the role of the state in the provision of social services, justice, and security. The fiscal implications of the new rules were large. Transfers from the central to local governments nearly doubled from 22% of current revenues in 1990 to over 42% in 2001, social security expenditures at the central level grew from 2.9% to 5.3% of GDP between 1990 and 1997, and defense spending increased from 1.4% to 3% of GDP over the same period.

TABLE 1.2 Colombia: Selected Macroeconomic Indicators, 1990–2000
In percentage of GDP (unless otherwise indicated)

	1990–95	1996	1997	1998	1999	2000	2001e
Real GDP Growth (%)	4.5	2.0	3.1	0.6	-4.3	2.7	1.6
NFPS Balance	-0.7	-3.0	-3.9	-4.6	-6.3	-3.9	-3.8
Central Government Balance	-1.3	-3.7	-3.7	-4.9	-7.1	-5.9	-5.8
Current Account Balance	-3.7	-4.9	-5.5	-5.3	-0.4	-0.5	-2.1
Inflation Rate (%)	24.8	21.6	17.6	16.7	9.2	8.7	7.6
Investment	18.4	22.2	21.3	19.6	12.9	13.4	15.8
Unemployment Rate (%)	9.5	11.2	12.4	15.2	19.4	20.2	18.7

14. The emphasis on decentralization was not, however, compensated by a reduction in the size of the central government. Central government expenditures, other than transfers to local governments and to social security, continued to rise during the 1990s, growing by 50%, from 4.2% to 6.3% of GDP during the decade. This pressure led to continuous attempts to raise revenues through no fewer than eight tax bills, with little emphasis until recently on trimming spending. While central government tax revenues increased by 1.9 percentage points, expenditures did so by 3.3 percentage points during the decade. From a situation of a nearly balanced budget in the early 1990s, Colombia thus ended 1999 with a Non-Financial Public Sector (NFPS) deficit of 6.3% of GDP (Table 1.2).

15. In addition, a rapid real appreciation of the peso through the early and mid-1990s, partly as a result of large capital inflows due to new oil discoveries, increased borrowing from abroad as a result of the country's new investment-grade rating, and the repatriation of foreign exchange undermined trade liberalization efforts. Capital inflows pushed up asset prices, particularly real estate. A strong peso was supported by a newly independent Central Bank with a Constitutional mandate to control inflation. The appreciating currency was particularly detrimental to the agricultural sector and to textile manufactures. In addition, while capital and imports were relatively cheap, labor became increasingly costly. The combination of these factors led to growing fiscal and external deficits, pushing Colombia first toward slower growth and rising unemployment from 1996 onward, and later into a full-blown recession.

16. The current account deficit had reached worrisome levels by 1997–98, standing at above 5% of GDP. The deterioration in the current account began in 1993 as a result of rapid growth in private investment and borrowing spurred by a boom in the real estate sector. By 1997, however, the external deficit reflected the imbalance in the fiscal accounts, spurred by growing public expenditures and rising interest payments. In addition, export revenues fell in 1997 and 1998 as a result of the drop in oil and coffee prices, Colombia's two largest exports, further aggravating the problem.

17. Colombia's deteriorating fundamentals, combined with a trade shock estimated at 1.5% of GDP, and with events in international credit markets, resulted in the virtual closing of financial markets to the country. This forced the Colombian authorities to turn to the domestic market to fulfill their large financing needs, putting increasing pressure on domestic interest rates. Interest rates were driven even higher by continued attacks on the peso in 1998 and 1999, confirming market concerns regarding the sustainability of Colombia's fiscal and external imbalances. The failed attempts by the Central Bank to defend the existing exchange rate band led to a cumulative loss of US$1.8 billion in reserves. The

benchmark deposit rate had risen to almost 20% in real terms, while the annual real lending rate rose to 26% in late 1998. The exchange rate band was finally abandoned in September 1999 and the peso was allowed to float freely.[7]

18. The economy, already suffering from the earlier demise of the construction sector in 1995–96, was thus hit by the collapse of productive activity as a result of galloping interest rates. Private investment fell by over 60% and private consumption dropped 7%. The sectors that suffered the most marked contractions were construction (-20%), manufacturing (-15%), and commerce and financial services (each -7%). With the severe recession that hit the country, however, imports plummeted as domestic demand collapsed, while exports benefited from the high international price of oil and the devaluation of the peso. The current account in 1999 and 2000 was therefore in near balance. The condition of the financial system, already under strain, worsened during 1998 and 1999 due to the sharp deterioration of loan portfolios and a large volume of nonproductive assets. High interest rates and negative economic growth stretched the payment capacity of most borrowers, and arrears in the loan portfolios grew to almost 15% in 1999. To head off a systemic crisis in the financial system, the government put in place programs to assist financial institutions and mortgage holders. Measures were also put in place to recapitalize viable private banks and to address the problems of public banks.[8]

19. Economic woes have been accompanied by high unemployment levels of about 19%, which have not reacted significantly to the moderate resumption of growth over the past two years. Shrinking demand has also been partially responsible for the drop in inflation from nearly 18% in 1997 to under 8% in 2001.

20. **Macroeconomic adjustment.** In response to the severity of the recession, the Colombian government embarked on a program of stabilization, supported by a three-year (2000–02) Extended Fund Facility from the IMF and the recently-negotiated Bank-financed SFAL. The government program aims to increase revenues and reduce expenditures; this is to be complemented by a rationalization and definition of the roles and competencies of central and local government.

21. A number of measures, mainly directed to enhancing revenues, have been taken. These include (i) passage of strict budgets since 2000; (ii) widening of the value added tax base; (iii) improving tax collection and fighting evasion and smuggling; (iv) changes in royalty allocation to attract private investment, particularly to the oil sector; and (v) recent passage of a tax bill expected to yield additional revenues on the order of 1.8% of GDP. These revenue measures are being complemented with structural measures in a number of areas. A financial system reform law was passed in 1999 raising minimum capital requirements and strengthening the faculties of the Banking Superintendency and Financial Guarantee Fund (FOGAFIN). A constitutional amendment was passed that would save part of the transfers to local government in order to finance local pension funds. In 2001, a constitutional amendment de-linking territorial transfers from the central government's current revenues for a period of eight years was also been approved by Congress, as was a reform of the resources and competencies of local government (Law 60/93). Legislation to limit the operational expenditures of government at both the central and local levels was also enacted. A number of other important reforms are currently under consideration by Congress, including the vital pension reform, a fiscal responsibility law, and a territorial tax reform.

[7] The peso has depreciated by about 15% in nominal terms since the collapse of the band, and the behavior of the exchange market has remained largely orderly.

[8] The government estimates the cost of cleaning up the balance sheets of private banks at about 4.5% of GDP, nearly half of which would come out of public coffers through FOGAFIN loans, with an additional 4% of GDP for the restructuring of public banks.

22. **Economic recovery**. The government's efforts have yielded some encouraging results. Real GDP grew by 2.7% in 2000 following the 4.3% drop in output in 1999. The recovery is nevertheless fragile, with economic growth reaching only 1.6% in 2001 as a result of weakness in both the domestic and external environments. External conditions deteriorated substantially in 2001, with significant declines in oil and coffee prices, and the sharp slowdown in world economic growth and international trade that intensified following the attacks of September 11th. On the domestic front, internal demand growth remained sluggish. There was little significant reactivation in the construction and real estate sectors, as credit supply and demand stalled. The private sector elected to pay off its debts and continued to be cautious about borrowing significantly for accelerating investments. The financial system, although stronger as a whole, suffers from continued fragility in its mortgage banking sector. The oil sector, Colombia's main export earner, saw earnings decline as a result of the aging of oil fields and guerrilla attacks on pipelines, combined with lower international prices. Unemployment remained high, at about 19 percent, and in response, much of the government's investment program focused on strengthening the social safety net, targeted to mitigate the negative impact of the economic contraction on the poor.

23. Colombia in 2001 again met the public sector deficit targets set out in its program with the IMF. The targets were modified to take into account the impact of lower-than-expected economic growth on government revenues. The NFPS fiscal deficit stood at 3.8% of GDP, while the consolidated public deficit was lower, at 3.3% of GDP, due in large part to the central bank's cash profits. The current account deficit widened by more than 2% of GDP in 2001 as traditional exports, particularly oil and coffee, weakened sharply both in volume and price, while growing domestic demand sustained imports. The growth of nontraditional exports to neighboring Andean countries, despite flagging demand in the United States, helped to moderate the expansion of the current account deficit. The capital account strengthened in 2001 as a result of further public sector borrowing and reduced net capital outflows from the private sector. International reserves remained at about six to seven months of imports in the coming years, with small yearly increases resulting largely from interest earnings on the reserves.

24. To finance its deficit, the government has relied on both external and domestic credit. Public sector external debt at the end of 2001 stood at about 28.5% of GDP, up from 24% and 26% in 1999 and 2000, respectively; total net public debt was about 46% of GDP. On the monetary front, the rapid growth in currency since 1999 subsided in 2001 in response to the recovery of the financial sector and the exemption from the financial transaction tax granted on deposits in mortgage banks. Financial system credit to the private sector languished, however, during the year, and the economic recovery continued to be financed largely by the productive sectors through the use of own capital and installed capacity. Nevertheless, after heavy losses in previous years, the financial system did record moderate profits in 2001, and prudential indicators improved for the system as a whole, with the exception of mortgage banks whose condition remains delicate.

25. **Economic Prospects**. GDP growth of about 2% is projected for 2002. Prospects for an acceleration of growth are hampered by weak domestic demand, high unemployment, and low rates of private investment. As mentioned above, lower-than-projected growth has meant an easing of fiscal targets under Colombia's program with the IMF as revenues have declined, and it is likely that targets would be eased again in 2002 should growth performance be weaker than the 2.5-3% projected by the Fund. The recent collapse of peace negotiations with the FARC, the country's largest guerrilla group, and the return to open hostilities compounds the down-side, particularly in terms of the fiscal outcome and the investment climate.

26. The external environment, namely declines in both the price and total production of oil, combined with low coffee prices, will also have an impact. In this regard, the government intends to continue its flexible exchange rate policy to encourage nontraditional exports and foreign direct investment. Developments in the US economy, Colombia's main trading partner and the largest importer of

Colombian goods, are particularly important, as are conditions in Venezuela, Colombia's second largest export market. Another risk in the external macroeconomic environment involves possible increased difficulty of access to international financial markets for emerging economies. Here, the government's commitment to sound fiscal management (as supported by the recent SFAL and the IMF program) has allowed it to tap international capital markets regularly over the past year, and has even enabled significant pre-financing of Colombia's 2002 external financing needs. The government also retains access to IFI financing.

27. Table 1.3 presents a medium-term scenario that assumes continued implementation of structural reforms to strengthen the fiscal accounts. Under such a scenario, an increase in the rate of GDP growth to levels approaching 2.5 to 3.0% is projected for 2003, and to 3 to 3.5% for 2004–05. Under a scenario of continuing reforms, the NFPS deficit would decline from 3.3% of GDP in 2001 to about 3.1% of GDP the following year, and would steadily approach 1.5% of GDP by 2005. The accruing benefits of structural reforms would make this fiscal stabilization possible despite expected declines in oil production over the next five years. Under this scenario, Colombia's total public debt would stabilize at about 50% of GDP in the long term.

28. As stated, maintaining sustainable deficits into the future requires the passage of structural reforms outlined above that are designed to improve control over public sector expenditures. The government has remained committed to its adjustment and reform program despite difficult domestic conditions. The significant reduction of the fiscal deficit since the onset of the recession and the passage of the bulk of its program of structural reforms are evidence of this. Nevertheless, a few important reforms, such as the pension reform, fiscal responsibility law and territorial tax reform, have yet to be approved by Congress. While these reforms are crucial for medium- and long-term fiscal sustainability, it should be noted that their short-run fiscal impacts are modest. The administration has also worked hard to build consensus and support for its reform package and for the fiscal adjustment efforts which will need to be continued by the newly-elected government.

TABLE 1.3 Colombia: Selected Macroeconomic Projections, 2000–05
In percentage of GDP (unless otherwise indicated)

	2000	2001e	2002pr	2003pr	2004pr	2005pr
GDP Growth (%)	2.7	1.6	2.0	2.8	3.5	3.5
NFPS Balance	-3.9	-3.8	-3.1	-2.6	-2.1	-1.5
Central Government Balance	-5.9	-5.8	-5.2	-4.6	-3.8	-3.3
Current Account Balance	-0.2	-2.1	-2.6	-2.8	-2.6	-2.5
Inflation (%)	8.7	7.6	6.0	4.0	4.0	4.0
Investment	13.4	15.8	16.5	18.3	19.1	19.2
Unemployment Rate (%)	20.2	18.7	17.5	15.7	15.3	14.8

Source: World Bank Staff projections

29. Attaining the envisioned level of economic growth would be supported by increases in public savings, thus helping to raise national savings and maintain a current account balance in the 2 to 2.5-percent-of-GDP range over the medium term. International reserves are projected to remain at about six to seven months of imports in the coming years, with small yearly increases resulting largely from interest earnings on the reserves.

30. A reduction of inflation from 7.6% in 2001 to 6% and 4% in 2002 and 2003, respectively, is forecast as the Central Bank moves toward inflation targeting in conducting its monetary policy. While some inflationary pressures can be expected as the economic recovery proceeds, continued high levels of unemployment, slackness in external and domestic demand, and productivity gains should enable the attainment of inflation targets.

31. A higher national savings rate and a sustainable current account deficit would create the required space for expansion in private investment that is critical to achieving an economic growth of 3.5% or above. Both private and public investment dropped significantly during the 1998–99 recession, and have not rebounded to levels sufficient for sustaining long-term growth at the 3.5% level envisioned—total investment in Colombia stands at about 16% of GDP. Central government investment has been reduced to about just over 1% of GDP, half its average level during 1990–97, and represents about one third of the resources currently spent on interest payments on central government debt. Private investment has undergone a decline since 1994, and now stands at only about 8% of GDP.

32. The key ingredient for improving Colombia's investment climate is achieving a reduction in both political and economic uncertainty. On the political front, the breakdown of peace negotiations has delayed a rebound in investment. While realizing Colombia's full growth potential could not happen under conditions of conflict, much can nevertheless be done on the economic front to improve the investment climate in the country. Bringing the fiscal accounts onto a sustainable path is therefore important, and would help to significantly reduce the country risk associated with Colombia. The reduction of the deficit, and, therefore, of the need to tap domestic markets to finance the deficit, would not only open needed space for the private sector, but would also enhance the credibility of the stabilization program and the prospects for the future. Fiscal stabilization would also create the space for public sector investment in areas complementary to private sector activity, effectively "crowding in" private investment. The prospects for a consolidation of the economic recovery in 2002–03 and beyond thus depend on the success of the government in garnering support for structural reforms to strengthen the fiscal position and on improvements in the climate for investment in the country.

2. THE SOCIAL SECTOR: PERFORMANCE AND CHALLENGES

33. Colombia's social programs have largely addressed the welfare of its citizens through the provision of education, health, social safety net, employment, training and labor protection. Today, these programs are central to the GOC's social sector strengthening program that aims to protect and accumulate human capital in the face of increased volatility and tight budgetary constraints.

34. The discussion below provides an overview of Colombia's major social programs, summarizing social sector issues and challenges.

A. An Overview of Public Social Spending

35. Following a period of almost complete stagnation through the 1970s and 1980s, public expenditure in Colombia began to grow dramatically from 1990 onwards. Between 1990 and 1997, overall public expenditures rose from 11% of GDP to 18.9% and had almost doubled by 2001, reaching 20.1% of GDP. This increase was driven primarily by spending in the social sectors, notably in health, education, and pensions resulting from the dramatic social reforms of the 1990's promulgated by the 1991 Constitution, Law 60 and Law 100 (see Figure 2.1, which presents the 1990-2000 trends in social spending relative to GDP by category of expenditure).

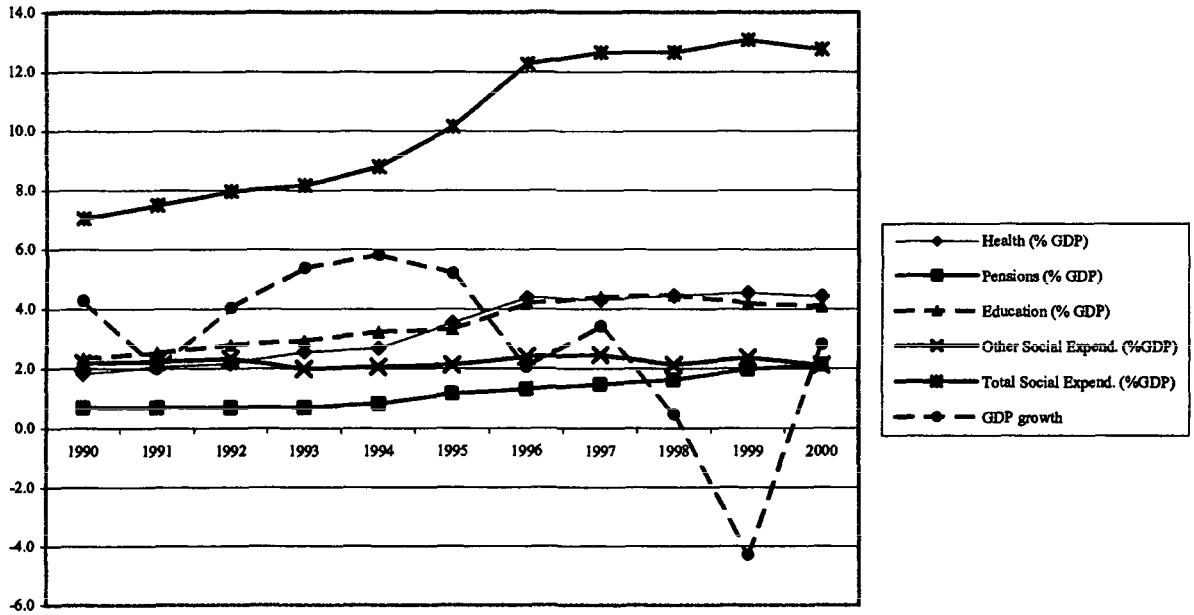
36. Three aspects of this growth in social sector spending are relevant to this discussion. First, total social spending (defined as health, education, pensions, and other social spending) increased sharply from 1993-1996, led by increases in health and education, and steady growth in pensions. The government budget for health and education rose from approximately 4% of GDP in the early 1990's to over 8% of GDP by 1996. Second, the rapid growth in social public spending was unsustainable, as evidenced by the fiscal imbalances accumulated in the closing years of the twentieth century as the economy went into recession. Third, spending for social assistance remained low and pro-cyclical even with onset of the crisis in 1998. Social assistance was not included in the social sector reforms of the 1990's that resulted in institutional reform, increased spending and decentralization. In contrast to the trends observed in other social sectors, central government budgeted expenditures on social assistance fluctuated around 1% of GDP during the first part of the 1990's and fell to less than 0.7% by 2000.[9]

37. Today Colombia is faced with the dual challenge of restoring a fiscal balance and protecting the gains it has made in human development. Although international comparisons of public social expenditures (Table 2.1) show that Colombia's allocation of 13.0% of GDP remains slightly below the LAC average of 14.5%, the only avenue for further increases in social spending will have to be through re-allocation.[10] Given the budget cuts already implemented, the protection and advancement of human development will depend critically on increasing the efficiency of existing resources through improved allocation.

[9] Social assistance is defined as spending on the four main social assistance programs reported in aggregated budgetary data – the ICBF family welfare institute, the RSS social fund, the INURBE housing institute and utilities subsidies.

[10] There is no fixed definition of what should be included as social sector programs. Consequently, estimates of social sector expenditures vary substantially. In Colombia, where it is legally stipulated that a minimum amount should be allocated for social programs, the official definition of social expenditures is quite broad (and has been changing) to comply with the legal mandate. In addition, the comparative data do not take into account differences in the amount of health expenditures financed by mandatory health insurance contributions.

FIGURE 2.1: Trends in Social Expenditures and GDP, 1990 - 2000



Source: Colombia Social Safety Net Assessment, 2002

TABLE 2.1 Level of Total Public Social Spending (PSS) and Spending by Sector in Selected LAC and Far Eastern Countries, 1996 – % of GDP

	Education	Health	Social Security and Welfare	Housing	Total
Argentina	3.5	1.8	8.0	0.8	14.1
Bolivia	7.4	2.2	4.5	0.2	14.3
Brazil	3.0	1.7	11.0	0.6	16.2
Chile	3.2	2.5	7.1	1.2	14.0
Colombia	***5.4***	***2.0***	***4.9***	***0.7***	***13.0***
Costa Rica	5.1	6.8	6.3	0.1	18.2
Dominican Republic	2.0	1.7	0.7	2.1	6.5
Indonesia	1.3	0.4	1.1	3.0	5.7
Korea	3.7	0.2	2.2	0.5	6.5
Malaysia	5.0	1.4	1.5	1.4	9.3
Mexico	3.8	0.5	3.0	0.5	7.8
Panama	4.6	5.6	5.7	1.2	17.1
Philippines	3.4	0.5	0.5	0.3	4.7
Turkey	3.5	0.7	1.4	0.4	5.1
Uruguay	2.1	1.9	19.4	0.5	23.9
Latin American Average*	4.0	2.7	7.1	0.8	14.5
Far Eastern Average*	3.4	0.6	1.3	1.3	6.6

*Average for the selected countries included in the table.
Source: Castañeda et al., 2000, based on Government Finance Statistics Yearbook (1998) of the IMF

B. Subsectoral Issues

(1) Social Safety Net

38. Colombia's historical reliance on economic growth as a social safety net is no longer available as an option. Today, Colombia must craft a functional social safety net to minimize social welfare losses from uncertainty and to facilitate economic adjustments. The GOC appreciates this point and recognizes the need to be better prepared to face future crises. The recent experience with designing and launching the *Red de Apoyo Social* (RAS) program held a valuable lesson: in times of crisis lack of preparedness imposes considerable costs in terms of the efficiency and timeliness of social assistance. Consequently, one of the GOC's priorities has been to develop an effective countercyclical social assistance system before the next economic crisis hit the country.

39. In Colombia social assistance programs consist primarily of programs administered by the Colombian Institute for Family Welfare (ICBF), including early childhood development and school feeding. Other programs are run by the *Red de Solidaridad Social* (RSS) social fund, including workfare and elderly programs as well as a mandate to spearhead initiatives assisting the internally displaced population. There are also national programs for low income housing run by INURBE, a system of water and sewerage subsidies and a program for secondary school vouchers that is being phased out. Colombia's pension and health insurance programs also contain redistributive components that provide a safety net function.

40. *Key Vulnerable Groups*. A recent Bank study, the *Colombia Social Safety Net Assessment* lays out the vulnerable population groups and their needs and matches them with existing social assistance programs. The study highlights the following conclusions:

(a) *Children and adolescents are the main age-specific vulnerable groups in Colombia today requiring attention from a reformed safety net.* Pre-school and primary school age children face important health and nutrition risks. In rural areas, this age group is at risk of malnutrition as over 85% are poor. Some health indicators are also preoccupying, particularly the decrease in vaccination rates, increase in prevalence of some diseases like diarrhea among children, and increase in the percentage of children receiving no medical treatment. In both rural and urban areas youth age 12-17 have been identified as exceptionally vulnerable due to their exposure to multiple aspects of violence and crime. This age group is at risk of dropping out of school, joining gangs or paramilitary groups, and engaging in prostitution or the narcotics trade. The probability of children dropping out of school among the poorest households in the four major cities increases significantly when households suffer an income shock (*Gaviria* 2000).

(b) *The elderly are particularly exposed to risks because they do not receive any substantial source of protection from the current safety net.* Pension coverage reaches 18% of the elderly, and only 2% in the poorest quintile.

(c) *The internally displaced people, a result of Colombia's internal conflict, constitute another critically vulnerable group.* The GOC estimates that there are currently 400,000 displaced people while other estimates put the number of displaced at close to 2 million.[11] This population has been evicted from areas where they have been engaged in productive economic activities and relocated in urban slums where employment prospects are limited, access to social services constrained and violence and crime are rampant. Available data suggest that many of the displaced are women (50%) and children (48% under 18) with limited skills and education. Despite the development of a framework in the 1970's and a comprehensive action plan in the late 1990's,[12] attention to the IDP has been complicated by (i) resources remaining insufficient for financing the national strategy; and (ii) a programmatic approach that channels assistance through a registry listing people as displaced, an identification process that has been both lengthy and difficult to manage given the stigma and risk of being identified as an IDP.

(d) *Unemployment is critical to vulnerability.* In the recent crisis, households experiencing the largest increases in poverty were those with only self-employed workers or only non-labor income. A higher employment rate within households remains the single best protection against poverty (Poverty Assessment, 2001).

41. The social safety net study also shows the need for institutional improvements in the following areas:

(a) *Establishing a Social Risk Management System.* Although Colombia made important advances with the introduction of the Red de Apoyo Social (RAS) safety net programs, these programs remain temporary in nature and a broader vision for Colombia's social safety net has yet to be articulated. Although individual programs are in place, Colombia needs to define the scope and function of the social safety net during crisis and non-crisis times. This articulation should involve a review of not only the new and existing social assistance programs, but also the social insurance programs in health and pensions targeted to the poor that play a key role in Colombia's social safety net. Looking ahead, the Government of Colombia needs to prepare itself to exploit the opportunity for further reform of the Social Risk Management System at the end of 2004

[11] This numerical discrepancy is a result of the different methodologies applied by NGOs and the government that presently rely on different sources of information and divergent methodologies for estimating the size and characteristics of the IDP.

[12] The institutional framework includes Law 387 launched in 1997, followed by the "Plan of Action for the Prevention and Attention of Forced Displacement" (CONPES 3057) implemented in November 1999. The latter plan redefined mechanisms and instruments for the prevention of displacement, the protection of the IDP and emergency humanitarian attention. It also established actions for their social and economic stabilization.

when external financing for the RAS programs concludes and the impact evaluation results of these programs will be available. Ideally, other impact evaluations of key social programs that compose or could be directed toward the social safety net would be available at this time to serve as an input to a more systemic reform of the safety net.

(b) *Increasing Social Assistance Spending.* Social assistance funding is not only relatively low but also pro-cyclical. Spending on those programs constitutes approximately 0.6% of GDP (not including the new, temporary Red de Apoyo Social programs). This percentage appears low when compared to countries at a similar stage of development[13], as well as to the needs of specific vulnerable groups that lack access to key social assistance programs. With respect to funding pro-cyclicality, a recent study reveals that for each peso of reduced GDP, social assistance fell by 9 pesos, making social assistance the most pro-cyclical component of social sector spending.[14] This overall pattern is evident in the recent economic crisis which resulted in reduced spending on social assistance programs, with earmarked programs such as ICBF suffering less dramatic reductions than those financed from general revenues including the RSS programs for the indigent elderly and internally displaced people.

(c) *Improving Poverty Targeting.* Existing social assistance programs are available primarily to formal sector workers. There is little use of Colombia's well-know SISBEN proxy means test outside of the health insurance system. Improvements in targeting could be achieved through expenditure re-allocation toward targeted safety net programs combined with the expanded use of SISBEN or other appropriate poverty-targeting schemes. Despite advances in improving the targeting of social expenditures and ongoing reforms to the SISBEN proxy means testing system, problems remain concerning heterogeneous coverage of SISBEN, manipulation of the instrument, lack of effective social control mechanisms, and limited monitoring and quality control.[15]

(2) The Health System

42. Before 1993 the Colombian health care system experienced four types of problems: (i) low levels of insurance coverage and access to services, (ii) inequity in the distribution of public subsidies, (iii) low quality of services in the governmental facilities and (iv) inefficiency in the use of public resources for health. Law 100 of 1993 radically reformed the health system of Colombia. The health reform created a mandatory universal health insurance system. Essentially, the reform sought to gradually re-direct government health expenditures from direct financing of health facilities based on historical budgets towards the subsidization of health insurance coverage of the poor, giving people a choice among competing health insurance agencies and providers. This reform was carried out in parallel with the decentralization of the management of health and education resources to departments and municipalities through Law 60.

[13] Spending on social assistance as a percentage of GDP averages 0.9% in Argentina, 1.1% in Mexico, 1.4% in Peru, 3.4% in Uruguay and 1% in Venezuela.

[14] CRECE (2001) looking at social assistance spending defined as RAS programs, ICBF programs, and other programs for the elderly, children and handicapped.

[15] Several of these issues are currently being addressed and are supported by the IDB Social Sector Adjustment Loan (see Annex H).

43. The biggest success of the health reform has been the increase health insurance coverage from 24% to 57% of the population between 1993 and 1997. Rural areas experienced a much higher increase in coverage from 7% in 1993 to 48% in 1997. Furthermore, increases in coverage concentrated in the lower income deciles, with insurance coverage in the first decile rising tenfold from around 4% in 1993 to 40% in 1997. However, the increase of unemployment rates starting end of 1997 resulted in a decrease in affiliation in 2000 at a level equal to around 53%. Similarly, between 1997 and 2000, affiliation rates decreased for all income deciles with the exception of the wealthiest.

44. Despite these achievements, Colombia's health system is under-performing as suggested by the following international comparison: in 1997-1998, Colombia's life expectancy at birth adjusted for disability (62.9 years) was less than that of Costa Rica (66.7), Panama (66.0), and Venezuela (65.0), whose health spending and GDP per capita were lower than Colombia's. To improve its performance, Colombia needs to complete implementation of its health system reform and to remedy a range of weaknesses affecting the system's effectiveness, efficiency and stability.

45. *The ISS-Health Problems.* In the context of overall health system reform, Law 100 also gave the ISS (*Instituto del Seguro Social*) the legal form of a public industrial and commercial company. As such, it could manage retirement pensions, workers' compensation, health insurance (ISS-EPS), and health service delivery (ISS-IPS). In health, ISS-EPS and ISS-IPS businesses are in practice a simple financing operation, which remains inefficient and unable to compete with the private sector.

46. *The Public Hospital System's Problems.* In the context of health reform, the public network of hospitals, health centers, and other health facilities was supposed to (i) compete with and complement the private network of health providers, and (ii) sell services to the affiliated population through the EPS and ARS providers. Simultaneously, since the National System of Social Security in Health (*Sistema Nacional de Seguridad Social en Salud*, SNSSS) did not cover the entire population, the public hospitals provided services to those not affiliated with an insurer.

47. *Health Financing Problems.* One of the key problems in the sources of health system financing, affecting both the contributory and the subsidized regimes, is evasion in the contributory regime.

48. *FOSYGA Accounts.* Another issue relates to the use of the Solidarity and the ECAT accounts of FOSYGA. By law, the contributions going into these accounts are to be used for expansion of health insurance coverage of the poor. The use of these accounts has been subject to expenditure ceilings. In itself, this policy practice can be justified as a way of enabling the GOC to control aggregate spending better. The problem, however, is that the unused resources accumulated in these accounts have been used to finance other expenditures.

49. *Accountability, transparency and information problems.* Aggravating the above problems are various deficiencies in the assignment of responsibilities, information availability, and oversight. These deficiencies, which affect the efficient functioning of a decentralized and managed competition health care system, include: (i) lack of clarity in the assignment of responsibilities; (ii) weak supervision of health insurers and providers of care; (iii) delays in fund transfers due to complicated and non-transparent bureaucratic processes; and (iv) inadequate information and mobilization of the reform's intended beneficiaries.

50. *Immunization and control of communicable diseases problems.* A critical problem that has arisen after the implementation of Laws 60 and 100 is the weakening of the country's system of protection against communicable diseases. In the past, Colombia was a leader in prevention activities. During the 1980s and early 1990s, Colombia achieved impressive gains in vaccination coverage levels and disease prevention. By 1995, coverage levels for all routine vaccines reached or surpassed 90%; levels that few countries in the Americas have accomplished.

51. Unfortunately, since 1997, coverage levels for all vaccines declined to below 80%. Coverage against measles declined from 95% in 1996 to 78% in 2000. In 1996, coverage for three doses of diphtheria-tetanus-pertussis vaccine (DTP3), often considered the key indicator of the Expanded Immunization Program (EPI/PAI) performance, was the highest in the Andean Region, i.e., 94%. However, in 2000, levels fell to 77%, the lowest in the Andean Region (Figure 2.2).

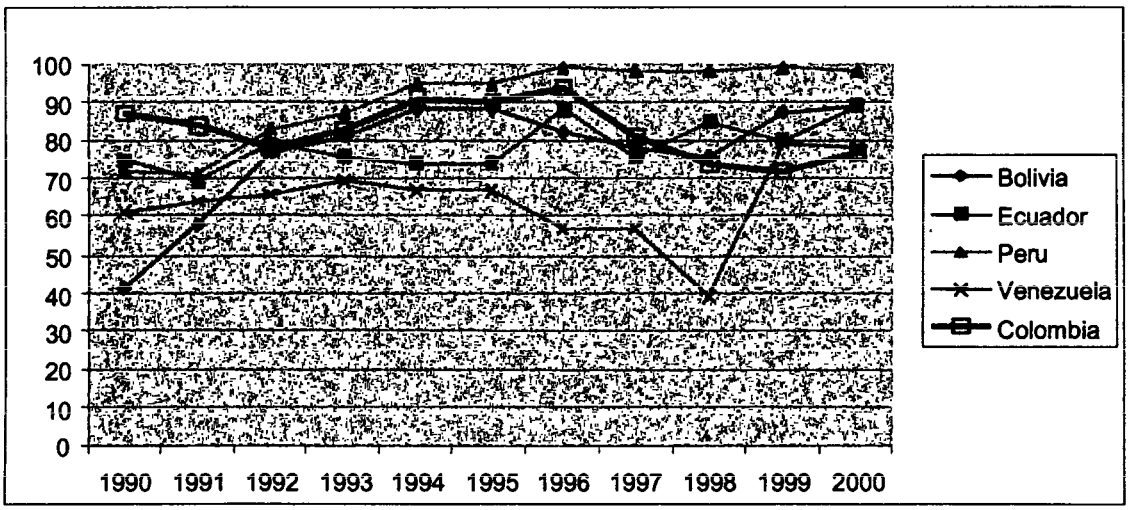
52. The above data are indicative of a general decline of the EPI/PAI, which had been earlier established as a national priority. The program experienced decreases in staff, training and supervision. The consequence is not only a decline in immunization coverage, but also reduced surveillance. The current system may not be sufficiently sensitive to detect the re-emergence of viral circulation in time to implement effective control activities.[16]

53. The underlying cause(s) of the decline vaccination program performance is complex. Inadequate funding has been one factor. Its impact has been reflected in shortages of personnel and supplies. Additionally, the combination of staff turnover and the lack of funds for supervision and training has resulted in a situation where inadequately trained and inexperienced staff fail to follow current vaccination guidelines or practices.

54. Equally important are institutional factors. Weaknesses in the design of the decentralization and health care reforms share some of the responsibility for the weak performance in vaccination activities over the past years. Details regarding the immunization situation in Colombia is elaborated in a recently completed report produced by a group of local and international experts (including PAHO) in cooperation with the Ministry of Health.

[16] The weakening of Colombia's immunization program and surveillance system could have serious consequences. For example, the reintroduction of measles virus via an importation (e.g., from Venezuela where there is a current measles epidemic), could have catastrophic consequences. Current vaccination coverage levels are far below the critical 95% level to prevent viral dissemination if reintroduced in the country. Based on measles coverage levels since 1997, over 600,000 children 1 to 4 years of age in Colombia (17% of all children in this age group) are susceptible to measles. With this number of susceptible children, the reintroduction of measles virus into Colombia could result in a large outbreak with considerable consequences in terms of morbidity, cost of medical care, and mortality among the very young and malnourished. Without major infusion of new funds and major institutional and organizational strengthening the program, coverage levels would either decline slightly or would be maintained at approximately current levels, in a best-case scenario.

FIGURE 2.2. Coverage levels for three doses of DTP among children <1 year of age: by country (Andean Region) & year: 1990 - 2000



(3) Education

55. Like other modern states, Colombia recognizes the fundamental importance of education in the economic and social development of a country – and the critical role of the government in education finance, provision and regulation. While education alone does not guarantee sustained high economic growth, poverty reduction and stability, its considerable value added when combined with sound governance and economic policies is undeniable. Colombia recognizes the contributions of education to the economic and social well-being of its citizens.

56. With a growing economy and increasing share of GDP going to education attributable to the 1991 Constitutional mandate, Colombia achieved notable educational progress.[17] Enrollment rates rose in the first half of the nineties compared to the mid-eighties. In the second half, however, enrollment rates did not change, as the economy faltered and funding increases became unsustainable. The stagnation in education coverage and availability of additional public funds for education illustrates the challenge of achieving additional educational progress in the coming years.

57. Despite its achievements, the Colombian education system has room for further improvements. In this regard, there are five critical issues related to the country's education system: (i) low and inequitable educational coverage, (ii) low internal efficiency and education quality, (iii) education finance and resource use issues; and (iv) decentralization weaknesses, and (v) civil conflict.

58. *Low and inequitable coverage.* Educational coverage remains inadequate in relation to the requirements of a modern economy and the needs of the poor. Enrollment in preschool programs is approximately 40% of the school-age population. Primary, secondary and tertiary education enrollment rates are lower than other middle income countries.[18]

[17] The enrollment rate at the primary level is far from universal -- only about 85%, compared to the average of 97% for middle income countries. Similarly, the secondary net enrollment rate of 62.1% is less than the middle income country average of 71%. This situation has been worsened by the recent economic crisis, which appears to have affected the schooling of the very poor (in income quintiles 1 and 2) at this educational level.

59. A important aspect of this issue is reducing educational inequality. The problem manifests itself in several ways: (i) Colombia's education Gini coefficient, which is higher than other countries in the region, such as Mexico and Chile; (ii) the failure of the urban–rural education gap to narrow even during periods of rapid GDP and public spending growth; and (iii) disparities in educational attainment among the poorest, middle, and richest income groups, which have increased over the last few years.

60. *Internal efficiency and learning achievement problems.* The Colombian education system is characterized by weaknesses at all grade levels, and particularly by repetition in the first grades of primary education. Although the internal efficiency of the system is improving, some changes still need to be made.

61. With respect to student learning achievement, results from the National Evaluation System for the Quality of Education (SABER) indicate that a majority of primary school students in grades 3 and 5 have an academic level below that of their age level. The performance of Colombian students on the recent UNESCO/OREALC assessment is in a median position when compared with other countries in the region. Furthermore, scores indicate a high level of disparity between the achievement of urban students and their rural counterparts, who scored consistently lower.[19]

62. Low educational quality in Colombia is due to both school-related factors and broader socioeconomic conditions, such as poverty. Among the school-related factors the more important are: (i) deficiencies in teacher training and/or allocation (most teachers want to be in urban areas); (ii) weak curriculum implementation, and a curriculum that places emphasis on memorization and rote learning; (iii) inadequate supervision; (iv) non-conducive school environment; and (v) limited time on task.

63. *Education finance and resource use issues.* Taken together, the public spending on education is considerable relative to GDP. An international comparison reveals that in 1996 Colombia's public education spending amounted to 5.7% of GDP, which is more than that of the average middle income country (about 4.8% 1995-1997). Colombia also spends more than other Latin American countries, especially if private education spending (4.2% for Colombia) is included in the comparison. The above discussion confirms the view that in Colombia there is scope for expanding educational coverage and improving student achievement, by focusing on efficiency gains and better targeting of educational assistance to the poor.

64. The scope for efficiency gains can be substantial. Evidence on opportunities for getting more outputs from existing educational resources can be drawn from various experiments (e.g. Bogota's innovative scheme for use of non-governmental providers of education services and the PACES voucher experiment). Their experience reveals that education can be provided at a lower unit cost, while maintaining, if not improving, educational outcomes through innovative methods of education delivery and the use of performance-linked contracts with non-government providers. The implication is that more students can be enrolled with currently available educational resources.

65. Contributing to the weakness of the education system is Colombia's education finance system. Financial transfers to the territorial entities are determined by the supply of teachers, rather than by the education needs of the student population. This tendency is partly due to the perverse incentives created by the FEC.[20]

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[19] Based on data from the same study, relative to other Latin American countries Colombia does much better in rural areas, mainly in math. Only Cuba does better. These results are due in part to the success of a pedagogical model, Escuela Nueva (EN).

[20] The use of the FEC, by which the central government picks up the cost of hiring additional teachers year after year, created an incentive for departments and districts to hire new teachers without due consideration of long term cost implications.

66. *Weaknesses in the design and implementation of decentralization.* The decentralization process has had limited success. Colombia has clearly implemented the decentralization of education management and operation in accordance with the Constitution. The municipality has now become a central player with the responsibility, autonomy, and resources to implement primary and secondary education programs. For decentralization to fulfill its education objectives, however, a variety of challenges and issues have to addressed. Briefly, they include:

(i) *Need to implement a sustainable fiscal framework for decentralization;*
(ii) *Institutional weaknesses;*
(iii) *Difficult and inconsistent application of the criteria for allocation of educational transfers;*
(iv) *Budgetary and staff weaknesses in MEN* (Ministry of Education);
(v) *Weak accountability and information for decision-making.*

67. *Civil conflict and education problems.* The problem of violence in Colombia has several dimensions that are directly or indirectly related to education. Violence affects educational opportunities and incentives to go to school. This problem in combination with youth unemployment, has been cited as one of the main contributing factors to the increased rate of crime and violence among Colombian youth. Complicating the situation, however, is that violence itself has had the effect of limiting access to education facilities by both users and providers.

(4) Employment and Training

68. *Employment is a key element in poverty reduction.* For the poor, who have little physical capital, it is often the only means for earning income legitimately. Employment opportunities allow the poor to mobilize available labor and increase household income. They also give the poor bargaining power for higher wages, eventually as labor supply becomes relatively scarce.

69. Empirical evidence on the importance of employment to the poor is discussed in Bank Report No. P7483-CO. Two findings regarding employment and poverty are worth noting. One is that unemployment disproportionately affects the poor (members of the first quintile experience unemployment rates over 4.5 times as high as those of the fifth quintile). The other is the relatively large impact of employment compared to other variables.

70. How employment can be expanded is one of the most serious challenges facing Colombia. One answer is to increase aggregate demand.[21] Another answer is that there are underlying factors determining both employment and output. One of these factors is the high cost of labor regulations, notably with respect to its effect on employment.[22] The employment impact of regulations has been found to be particularly detrimental to young, female and informally-employed workers. The young suffer not only foregone current income, but also future income due to the lack of opportunities for training on the job as a result of reduced formal employment.

[21] Employment clearly responds to aggregate demand fluctuations, with an elasticity close to 80%. Bogotá's aforementioned experiment is an attempt to overcome the detrimental effects of this policy and can provide valuable lessons for other areas.
[22] James Heckman and Carmen Pages (2000), "The Cost of Job Security Regulations: Evidence from Latin American Labor Markets"; Adriana Kugler and Maurice Kugler (2001), "Effects of Payroll Taxes on Employment and Wages: Evidence from the Colombian Social Security Reform", and Hugo Lopez (2001), " *Mercado Laboral Colombiano: Funcionamiento y Barreras Institucionales*".

71. Aware of the cost of labor regulations and the importance of employment, the GOC recently introduced a bill in Congress to address these issues. In essence, the bill seeks to reduce labor costs and allow firms to hire young workers at less than minimum wages in exchange for training provided by the firm or other providers (not necessarily SENA). There are, however, obstacles to its approval.

(5) Transparency and Citizens' Oversight of Social Programs

72. Colombia has pioneered a system of public expenditure results evaluations that monitors government program performance. The National System for Evaluation of Results of Public Sector Performance (SINERGIA) has been in operation since 1977 and encompasses all 16 sector ministries and 170 public entities.. Recently, the National Planning Department and Ministry of Finance and Public Credit have signed Efficiency Agreements, linking funding to outputs. Despite these advances, however, impact evaluation results are almost non-existent and there is no systematic public information system to disseminate results of public sector performance or engage the public in the monitoring of national program performance.

3. THE GOVERNMENT REFORM PROGRAM

73. The Colombian government has initiated various steps to address the social sector challenges articulated in the previous section. These steps are aimed at securing the present and future well being of Colombians and encompass both remedial and structural measures that have been developed with support from the Bank and the IDB. This section summarizes the various social sector policies and actions which the proposed lending operation would support in parallel with IDB's social sector loan. It presents the rationale for these policies and describes their relevance to achieving the outcomes set fort in the GOC's social sector strengthening program.

74. The GOC can no longer rely primarily on increased resources for the social sectors as its main strategy for sustaining social progress. It needs to adopt a new strategy based on improving efficiency and equity in the use of social sector expenditures. The GOC has recognized this exigency and has acted accordingly. In its final year in office, the government remains committed to implementing this new strategy, seeking to reinforce and, in a some cases, initiate new actions that would further consolidate its reform program. This commitment reflects its appreciation of the importance of social services in poverty reduction, promotion of stability, and economic growth in the long run. It also reflects Colombia's widely held belief that the state should extend a helping hand to citizens in need, particularly to the marginalized population, the vulnerable and the victims of the internal conflict.

75. The policies that make up Colombia's reform program, including its overall strategic vision and the social sector strengthening initiative, are described in the government's Letter of Development Policy (Annex D). The authorities' ownership of the program is strong and widespread, and the President of Colombia has expressed the GOC's commitment to continue implementing reforms until the very end of his administration (see letter of President Pastrana, Annex C). While supporting the GOC's full reform program, the Bank will explicitly require certain key commitments for the disbursement of the loan under the proposed SECAL operation, as elaborated later.

76. Colombia's social sector program seeks to strengthen the state's institutional capacity, the incentive structures of the main social problems, transparency and citizens' participation in order to achieve the following objectives:

(a) *Improved health care* by: (i) increasing immunization rate; (ii) raising health insurance coverage; and (iii) strengthening the quality of health insurance agencies and health service providers;

(b) *Human capital accumulation* through (i) the expansion of enrollment at all levels of education, including preschools; (ii) increased student learning; and (iii) improved on-the-job training opportunities; and

(c) *Adequate protection to key population groups against the life threatening and crippling effects of poverty and economic crisis by establishing an integrated Social Risk Management System* and related measures to: (i) launch a counter-cyclical social assistance system; (ii) improve the poverty targeting of social protection programs; (iii) effectively assist key underserved vulnerable groups, including pre-school children, the elderly and the internally displaced population; and (iv) improve the efficiency and effectiveness of social assistance programs through improved targeting, cost-recovery, monitoring and evaluation.

(1) Social Safety Net

77. To address the social consequences of the 1998 economic crisis, GOC introduced the *Red de Apoyo Social* (Social Support Network, RAS) that is based on three programs: workfare, conditional cash transfer and youth training grants based on beneficiary choice of competing providers. These new programs are beginning to address immediate human development needs in the wake of the crisis and the shortcomings of existing programs, but it took almost two years to implement a response. Thinking about the long term development of its social protection policy, GOC has set up a credible program for the evaluation of these new initiatives and their eventual integration into a counter-cyclical social protection system to address future crises.

78. The GOC's recognition of the structural deficiencies of the country's social protection system and the delays in the delivery of urgently needed assistance during the 1998-99 crisis led to a serious re-thinking of the system. Consequently, the RAS program has been followed by continuing dialogue and consultation between the GOC, the Bank and the IDB on measures to strengthen the country's social safety net system. The discussions are reflected in the aforementioned social safety report on Colombia produced by the Bank and the GOC in close collaboration with the IDB.

79. Based on those discussions, GOC has developed a reform program for its social safety net and requested Bank and IDB parallel financial support. The program includes: (i) establishing a social risk management system that would include a counter-cyclical strategy to address vulnerabilities in times of crisis; (ii) improving poverty targeting instruments and outcomes; and (iii) reforming social assistance programs to improve their efficiency and effectiveness vis-à-vis key vulnerable groups.

80. *The "Sistema Social de Riesgo".* Significant initial steps have been taken toward establishing a 'Social Risk Management System' (*Sistema Social de Riesgo*)[23] that would be based on principles of risk prevention, mitigation and coping and would define the role of social protection particularly during periods of crisis. As a first step a "Social Protection Fund" is being established as the principal financial instrument to support the system. The fund would support social assistance spending during recessions once there have been two consecutive trimesters of negative GDP growth. The fund would accumulate resources during periods when GDP growth exceeds 4%. The proposed savings rule governing accumulation stipulates that 50% of the difference between actual income and estimated income given 4% GDP growth would be allocated to the fund.[24] The GOC's proposed strategy, which has recently been approved by CONPES, is to establish the fund by legislation in 2002.

81. *Improving Poverty Targeting.* The proxy means testing system SISBEN (*Sistema de Selección de Beneficiarios*) is being updated and adopted as the main instrument for targeting social assistance programs in Colombia. The updating consists of (i) improving the SISBEN poverty estimation instrument and methodology; (ii) developing a system of norms governing the application of the SISBEN instrument to assess poverty levels, a function carried out by municipalities; (iii) monitoring and evaluating the quality of the information collected by consolidating databases, carrying out field-based spot reviews and evaluating the efficiency and effectiveness of the instrument; (iv) applying a system of sanctions and incentives aimed at minimizing the manipulation of SISBEN and rewarding its regular use and updating; and (v) establishing clear norms and procedures between local and central levels for reporting and resolving problems and ensuring the transparent use of the instrument. It is anticipated that a full re-application of SISBEN will be completed by 2005. Nonetheless, the success of this effort will depend on municipalities' ability to successfully apply SISBEN in their local areas.

[23] See CONPES *"Sistema Social de Riesgos y Fondo de Protección Social"* December 2001.

82. *Reforming Social Safety Net Programs*. Initial steps are also being taken to (i) improve the flexibility of the Colombian Institute for Family Welfare (ICBF) by introducing a pilot project in 10 municipalities separating financing from provision of services and giving local communities an opportunity to influence the allocation of funds to specific priorities; and (ii) eliminating program overlap within selected social assistance programs, notably by transferring some of the smaller programs in the Social Solidarity Network (RSS) social fund and the Office of the Presidency to other agencies. A noteworthy action taken by ICBF with regards to CAIP, a poorly targeted and costly early childhood development program, is its decision to charge fees on beneficiaries according to their ability to pay to generate funds for its expansion. A redirection of funds from less well-targeted social programs such as the SENA training courses or the *Cajas de Compensación* toward well-targeted social assistance programs has, however, not been considered.

(2) Education and Training

83. To put the GOC's adjustment efforts in education and health in proper perspective, it is important to view them in relation to recent reforms involving fiscal strengthening. These reforms sought to address weaknesses in Colombia's fiscal accounts; shortcomings in intergovernmental fiscal relations; inefficiencies in the provision of key public services, including education and health; and increasing fiscal pressure from the pension system and public sector debt. This fiscal strengthening agenda would put the non-financial public sector accounts on a more sustainable path while contributing to enhancing and improving the provision of social services.

84. *Intergovernmental relations*. The government program in intergovernmental fiscal relations is particularly relevant because of the decentralization of health and education to territorial entities. In this regard, reforms include: (i) making subnational governments fully responsible for expenditures; (ii) increasing subnational tax revenues; (iii) simplifying and making more transparent the transfer system; and (iv) reducing moral hazard from subnational borrowing and reinstate hard budget constraints.

85. As laid out in the Bank's report on the Structural Fiscal Adjustment Loan[25], the Colombian Congress recently approved a Constitutional reform (*Acto Legislativo*) that seeks to de-link transfers from current revenues, and put the growth of transfers from the central government to the territorial entities on a more sustainable path, thus limiting the growth of central administration's operational expenditures (*gastos generales*).[26] The reform combines the current three major sources of transfers financing—*Situado Fiscal, Participaciones*, and FEC—into the *Sistema General de Participaciones* (SGP), and includes a six-year transition period (2002–08). Specifically, the reforms include that total transfers will: (i) grow by 2% in real terms during 2002–05, and 2.5% during 2006–08; and (ii) from 2009 increase at the average growth rate of the central administration's current revenues during the four preceding years.[27] It is expected that after the *Acto Legislativo* is implemented, the annual transfers would decline from about 5% of GDP in 2001 to about 4% of GDP in 2010, and would generate fiscal savings equivalent to a total accumulated amount of about 5% of GDP over the next 10-years.

[25] The World Bank (2001), Proposed Structural Fiscal Adjustment Loan, Bank Report No. P 7483-CO

[26] The limits on the growth of the central administration's operational expenditures will be equal to (a) 1.5% in real terms per year for 2002–08; and (b) thereafter, a rate of growth equal to the average growth of the central administration's current revenues during the previous four years.

[27] In addition, if real GDP growth exceeds 4% in any year of the transition period, SGP resources would be increased proportionally, but only after adjusting for the transfers made during years where real GDP growth was less than 2% (2002–05) or 2.5% (2006–08).

86. *Reform of Law 60.* The Constitutional reform of transfers is complemented by the amendment of the 1993 Law 60, which specifies the mechanism for distribution of resources among territorial entities. These reforms, over the long term, will help to (i) reduce earmarking of transfers so that they specify only the sector allocation (for example, education and health), not the economic category (for example, wages and investment); and (ii) distribute all transfers on a capitation basis to pay for social services (as equalization grants to entities with lower than average per capita tax bases).

87. With respect to expenditures, the authorities seek to control the cost of general administration of subnational levels and to allocate public resources more closely toward the original design of decentralization in the Constitution—which foresaw an allocation according to service needs by population, with adjustments for poverty, among other factors. To control general administration costs, subnational governments are getting structural adjustment loans to finance downsizing of personnel (severance pay, etc.) under the terms of Law 617 of 2000.

88. The amendment of Law 60 (Law 715) includes, *inter alia*, (i) the automatic certification of municipalities (that are capitals of departments and/or have more than 100,000 inhabitants) to autonomously manage the provision of education services; and (ii) specific education performance goals included in a performance matrix (*matriz de desempeño*). The government will use the performance agreements to certify municipalities for the autonomous management of education-related resources. In accordance with SFAL agreement, at least 40% of the student population would be covered under this approach.

89. More specifically, the automatic certification or performance agreements will imply that (i) the transfer of resources to municipalities will be calculated on the basis of the number of students who attend class (not the number of teachers on the payroll); (ii) minimum coverage goals will be established with the objectives of increasing enrollment and reducing drop-out ratios; (iii) certified municipalities will be authorized to reallocate resources from teacher vacancies—both existing and new—within the education sector and to eliminate teacher positions; (iv) certified municipalities will be able to reallocate teachers within the local jurisdiction; and (v) the Ministry of Education will provide technical assistance to certified municipalities, if requested. The central government will publish and otherwise disseminate quarterly performance monitoring and evaluation reports of the certified municipalities.

90. Application of the new model of allocating national transfers for education among municipalities will require enabling regulations. While Law 715 has specified the principle that the allocation should be based on number of students, population to be attended, and poverty indicator, the details of how it will actually be implemented (e.g. regarding the indicators, weights and procedures to be used) have still to be worked out. GOC will issue regulations that would enable consistent and effective application of the resource allocation model.

91. *Additional measures.* To support these education sector strengthening objectives, additional measures would be undertaken, including:

- Document and publish successful experiences with education delivery approaches based on performance (concession) contracts with non-governmental providers as well as voucher programs such as PACES;
- Establish regulatory framework that would enable public educational institutions to contract private providers to deliver education services, as stipulated in Law 715;
- Design and organize (and provide, if requested) technical assistance for municipalities and/or Departments willing to try the above-mentioned alternative education delivery approaches;
- Strengthen the capacity of the Ministry of Education (MEN) to assist territorial entities develop their own information systems in support of the implementation of Law 715;

- Develop a methodology and action plan for the evaluation and dissemination of innovative models for expanding basic and middle education technology;
- Disseminate (by MEN) the results of the last SABER assessment in national media by Department, municipality and school characteristics; and
- Establish a policy strengthening the ability of Colombia's student loan program to meet the financial needs of higher education students, especially of poor and deserving students.

92. Finally, with respect to on-the-job training to complement education, SENA has decided to use its resources to finance implementation of the *Jóvenes en Acción* (but maintaining its fundamental rules and design). *Jóvenes* is a pilot project of RAS giving cash grants to the young poor that would allow them to choose on-the-job training supplied on a competitive bases by private firms. GOC has also introduced legislation to reduce labor cost to increase employment and opportunities for on-the-job training. The legislation would further permit hiring of young workers and paying them below legal minimum wages in exchange for training to be provided by the firm or other training providers (not necessarily SENA).

(3) Health

93. Through the new Law 715, GOC has taken important steps to address some of the problems facing Colombia's health system. Law 715, which aims to promote transparency and accountability in the health system as well as to reward performance, stipulates:

- The distribution of transfers (allocated to the health sector out of the above-mentioned *Sistema General de Participationes*) among public hospitals, insurance coverage and public health.
- Speeding up of the flow of transfers from departments to hospitals and from municipalities to ARSs;
- Clearer assignment of responsibilities; and
- The distribution of resources among territorial entities based on performance related factors.

94. Under the old system of allocation established by the Law 60 of 1993, there is no clear assignment of responsibilities as far as supply and demand subsidies and public health are concerned. Transfers follow a complicated path from the national government to territorial entities (departments and municipalities) to health system administrators (ARSs) and finally to health care providers. This process has created delays in the flow of transfers and resulted in the accumulation of debt among the various entities involved.

95. Under the new law, departments will assume responsibility for public and private hospitals, while municipalities will assume responsibility for increasing the coverage of the subsidized regime. On issues of public health, such as vaccination, municipalities will be responsible for the execution of the immunization programs and, accordingly, will receive the necessary funds. In the case of public hospitals, resources will be allocated according to the number of *vinculados* in the department, while in the case of subsidized insurance according to the number of affiliates in the municipality (*vinculados* are persons eligible for subsidized health insurance that are not yet affiliated with ARS).

96. The new law is expected to spur the transition from a supply to a demand-based subsidy system. Given that the number of *vinculados* will have been decreased and the public restructuring program will have contributed to limiting costs, resources per *vinculado* will be higher. This will permit a greater allocation of resources to financing the expansion of coverage among the poor through the subsidized regime, relative to direct subsidy to hospitals.

97. With respect to vaccinations, targets for optimum levels of vaccination coverage will be set and the monitoring of whether the targets are met will be used to adjust the amount of resources allocated to municipalities.

98. *Restructuring of public hospitals.* In response to the problems faced by the public hospital network, some steps have been taken to restructure public hospitals. The objectives of this restructuring program are to guarantee the financial viability of public hospitals and improve the productivity in health service delivery. To achieve the first objective the program has taken actions to reduce costs, including: (i) reforming the personnel structure, (ii) resolving accumulated debts and (iii) renegotiating collective bargaining agreements with hospital unions.

99. To achieve the second objective, the program includes actions such as (i) reaching agreements between territorial entities and hospital directors to advance long-lasting restructuring and to develop functional health service networks and (ii) identifying and analyzing existing information regarding supply and demand for health services in different regions in order to better define plans for managerial and technology improvements. Preliminary results from a pilot program aiming to restructure 27 hospitals (out of a total of about 170 medium and high complexity public facilities) administered by the Ministry of Health appear to be positive – in one year hospital costs have been reduced by 30%.

100. *SISBEN improvement.* As previously mentioned in relation to the social safety net discussion, the government has initiated a reform of the SISBEN proxy means testing system that allows for the targeting of public subsidies to the poor. SISBEN has been used primarily to identify beneficiaries qualifying for affiliation to the subsidized health regime. The new guidelines for the reformed targeting system have recently been approved by the CONPES and include: (i) adjustment of the identification instrument (the SISBEN index) to capture regional differences and dynamic aspects and a strategy for the adoption of the new instrument; (ii) a system of quality control and centralized monitoring through regular evaluations of the SISBEN surveys and punitive measures in cases where the municipality responsible for its application has an identification error greater than 15%; and (iii) strengthening supervision and administration at the local level.

101. *ISS-Health services.* In an effort to address the Social Security Institute's (ISS) financial problems, the government has agreed on a restructuring plan for ISS-Health services. The main objectives of this plan is to improve quality of services to affiliates, eliminate inefficient supply subsidies to ISS hospitals (ISS-IPS) and limit fiscal costs to the national government. The ISS-Health is currently facing both 'stock' and 'flow' problems that need to be addressed. With respect to its existing accumulated deficit, the program includes (i) transferring of resources to the ISS only after the renegotiation with collective bargaining agreement with its labor unions has been successfully completed, (ii) lifting the sanction applied by the Health Superintendency prohibiting new affiliation to the ISS after the underlying causes of the sanction have been resolved and (iii) withholding compensation transfers from FOSYGA to the ISS until more accurate information on the number of its affiliates has been provided. To resolve the 'flow' problem, the government aims to increase revenues and decrease costs. Measures for reducing costs include the restructuring of accumulated debt, rationalizing clinics and ambulatory health services and improving contracting mechanisms with own and external health care providers. Measures for increasing revenues constitute better collection of contributions by affiliates through reforms to the current system of self-estimated contributions, increased collections or arrears and enrolling more affiliates after the sanction imposed by the Health Superintendency is lifted.

102. *Solidarity account of FOSYGA.* According to the *Estatuto Orgánico de Presupuesto* the solidarity account of FOSYGA forms part of the national budget, thus has a limit/ceiling of expenditure. This has resulted in resources accumulating in the account, which subsequently had on occasion been used for purposes other than the ones defined by the solidarity account. GOC is about to issue a regulation stipulating the exclusive use of the said accumulated resources for financing subsidized health insurance coverage, as originally intended. Putting it differently, if the decision is taken that accumulated resources above the expenditure ceiling of the account are to be used, these resources can only be employed to finance the subsidized health insurance regime.

103. *Strengthening of the National Health Superintendency.* The GOC has started to address the budgetary problems and other issues hampering the ability of the Health Superintendency in carrying out its responsibility of oversight, control and monitoring of insurers (EPSs and ARSs), health care providers and territorial entities. Following the principles governing the operation of other superintendencies in Colombia, a decree is about to be signed enabling the Health Superintendency to charge a fee to the entities that are under its supervision. This measure will enable the Health Superintendency to carry out its fiduciary responsibility more effectively.

104. Additionally, GOC will (i) complete a business study currently being carried out by the Health Superintendency analyzing its operation and ways of strengthening its performance, and (ii) disseminate systematically to the public its assessment of the performance of its supervisees. The former will enable the Health Superintendency to set clear targets and develop supervision strategies and benchmarks, while the latter will provide information to eligible affiliates for making informed choices regarding insurers and health care providers. The last point is expected to improve quality control, as they will be under greater pressure to perform better, as informed clients tend to stay away from unreliable entities with bad practices.

105. *Communications plan for the subsidized regime.* To complement the above measures, GOC is developing a time-bound communications action plan to inform eligible individuals of the subsidized regime regarding their legal right to be affiliated to an ARS, the affiliation process and importance to them of the full implementation of the supply to demand subsidies reform program. Emphasis will be given to the difference between being classified as eligible by the SISBEN proxy means test and actual affiliation to an ARS. Furthermore, the campaign will concentrate on issues such as consumer's rights to select the insurance provider and health care package of their choice.

106. *Strengthening the immunization program.* The Ministry of Health (MOH) has shown resolve to strengthen the EPI/PAI immunization program. In collaboration with Panamerican Health Organization (PAHO), national authorities conducted a detailed evaluation of the entire national vaccination program. The GOC has now allocated the funds necessary to purchase vaccines and syringes and to carryout a national vaccination campaign in 2002. The government has also clarified the responsibilities between the MOH and the National Institute of Health (INS) in terms of EPI/PAI coordination and supervision at the national level.

107. Equally noteworthy, the MOH/INS in collaboration with the local PAHO office, is developing a detailed needs analysis for the national cold chain to ensure adequate storage and transport of vaccines. Moreover, the MOH is developing performance indicators for monitoring vaccination coverage levels at the municipality level and has begun to address the development of a functional information system for the collection, analysis and dissemination of information on vaccination activities. The above indicators will be used to certify compliance by the private sector with vaccination guidelines and the information system will monitor the number of vaccine doses given by provider as well as by geographic location.

108. However, to ensure the efficient functioning of the EPI/PAI program and to ensure achievement of acceptable coverage levels, the government is initiating the following additional steps to accelerate the implementation of needed reforms and address issues that have lead to poor vaccination practices (e.g., missed opportunities to vaccinate):

- Development and completion of a detailed Plan of Action based on the recommendations from the National Evaluation that clearly specifies short and long-term activities to remedy weaknesses in the national EPI/PAI program. These activities will be coupled with performance indicators to measure their implementation and their impact.
- Pilot testing of the computer software PAISOF-2 and development of a plan for its national application to ensure access to adequate and accurate information to monitor performance via standard indicators.
- Finally, development and institutionalization of measures to strengthen the coordination and exchange of information between providers to eliminate missed opportunities to vaccinate due to either lack of information sharing or to restrictive billing procedures.

(4) Transparency and Citizens' Oversight

109. Through the creation of SINERGIA, the Government of Colombia has made important advances in establishing a foundation for enhanced governance through the use of key performance indicators. Building on this solid base, the GOC proposes to (i) move beyond monitoring and establish periodic impact and performance evaluations of the main public sector programs financed by the national government, and (ii) establish a system of public monitoring to improve transparency and accountability.

110. Under this new policy, impact evaluations would first be carried out of ICBF's daycare and nutrition programs as well as of the main SENA training programs. The results of these evaluations will be produced by the end of 2004 and made available at the same time as the RAS safety net program evaluations allowing for the next administration to carry out a comprehensive review of the social safety net system. The system of public monitoring will bring to the general public information that has to date been the purview of central government officials. Adapting the successful model of "*Bogota Como Vamos*" implemented at the municipal level, the central government will establish a public information and monitoring system that will not only give the public information about the central government's performance, but also allow the central government to benefit from public opinion and open dialogue with its citizens.

4. THE SOCIAL SECTOR ADJUSTMENT LOAN (SECAL)

A. Objectives and Content

111. The proposed SECAL, a one tranche loan to be completed before the end of the current Administration, has three overarching objectives. First, the SECAL aims to encourage and enable the current Administration's momentum on several key social reforms that have been developed with active Bank support. This objective includes consolidation of the current stage of Colombia's Bank supported social sector strengthening program. Begun in 1998, this program is based primarily on education and health reforms supported by the promulgation of regulatory measures and the establishment of an integrated social risk management policy framework. Second, the operation seeks to promote continuity in Colombia's social sector development by encouraging the next Administration to incorporate in its medium term strategic agenda follow up activities the Bank deems critical to carry forward the reforms the loan is supporting. Third, in light of the breakdown in the peace process, weak economic growth and financial uncertainty, the loan aims to provide the GOC needed financial cushion as well as support for social measures complementing the fiscal reforms under the Structural Fiscal Adjustment Loan (SFAL). Together, these objectives establish a foundation for the expansion of key reforms that with follow up actions can significantly contribute to the advancement of social sector strengthening and the political sustainability of fiscal reforms.

112. Table 4.1 presents the tranche release conditions, key strategic goals and actions for the next few years (medium term framework), and the progress indicators for monitoring achievement of said goals. This medium term framework provides a "road map" on how the activities being promoted by the operation would ultimately lead through follow up actions to sustained improvements in education, health and social protection, particularly of the poor and vulnerable. Although the goals and actions listed under the medium term framework are not legally binding, they have been endorsed by the GOC in its Letter of Development Policy (Annex D) and are consistent with the views expressed by the technical team of incoming Administration. The list under the column "Policy Actions for SECAL Tranche Release" present the legally agreed actions that would constitute conditions for Board approval and trigger a one tranche disbursement of the loan. The specificity and definition of the conditions as well as the evidence of compliance are discussed in Annex G.

113. Formally, the operation is not a programmatic loan. Yet in substance, it is part of a coherent program of activities complementing ongoing Bank operations and initiating follow up measures to carry forward ongoing social reforms. On the one hand, as mentioned at the outset, the loan complements ongoing lending and analytical activities, including among others: (i) the aforementioned series of coordinated operations launched by GOC and the Bank in collaboration with IDB to protect advances in the social sectors and implement a effective social safety net in the face of the recent recession and its persistent negative consequences[28]; (ii) the SFAL adjustment measures controlling education and health expenditures; and (iii) human capital investment projects, notably the Youth Development LIL, Rural Education, and Decentralization Education Management Projects, which support institutional strengthening and experimentation with innovative approaches for dealing with issues of decentralization, violence and the education of poor children, particularly children in isolated areas.

[28] These are the Community Works and Employment Project, Human Capital Protection Project, *Colombia Social Safety Net Assessment* and the *Colombia Poverty Report.*

114. Looking to the future, the proposed SECAL would set the stage for the next phase of social sector reforms by supporting: (i) the restructuring of traditional, calcified social assistance programs including the large ICBF child welfare program; (ii) the establishment of a system of periodic impact and performance evaluations of social programs, beginning with an analysis of the main safety net programs and the SENA training program to lay the groundwork for a full social assistance reform; (iii) reforms in health and education service provision and financing, as outlined above; (iv) attention to the internally displaced population, one of the most vulnerable groups in Colombia today; and (v) enhanced Government transparency and accountability in the social sectors through information dissemination and dialogue. These initiatives will be carried forward in the medium term, as laid out in Table 4.1.

115. With respect to financial objectives, the GOC is counting on the proceeds of this proposed loan to ensure that it will be able to protect both its social and discretionary investment expenditures, which might have to be cut if the country is forced to resort to higher interest private financing. Recent data indicating weak economic growth and greater financial uncertainty coupled with the breakdown in the peace have reinforced this concern. Beyond the financial cushion it would provide, the operation would balance the Bank's assistance to Colombia by providing a vehicle for addressing social deficits, as a complement to the fiscal deficits addressed by the SFAL.

116. The diffusion of innovative education delivery models supported by the SECAL could improve the access of populations affected by violence to good education as these population are generally located in the areas targeted by the education reforms.

117. Finally, the tranche release conditions in the proposed SECAL complement the SFAL and the recently approved IDB social sector loan. A comparison of the SECAL tranche release conditions with those of the SFAL and the IDB loan is presented in Annex H. Given the parallel financing between this proposed SECAL and the IDB loan, there are both overlaps and string complements in the tranche release conditions between the two loans. It should be mentioned, however, that only those measures that were taken recently or about to be completed have been included in this SECAL's policy matrix. With respect to the Bank's SFAL, it should also be noted that this SECAL's tranche release conditions complement but do not overlap with the legal conditions stipulated in the SFAL's policy matrix, except the general macroeconomic condition. Close coordination with IDB has been and will be maintained to ensure policy consistency and facilitate implementation of the conditions.

TABLE 4.1 Social Sector Adjustment Loan Policy Matrix

Policy Actions for SECAL Tranche Release (see Annex G for details)	Medium-Term Framework: (2002-2005)	Progress Indicators
A. General Conditions of the SECAL The macroeconomic framework of the Republic of Colombia is consistent with the objectives of the program.		
B. Specific Conditions of the SECAL		
Transparency and citizens' oversight of social programs 1. Introduction of a system of impact and performance evaluations and public monitoring of Colombian Goverments's (GOC) main social sector programs. Approved CONPES establishing: (i) periodic impact and performance evaluations of the main social sector programs financed by the national government and (ii) public monitoring to improve social sector transparency and accountability. The system will be launched through (i) impact and performance evaluations of the main ICBF family welfare, RAS safety net, transfer and SENA training programs; and (ii) the establishment of a system of public monitoring of social sector programs to improve transparency and accountability through the dissemination of monitoring and evaluation results and consultation with civil society. [A CONPES is an authoritative statement of government policy and guidelines issued by the National Council of Social and Economic Policy.]	**Goals**: to improve the governance of social programs through greater transparency of their impact and citizens' oversight of their performance. **Measures**: • Completion of evaluation of ICBF family welfare, RAS safety net, *Cajas de Compensación* transfer and SENA training programs. • Evaluations used as basis for the full establishment of the Social Risk Management System. • Establishment of a system of public monitoring of Colombia's main social programs, building on the work of SINERGIA.	• Increase in rate of citizens' and policymakers' awareness about the coverage, impact and efficiency of social programs • Number of social programs evaluated and number of evaluations publicly disseminated • Increased participation levels in public monitoring system activities (#web site hits, attendance at town hall meetings, etc.)
Social Safety Net 2. Development of a comprehensive Social Risk Management System, including: norms for its role in normal and crisis periods, including a system for maintaining/expanding the coverage of pre-qualified programs during crisis periods using emergency financing; and the function of and relationship between social assistance and insurance programs. 3. Improving the coverage, effectiveness and efficiency of ICBF through (i) a pilot decentralizing and separating financing from provision in 10 municipalities; (ii) ICBF board approval and implementation of a cost-recovery policy based on sliding-scale fees graduated by income from users of CAIPs formal day-care centers; (iii) improved monitoring through the launching of a citizens' oversight plan in each ICBF regional office; and (iv) a technical review of the management information system. 4. Attention to the internally displaced population (IDP) though (i) adoption of a common methodology for characterizing the IDP; and (ii) development and launching of a time-bound action plan for eliminating barriers to IDP's access to social programs.	**Goals**: (i) to improve the state of readiness of Colombia to assist the vulnerable poor during times of crisis; (ii) to strengthen social assistance and insurance to chronically vulnerable poor during normal times; (iii) to improve the quality and coverage of early childhood development services; and (iv) to assist the internally displaced population (IDP). **Measures**: • Improved targeting, efficiency and coverage of main social assistance and training programs • Functioning counter-cyclical social risk management strategy with clear saving and spending rules • Increasing financing of social assistance programs as % of GDP • Clear cost-recovery mechanisms applied in all CAIP formal daycare centers • Commonly accepted measure of the size and characteristics of the IDP • Implementation of measures eliminating barriers to	• Authorized list of pre-qualified social assistance programs ready for expansion during crisis periods • Reduced time lag implementing counter-cyclical safety net response in future crisis (less than 2 years) • % of GDP devoted to social assistance programs • % of poor with SISBEN documentation card • Updated SISBEN proxy means test • Increase in coverage and improved targeting of ICBF day-care programs • Improved infant and child malnutrition rates • Increased local citizens' participation in ICBF oversight activities • General adoption of citizen's oversight model by ICBF based on results of regional plans • % of municipalities that have adopted ICBF decentralized model separating financing from provision

	IDP's access to health insurance and social safety net programs.	• Improved coverage of health, education, social assistance and social insurance programs among IDP
Health 5. Expansion of health insurance coverage and improvement of resource use through: (i) expansion of the subsidized health insurance coverage (Régimen Subsidiado) by 350,000 additional individuals belonging to SISBEN levels 1 and 2 by December 31st, 2001; (ii) approval of new resource allocation model for territorial entities according to the number of affiliates, number of vinculados and public health coverage targets (e.g. vaccination rates); (iii) approval of CONPES defining the implementation rules for the distribution of health transfers pursuant to Law 715 of 2001; (iv) agreement to use the FOSYGA Solidarity Account resources exclusively for subsidizing health insurance coverage; (v) enactment of regulations (decretos reglamentarios) for the implementation of Law 715 with respect to the assignment of responsibilities for public health and the methodology and information for the distribution of health transfers pursuant to said law; and (vi) allocation in the 2003 proposed budget of necessary resources to inform eligible poor population about the subsidized health insurance regime rights and affiliation procedures. 6. Strengthening of the operation of the National Health Superintendency through: (i) approval of the necessary decrees requiring fee payments by EPSs, ARSs, territorial entities and hospitals to the National Health Superintendency and establishing the fee level; (ii) signed contract for a business study, financed by the Program Support to the Reform (Apoyo a la Reforma), regarding the operation of the Superintendency and the ways that its role can be reinforced; and (iii) internet dissemination of information on the performance of EPSs, ARSs, territorial entities and hospitals by the National Health Superintendency. 7. Strengthening of the Expanded Program of Immunization (EPI) through: (i) budget allocation to finance year 2002 immunization needs to achieve at least 95% vaccination coverage; (ii) development of detailed Action Plan based on the recommendations of the National Evaluation to strengthen the EPI immunization program and initiation of certain key measures; (iii) allocation of resources for executing the EPI plan; and (iv) clarification of the assignment of responsibilities at the central level regarding immunization.	**Goals**: to improve health status and reduce financial risks from illness through (i) the achievement of universal health insurance coverage and (ii) the strengthening of the control of communicable diseases. **Measures:** • Continued expansion of the health insurance coverage of non-affiliated population including the poor and the self-employed through: (i) full implementation of the health reform law (Law 715) mandating transformation of supply to demand subsidies for health care; (ii) reduction in the evasion and underpayment of health insurance contributions; (iii) exclusive use of the FOSYGA Solidarity Account resources for subsidizing health insurance coverage; and (iv) improved communications program informing the public in general and the poor in particular about the affiliation process, eligibility rights, and allocation of resources to territorial entities for demand and supply subisidies; • Full implementation of Law 715 mandate on quality assurance, promotion of public accountability of insurers and health care providers with the support of a strengthened Health Superintendency and development of citizens' oversight (Veeduria Ciudadana) of the use of public health resources; • Optimization of the financial flow of health sector resources, including, prevention of illegal use, retention or use for other purposes; • Restructuring of the network of public hospitals in order to operate as efficient providers of health care services with limited direct government subsidies and adoption of a new health care model focusing on primary health care; • Full implementation of the measures to strengthen the Expanded Program of Immunization based on the recommendations of the National Evaluation, including the completion of activities related to recommendations for the strengthening of the cold chain.	• Improvement of health status indicators such as life expectancy, life expectancy adjusted for disability, and infant mortality • Increase of insurance coverage to at least 85% of the total population • Increase of treatment rates, particularly for the poor • Reduction of the amount of direct government subsidies to public hospitals as a percentage of total (supply and demand) subsidies • Decrease of the rates of evasion and underpayment of insurance contributions • Dissemination of information to consumers regarding the financial performance and the cost and quality of the services of insurers and health care providers, • Increase of (i) the rate of citizens' awareness regarding health insurance rights and use of public health resources; and (ii) the rate of citizens participation, particularly the poor, in oversight activities • Decrease of unit costs of public hospital services • Full immunization coverage of at least 95%

Education 8. Improving public education regulatory framework through: (i) approval of a new resource allocation model for territorial entities according to number of students, population to be attended, and poverty indicators; (ii) approval of CONPES defining the implementation rules for the distribution of the educational transfers pursuant to Law 715; and (iii) enactment of regulations (*decretos reglamentarios*, ministerial directives, resolutions, and circulars) for the implementation of Law 715 in regard to information system, including regulations strengthening the capacity of the Ministry of Education to assist territorial entities develop their education information systems for resource allocation, and guidelines for public education institutions contracting with private providers for the delivery of educational services; and (iv) allocation in 2002 budget of resources to strengthen the Ministry of Education's capacity to assist territorial entities develop their education information systems. 9. Ten performance agreements (Matriz de Seguimiento al Plan de Reorganizacion) signed between the authorized representatives of both the National Government and Territorial Entities to rationalize the teaching force and extend education system coverage. 10. Signing of a Monitoring Agreement (Convenio de Seguimiento) between authorized representatives of the national government and the Mayors of selected districts receiving educational transfers according to the Law 715 formula. Said agreement will allow the Ministry of Education to monitor compliance of the following measures that the districts agreed to undertake: (i) improve the reliability of the information on the number students; (ii) streamline the administrative structure of the Education Secretariats (Secretarias de Educacion); and (iii) increase investment in non-salary education inputs and universal assessment of the educational achievement of children. 11. Public dissemination of information through, inter alia, national media, publications and press releases regarding: (i) student learning achievement of the last SABER assessment and (ii) the updating of the "Portfolio of Education Services" (Portafolio de Ofertas Educativas) and its inclusion of unit cost estimates. [The Portfolio is a brochure on pedagogical models local authorities should consider for increasing both enrollment and quality.] 12. Development of a methodology and shortlist for selection of consultants to evaluate models for expanding basic and middle education using education technology (e.g. SAT, telesecundarias, postprimaria and accelerated methodologies).	**Goals**: to improve overall educational status for children through increased efficiency and equity in the allocation of resources. **Measures**: • Full implementation of the Law 715 formula for allocating education resources to territorial entities • Continued implementation of the Matriz de Seguimiento al Plan de Reorganizacion to the year 2003 • Implementation of assessment of student learning achievement • Development of a well functioning information system for resource allocation in the educational sector • Completion of impact evaluation of pilot pedagogical models for rural areas by 2004 and their dissemination nationwide. • Promotion of the use of private delivery mechanisms to provide education services	• Increase of enrollment rate and student learning achievement • Increase of student/teacher ratio in accordance with norms established by MEN • Implementation of the SABER (criteria-based) evaluation system implemented every other year and the universal (norm-based) assessment for all districts every year • A well functioning information system for all municipalities by 2004 • Rate of awareness of the pedagogical models among local education authorities • Rate of adoption of private delivery mechanisms to provide education services
Technical Assistance 13. $5 million will be aside set for technical assistance (TA) and added to the 2002 budget and/or 2003 budget proposal.		

B. Fiscal, Timing and Other Risks

118. **Economic risks.** The GOC has demonstrated strong and continued commitment to prudent macroeconomic management and structural reform, but there remain significant internal and external risks that could affect the fiscal accounts, as discussed in Section 1. On the external front, the principal risk is posed by the threat of further deterioration in the external macroeconomic environment led by a deeper slowdown or recession in the world economy. The most important transmission channels are (i) a further deterioration in the terms of trade, particularly resulting from continued unfavorable coffee prices and volatile oil prices; and (ii) the closure of access to international financial markets due to crises in major markets and/or emerging market countries.

119. On the internal front, the major risks concern the fragility of Colombia's economic recovery, compounded by the collapse of the peace process. As mentioned earlier , in 2001 the economy grew 1.6 percent, down from 2.8 percent a year earlier, although it still higher than the Latin America average. Prospects for an acceleration of growth are hampered by weak domestic demand, high unemployment, and low rates of private investment. The problem is exacerbated by the recent collapse of peace negotiations with the FARC, the country's largest guerrilla group, and the return to open hostilities which could negatively affect the investment climate as well as the Government's fiscal program (due to pressures for increases in military expenditure and spending to rebuild damaged infrastructure). In addition, despite GOC's sustained and strong commitment to the adjustment and reform program as evidenced by the significant reduction of the fiscal deficit (by nearly 50 percent) since the onset of the recession and the passage of the bulk of its program of structural reforms, a few important reforms (e.g., the pension system, fiscal responsibility and territorial tax reforms) have not yet been approved by Congress.

120. What are the implications of these risks for the proposed SECAL? First, meeting the macroeconomic conditions is more difficult now than six months ago. However, given the GOC's increased effort to maintain fiscal discipline, raise revenues, and control public expenditures, the risk of non-compliance remains moderate and within manageable range. Currently, Colombia's program with the IMF remains on track, following some easing of fiscal targets due to lower-than-projected growth and revenues. There is some likelihood that the fiscal targets might be eased again in 2002 should growth be weaker than the 2.5-3 percent currently projected. It should be noted, too, that slower growth could mean that deposits to the counter-cyclical social protection fund would not be made in the foreseeable future. While not a specific condition of the proposed loan, slower build-up of the counter-cyclical social protection fund would undoubtedly lead to some delay in advancing Colombia's efforts to develop a more responsive system of social protection. Second, while delays in the legislative approval of the previously mentioned reforms (pensions, fiscal responsibility and territorial taxes) are unlikely to have more than a modest fiscal impact in the short-run -- thus not immediately affecting the country's macro-balances – progress in each of these areas is critical for medium and long-term fiscal sustainability and will need to be addressed by the incoming administration as a matter of priority.

121. **Timing and political risks.** The presentation of a single-tranche loan to be disbursed by the end of the current Administration's term was deemed an important risk during the preparation of this operation. Given the expectation of a new Congressional session in July and an inauguration of a new Administration on August 7, 2002, there was considerable concern that the various reform initiatives embodied in the SECAL might not be embraced by an incoming administration, with the attendant risk that actions already taken might be reversed and/or that little would be done in the way of follow up. This risk has been substantially mitigated in recent weeks, however, by the decisive first-round election results which have enabled discussion of the SECAL with the incoming team of President-elect Uribe prior to presentation of this loan to the Board. Indeed, discussions with Mr. Uribe's team have clarified that the incoming administration strongly endorses the operation and, cognizant of the urgent financial needs of Colombia, is in full support of presentation of the proposed loan to the Board before the change of government. Moreover, given the strong electoral showing enjoyed by Mr. Uribe there is clearly a very promising political foundation for moving forward the reform agenda of fiscal discipline, economic reforms, and social development This expectation is reinforced by the consultations undertaken by the Bank during loan preparation with a wide variety of stakeholders from across the political spectrum, which indicated broad support for the medium-term social sector strategy being supported by this operation.. Finally, it is worth noting, that the operation supports programs that are already providing substantial benefits to their target population and have considerable popular support. The most important example is the expansion of the affiliation of poor families with the subsidized health regime (ARS). In the second semester of 2001, a total of 1,554,852 poor persons were added to the ARS, implying an additional amount of roughly $118 million per year of direct assistance to the poor and accelerating the supply-to-demand transformation of Colombia's health system.

C. Loan Amount, Conditions, Financial Safeguard, and Disbursements and Audits

122. The proposed (US$155 million) SECAL in the form of a fixed spread, U.S.-dollar-denominated loan would be made to the Republic of Colombia. Disbursements under the proposed loan would be made to an account (Deposit Account) of the Republic of Colombia, established at the *Banco de la República* for this purpose. As mentioned, the proposal is to disburse the loan in one tranche upon Board approval. This tranche arrangement has been designed with the Government and reflects the GOC's and the Bank's assessment of the necessary timing for implementing the proposed conditions.

123. To ensure compliance with financial safeguards, the Government is committed to continue improving public expenditure management, including both procurement and financial management, and combating corruption. Over the last few years, the Bank (at the authorities' request) has undertaken a substantial amount of analytical work to support the Government's efforts for improving public expenditure management. This included Colombia—Country Financial Accountability Assessment (September 1998); a second Country Financial Accountability Assessment, which is scheduled to be carried out in FY03, and will pay particular attention to financial accountability arrangements at the sub-national and municipal levels; the Country Procurement Assessment Report (CPAR, March 2001); the Public Financial Management Project (PFMP-I, closed March 2001); and the on-going PFMP-II (February 2001) which follows and expands on the earlier project. In addition, the Bank has supported the Government's anti-corruption program through the World Bank Institute as well as an Institutional Development Facility (IDF) grant completed earlier this year.

124. The Government of Colombia has established a Public Procurement Project in the National Planning Department, which is working on the development of a paper on national procurement policy based on the recommendations of the CPAR. The recommendations to improve procurement include the establishment of an institutional framework for an orderly and consistent development and dissemination of policies, regulations, and standard bidding and contract documentation. In addition, CPAR recommended giving priority to simplification and not to the introduction of new rules, control and punitive measures that could easily aggravate existing problems and provide additional opportunities for corruption. With regard to financial management, the Office of the Accountant General is being strengthened to allow it to become more effective, as are institutions (both public and private) involved in the professional practice of public accounting. As indicated above, these efforts have been supported through two specific Bank operations—the PFMP I and the follow-on PFMP II—both highly praised by QAG, and recently completed sector work on corruption.

125. Moreover, these two projects have also supported the Government of Colombia's measures to strengthen institutional capacity and analysis in a number of key areas of public expenditure, such as macro-programming, formulation and monitoring of the budget, budget execution—including the development and implementation of an Integrated Financial Management System (SIIF)— and evaluation of results of public expenditure—including the implementation of the National System for Evaluation of Results of Public Sector Performance (SINERGIA). Despite important progress in areas of public expenditure, further strengthening of financial management processes is needed. These deficiencies include (i) divergence between budgeted expenditures and the Government's strategic development priorities; (ii) lack of clarity regarding the roles and reporting requirements of government institutions; and, (iii) the need to enhance public sector transparency and accountability by improving the dissemination of the objectives, performance evaluations and budgetary results of public entities. The on-going PFMP II is supporting reforms in these areas. In April 2002 an inter-institutional committee was commissioned, comprised of representatives of the Office of Controller General, the Accountant General and the Bank, with a mandate is to make recommendations for the strengthening of Financial Management arrangements for projects implemented in Colombia. The recommendations will be submitted to the various authorities by June 30, 2002. The recommendations will be submitted to the various authorities by June 30, 2002.

126. In addition, the IMF's safeguard assessments report on the audit mechanism for the Colombian central bank, completed in May 2001 under the transitional procedures, concluded that the current auditing arrangements are capable of providing high-quality audit services. However, while external audit of the central bank's financial statements is undertaken, it does not comply with the strict definition of an independent audit under the International Standards on Auditing (ISA). The principles governing central bank auditing mechanisms are enshrined in the Colombian Constitution of 1991, whereby the President is responsible for auditing the central bank, and is permitted to delegate this function to the Banking Superintendent and to an independent State agency, but not to a private firm. Based on this finding, and on the legal issues involved, the IMF and the Colombian authorities are looking for alternatives to overcome this matter. The Government also intends to request IMF assistance it in addressing issues of fiscal transparency, and an IMF fiscal transparency mission is envisaged for early next year.

127. For the purpose of SECAL's disbursement and audits, prior to furnishing to the Bank the request for withdrawal from the Loan Account, the Government will open and thereafter maintain in its central bank, a deposit account in dollars on terms and conditions satisfactory to the Bank. All withdrawals from the Loan Account will be deposited by the Bank into the Deposit Account. The Bank will monitor and assess ex-post (through supervision missions with the Government's permission) the use of the Deposit Account based on the Comptroller General Audit Report. The Government undertakes that the proceeds of the loan will not be used to finance ineligible expenditures. If the Bank determines at any time that any proceeds of the Loan have been used to make a payment for an ineligible expenditure, the Government will, upon notice from the Bank, (i) deposit into the Deposit Account an amount equal to the amount of said payment, or (ii) if the Bank has requested, refund such amount to the Bank. Amounts refunded to the Bank upon such request will be credited to the Loan Account for cancellation. Although a routine audit of the deposit account will not be required, the Bank reserves the right to conduct one.

5. BANK STRATEGY

A. The CAS and the Proposed SECAL

128. As the Country Assistance Strategy Progress Report (CAS-PR, Annex A) reconfirmed, the World Bank's main objectives in Colombia are to support poverty reduction, social development and sustainable economic growth. Anchored with a stable macro-economic environment and fiscal sustainability, these objectives were to be achieved by interventions in key areas (i) promoting peace and development; (ii) enhancing rural development; (iii) strengthening human capital; (iv) attaining public sector responsiveness and efficiency; (v) improving infrastructure services; and (vi) ensuring sustainable development. These priorities have not changed and continue to be supported by the Bank's lending program.

129. The proposed SECAL is consistent with the CAS and the World Bank's Social Sector Strategy for Colombia (Annex E). It is part of a series of social protection projects that the GOC, World Bank and IDB agreed at the beginning of the economic crisis to assist the poor, particularly those most affected by the crisis. Two of them are investment projects currently under implementation that form part of the GOC's *Red de Apoyo Social* (RAS) safety net strategy: (i) the Community Works and Employment project which provides temporary employment to poor unemployed workers in urban areas through small community projects; and (ii) the Human Capital Protection project that funds a conditional cash transfer program to protect children's health, education, and nutrition.

130. As planned, the Government has asked the Bank to prepare the third project of the series, a Social Sector Adjustment Loan (SECAL) to support structural reforms needed in the social sectors to ensure that the impact on poverty and the sustainability of the government's interventions in this area are maximized. As envisioned in the CAS, the operation would assist Colombia in establishing a social protection system that reacts quickly in response to economic crises and that is better targeted, more transparent and properly evaluated. The operation would also enable the implementation of recent health and education reforms.

131. The SECAL will directly contribute to achieving the CAS-PR's objectives of poverty reduction, social development and economic growth. Complementing the SFAL, the SECAL will help (i) protect the poor from the potential effect of the fiscal adjustment; and (ii) ensure that key social services, including safety net programs, are targeted to the poor, and delivered more efficiently and effectively. In the long run, the social sector strengthening program would improve Colombia's social protection system, while at the same time building up human capital.

132. The proposed SECAL operation is fully consistent with the strategy proposed in the CAS and CAS-PR, not only in terms of policy content but also in terms of overall lending and exposure limits. The overall external debt exposure of Colombia is relatively high, but manageable (see Annex A9).

B. Complementarity with Other World Bank Operations and Activities

133. First, as mentioned, the two ongoing Bank operations (the Community Works and the Human Capital Protection Projects) supporting the government's social assistance program complement the SECAL. Bank financing for those two projects totals US$250 million.

134. Second, there are the Financial Sector Adjustment Loan (FSAL) for US$500 million (approved by the Board in November 1999) and the recently-approved Structural Fiscal Adjustment Loan (SFAL) for $400 million projects. These projects help Colombia achieve economic recovery, sustained economic growth and stability – critical conditions for attaining long term success in social protection, human development and poverty reduction. The FSAL operation supported a comprehensive program of financial structural reforms that sought to promote the development of a healthy and sustainable financial system, while the SFAL supports the Colombian government's fiscal strengthening program. The latter gives the government fiscal space for protecting social sector expenditures and implementing difficult structural measures—such as reforming transfers and expenditure responsibilities in health and education, restructuring public hospitals, and redefining pension systems.

135. Third, two studies have provided analytical information to this operation. The Colombia Poverty Report assesses and reviews (i) the evolution of poverty and inequality in urban and rural areas over the past two decades; (ii) the incidence of crime and violence and related household responses; and (iii) selected aspects of public assistance, including an overview of public social expenditures and a specific review of the subsidized health insurance system. The Colombia Social Safety Net Assessment evaluates reforms to Colombia's social safety net, both for addressing the needs of vulnerable groups during normal times and for developing a counter-cyclical strategy that could be implemented rapidly during future crises. The study (i) assesses vulnerability and risk management in Colombia; (ii) evaluates how the three new emergency *Red de Apoyo Social* safety net programs fit into the broader social safety net over the long-term; (iii) assesses the efficiency, effectiveness and gaps in Colombia's existing social assistance programs; and (iv) proposes technical, program and policy reforms aimed at improving the social safety net.

C. Complementarity with Other Institutions' Operations

136. The Bank and IDB are financing in parallel the social sector strengthening program. The IDB has recently processed a US$390 million social sector loan (approved by its Board on December 19, 2001). The IDB loan committed GOC to a set of policies and actions laid out in the policy matrix for said loan in Annex H. This proposed SECAL would not only support the measures agreed with the IDB, but deepen and widen the program by including the measures described below.

137. It should also be mentioned that as part of the Bank's close collaboration with the IDB, the workfare and conditional cash transfers projects have been designed with IDB and have been also financed in parallel by the IDB for US$250 million. Finally, the Bank and IDB have coordinated their analytical efforts, particularly in regard to the social safety net study.

THE REPUBLIC OF COLOMBIA

Country Assistance

Update Note[1]

The Current Strategic Framework

A1.The last Country Assistance Strategy (CAS) for Colombia was discussed by the Board of Executive Directors in November 1997, and the Country Assistance Strategy Progress Report (CAS-PR) was discussed in November 1999. Under normal circumstances a new CAS would have been presented in the middle of 2002. However, it was decided that a new CAS would be better justified following the start of the new administration in early FY03 to coincide with Colombia's political cycle. In addition, we are currently preparing a collection of policy notes summarizing the major challenges in Colombia's social-economic development. The policy notes will serve as a bridge to the new administration, which will take office in August 2002. This work will be the analytical basis for the new CAS. The present note provides an update on the strategic framework under which the Bank proposes to operate until the Board of Executive Directors discusses the new CAS.

A2.Following participatory consultations with government leaders and civil society the CAS identified, and the CAS-PR reconfirmed, the main objectives of poverty reduction, social development and sustainable economic growth. Anchored with a stable macro-economic environment and fiscal sustainability, these objectives were to be achieved by interventions in key areas (a) promoting peace and development; (b) promoting rural development; (c) developing human capital; (d) attaining public sector responsiveness and efficiency; (e) improving infrastructure services; and (f) ensuring sustainable development. These areas of intervention have not changed and continue to be supported by the Bank's lending program. Furthermore, the CAS-PR recognized that Colombia's economic performance, especially economic growth and the fiscal balance, had deteriorated since the presentation of the CAS and recommended strengthening fiscal stability to restore growth and reduce poverty. The CAS-PR confirmed that a reduction of the fiscal deficit was a key macroeconomic objective of the government, and it recognized that without a correction of fiscal imbalances, Colombia could face financing gaps and problems in accessing external financial markets. Worsening economic conditions, combined with uncertainty as a result of the country's long-standing internal conflict, could hinder the achievement of the government's objectives as reflected in the CAS. In addition, the international economic and financial repercussions of the tragic events of September 11, 2001 have reinforced the importance of a return to fiscal sustainability as these repercussions may be severe and could further restrict capital flows to Colombia and augment the deterioration of the country's terms of trade.

A3.The CAS presented a base-case IBRD lending program of around US$300 million per year for FY98-00. This relatively low lending ceiling was determined by Colombia's preference at the time to limit its IBRD borrowings. The CAS-PR moved the assistance strategy to a high-case lending program, with increased emphasis on adjustment lending, to around US$450 million annually. This movement was

[1] This Country Assistance Update Note was written on November 16, 2001 and discussed with the Board in conjunction with the Structural Fiscal Adjustment Loan (see Annex A of SFAL Memorandum of the President). Recent critical developments are noted in subsequent footnotes.

justified by (a) the need to cushion the adverse social impact of the economic recession, financial instability and internal conflict on the poor and vulnerable, and (b) the Government's commitment to undertake fiscal adjustments and implement structural reforms to be supported by an IMF program. These triggers remain valid. Furthermore, the CAS-PR indicated that we would reassess the lending program and move to a base-case or low-case scenario if (a) the fiscal stabilization program supported by the IMF program went off track; (b) project implementation problems arose; or (c) increased violence and social unrest significantly reduced our ability to work effectively in Colombia. These risks have not materialized.

Recent Developments

A4. **Peace Process.** Colombia has been ravaged by intense conflict for the past 40 years, financed in part by the illegal drug trade. About 40,000 people have died in clashes during the last decade alone. President *Andrés Pastrana* has made a highly ambitious peace initiative the focus of his administration. The two main rebel groups in Colombia, the FARC and ELN, as well as the paramilitary group, the AUC, are on the United States' official list of foreign terrorist organizations. On October 7, 2001, Mr. *Pastrana* decided to continue the peace negotiations by extending the demilitarized zone for three months, but with firmer conditions, most notably the negotiation of a truce and agreements to end kidnappings and attacks on the civilian population[2]. The refocused peace discussions will center on a ceasefire and on obtaining commitments from guerrillas to respect international humanitarian law. Colombia will continue to need the assistance of the international community to fight terrorism and to address the socio-economic determinants of violence in order to construct the underpinnings for peace and development.

A5.**The Economy**. Economic growth for 2001 is now projected to be about 1.5-2.5 percent—down from last year's 3 percent. While this projected real economic growth is above the country's annual average real growth trend of less than 1 percent observed over the past five years, it is still well below the 4.5 percent annual real economic growth of the early 1990s. The manufacturing industry and nontraditional exports have provided the main impetus to growth over the past year; improved performance in agriculture, commerce, and construction have also contributed to the expansion of output. However, weakening of investment spending, disruption of oil exports, falling coffee export prices and strikes in both public and private sectors have negatively affected economic growth. Inflation continues its downward trend and is expected to attain the Central Bank's year-end target of 8 percent for 2001. The balance of payments' current account deficit is projected at 2.6 percent of GDP—up from the deficit of about 0.2 percent of GDP in 2000. This is due to an increase in domestic demand for imports, and the simultaneous weakening of traditional exports, particularly oil and coffee. Nevertheless, gross international reserves (in months of goods and services) are projected at around six months for the rest of 2001. While these projections take into account the initial impact of the tragic events of September 11, 2001, they will have to be further assessed. Nonetheless, it is certain that the impact on global financial markets and economic growth will be substantial and that as a result, Colombia's economy will also be negatively affected, including by restricted access to capital markets and further deterioration of terms of trade (particularly coffee and oil). Colombia's total external financing needs are projected at about US$ 8 billion per year for the 2001-2003 period. Total public external debt has risen steadily, both in absolute terms and as a proportion of GDP. In gross terms, it has almost doubled from 27 percent of GDP in 1994 to 50 percent in 2000.

[2] Since then, the negotiations between the government and FARC broke down, ending the peace process.

A6. The government's macroeconomic program has three pillars (a) sound fiscal management, including the implementation of fiscal reforms; (b) an inflation-targeting monetary policy; and (c) a flexible foreign exchange regime. If this macro-economic policy mix is maintained, and given a stable economic environment, average real economic growth is projected for the medium term (2002-2003) at about 2.5-3 percent per year, and for the long-term (2004 and on) at about 3-3.5 percent annually, fueled mainly by investment expansion. As a result of the implementation of the forthcoming fiscal reforms and the continuation of sound macroeconomic management, the deficit of the Non Financial Public Sector would decline and reach about 1.5 percent of GDP in 2005. Inflation is projected to continue its downward trend, and to stabilize at about 4 percent in 2003 and beyond. The external current account deficit would reach about 2-3 percent of GDP, and gross international reserves are projected at about seven months of goods and services imports. Finally, in this macroeconomic framework, Colombia's net total public debt would stabilize at about 50 percent of GDP by 2005.

A7. **IMF Program**. The government's stabilization program is being supported by an IMF Extended Facility, the first of its kind for Colombia, which was approved in December 1999 and extends through the end of 2002. The government entered into an Extended Facility Program in order to send a positive signal to international markets; it was understood that the arrangement was precautionary and that it would not be drawn upon unless there was a pressing balance-of payments need.[3] The government requested that the Fund focus on stabilization and balance of payment issues and that the Bank take the lead on key structural issues. Therefore, the Fund's program concentrates on stabilization of the fiscal accounts within the duration of the program, and the Bank has taken the lead in identifying and supporting key structural reforms that will contribute to bringing Colombia's fiscal accounts onto a sustainable path in the long term. Colombia has so far met, and at times exceeded, the performance targets under the IMF program; two program reviews have been successfully completed, and the third is expected to be presented to the Fund's Board in early 2002. All performance indicators are expected to be met with the exception of the original program targets for the fiscal deficit. The weakness of the economic recovery this year, combined with external variables such as low commodity prices and the events of September 2001, make it likely that deficit targets for both 2001 and 2002 will be modified in the current program review -- the targeted fiscal deficit is expected to shift from 2.8 to about 3.3 percent of GDP for 2001 and this adjusted target will be met[4].

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[3] We support this strategy for several reasons, including: (a) the signal to international markets is working as can been seen by Colombian spreads, particularly in light of the recent events of September 11; (b) the fact that the Central Bank is bound by strict constitutional restrictions against lending to finance the deficit—an exemplary practice; and, (c) more importantly, the division of labor and responsibilities between the Fund (stabilization and balance of payments) and the Bank (structural issues).

[4] Portfolio performance in Colombia as of June 2002 remains satisfactory. The portfolio increased to 24 projects with net commitments and undisbursed balance rising to about US$1.5 billion and US$857 million, respectively. As before, only one project is currently rated unsatisfactory. The disbursement ratio fell a little to 23.5 percent in FY02, but proactivity index remains at 100 percent. Colombia continues to surpass all of the key portfolio performance indicators included in the CAS and CAS-PR.

Proposed Bank's Assistance Program Through the Next CAS

A8. **Portfolio Performance**. At the presentation of the CAS-PR, it was recognized that the quality of the portfolio had improved substantially since the presentation of the CAS; this trend has continued. Portfolio performance in Colombia remains satisfactory. The portfolio currently contains 23 projects, with net commitments of about US$1.3 billion and an undisbursed balance of about US$663 million. Only one project is currently rated unsatisfactory. The disbursement ratio was 24.6 percent in FY01, up from 20.2 percent in FY95. The proactivity index is 100 percent. Colombia has surpassed all of the key portfolio performance indicators included in the CAS and CAS-PR[5].

A9. **Country Procurement Assessment Report** (CPAR). A CPAR was completed in March 2001. Its findings will be broadly discussed and its recommendations incorporated into the next CAS. The report found that for Bank-assisted projects procurement is carried out in accordance with Bank policies and procedures, and procurement performance under those projects is generally satisfactory and free of major problems. Two procurement audits and four agency procurement capacity assessments carried out in the last two years have found no major problems and determined that the procurement risk in Bank projects is lower than average. However, the CPAR found that public procurement and contract management had deficiencies that had the potential to result in inefficient use of public funds and could be a source of corruption. The findings and recommendations of the CPAR to strengthen public procurement were discussed with the Colombian authorities. Following recommendations of the CPAR, the government is implementing with its own resources a Public Procurement Project. In addition, the second Public Financial Management Project (PFMP), approved by the Bank Board on March 22, 2001 includes a component to strengthen public procurement.

A10. **Country Financial Accountability Assessment** (CFAA). A CFAA was carried out in September 1998. As a result of the recommendations in the 1998 CFAA report, the Office of the Accountant General and public accounting institutions have been strengthened. These efforts have been supported by recently completed sector work on corruption and by the Bank-financed PFMP I and II. These projects have supported the government's measures to strengthen institutional capacity and analysis in a number of key areas of public expenditure: macro-programming, formulation and monitoring of the budget, budget execution, including the development and implementation of an Integrated Financial Management System (SIIF), and evaluation of results of public expenditure, including the implementation of the National System for Evaluation of Results of Public Sector Performance (SINERGIA). Despite important progress in public expenditure management, further strengthening of financial management processes is needed. These weaknesses include (a) divergence between budgeted expenditures and the government's strategic development priorities; (b) lack of clarity regarding the roles and reporting requirements of government institutions; and (c) the need to enhance public sector transparency and accountability by improving the dissemination of the objectives, performance evaluations and budgetary results of public entities. The on-going PFMP II is supporting reforms in these areas. The next CFAA will be completed prior to the CAS and will have a special focus on sub-national finances. Its recommendations will be incorporated into the strategy and program of the next CAS.

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[5] At the time of writing this SECAL, Colombia continues to meet the performance targets under the IMF program. Three program reviews have now been successfully completed; the fourth and final review is scheduled for September 2002. Most performance indicators are expected to be met, although the target for the fiscal deficit is likely to be affected by the weakness of the economy, combined with external variables such as low commodity prices and deteriorating conditions affecting trade. The targeted fiscal deficit for the combined public sector is 2.3 percent of GDP. After taking into account government plans to increase security-related outlays by 0.3 percent of GDP, the resulting deficit agreed to under the IMF program is currently 2.6 percent of GDP for 2002.

Proposed Bank Lending and Analytical Program Through FY02

A11.**Lending Program for FY02**. As mentioned above, the CAS-PR moved the assistance strategy to a high-case lending program, including adjustment lending, to around US$450 million for the lending program of FY98-01. Including FY02, the proposed lending program would total about 2 billion and average about US$400 million per year. In FY98 and FY99, we committed US$132 million and US$142 million, respectively. In FY00, six operations were approved for a total of US$935 million (including the US$500 million Financial Sector Adjustment Loan and the exceptional US$225 million Earthquake Recovery Loan). In FY01 we committed US$185 million. In FY02, we expect to present six operations, including the SFAL currently under consideration and the Social Sector Adjustment Loan (for an amount of about US$150 million). This would bring our proposed FY02 program to about US$630 million. With the exception of the SFAL, all of the operations that we propose for FY02 were specifically included in the CAS-PR. Although a fiscal adjustment operation was not explicitly envisioned in the CAS-PR, the strategy clearly identified the need to support Colombia's program of fiscal and other structural reforms.

A12.The Bank's FY02 program supports the short-term and longer-term efforts of the Government of Colombia to protect and promote the welfare of the poor through a series of interrelated lending operations, as well as analytical work.

- **Magdalena Medio II**. The Bank has supported this program through a recently completed LIL (Magdalena Medio Regional Development Project) and will continue its support through a second LIL approved in September, 2001. The first project was very effective in creating a longer term vision of a better future for the poor in this region in the midst of conflict. It aims to strengthen human and social capital, and start a community-led process of improving basic services and investment. The second project will gradually shifting the focus of decision-making and leadership of the program to local and regional actors, with communities playing a lead role.

- **Water Sector Reform Assistance Project**. The Bank approved a $40 million project in October, 2001 to support Colombia's initiative to reform municipal water utilities in underserved rural and urban areas in the country's Caribbean coastal region. The project will provide technical assistance to guide municipal leaders as they incorporate the private sector in the management and operations of their water utilities and expand water and sewerage services to more people, especially the poor.

- **Productive Partnership Project**. This project aims to establish a successful program of productive partnerships between agribusiness and small farmer producer organizations. It will do so by providing an integrated package of incentives and assistance for the development and implementation of demand-driven, sustainable subprojects that generate income and employment opportunities for rural communities. The project would contribute to (i) reactivating the rural economy; (ii) improving the welfare of poor rural inhabitants; and (iii) generating an enabling environment for the peace process in the country.

- **Judicial Reform**. This project constitutes the first phase of a long-term initiative to improve judicial conflict resolution services in the civil, labor and family law jurisdictions. The proposed project is expected to have three key impacts (i) improvement of the judiciary's social legitimacy and ability to respond to society's justice needs; (ii) increased incentives for the resolution of labor, family and civil conflicts through peaceful means, thus improving the prevalence of the rule of law and peaceful coexistence; and (iii) more effective enforcement of contracts at lower cost.

- **Structural Fiscal Adjustment Loan** (SFAL). The proposed SFAL would support Colombia's efforts to achieve macroeconomic stability and consolidate growth by undertaking structural reforms that would put the country's fiscal accounts on a sustainable path. The Bank's strategy would assist the government to (i) ensure that the fiscal decentralization process is economically sustainable through the reform of intergovernmental fiscal relations, including transfers, and the imposition of hard budget constraints on subnational governments; (ii) rationalize central government expenditures to sustain fiscal discipline; and (iii) support structural reforms in sectors where both national and subnational governments share responsibilities, including education, health and pensions. The SFAL will ensure that within the fiscal strengthening program, public resource allocations to social programs are protected, particularly those for health and education. By consolidating growth and fiscal sustainability, it will support poverty reduction. History has shown that Colombia has enjoyed significant declines in poverty during periods of positive growth and fiscal balance. For example, from 1988 to 1995, as average GDP grew at rates of about 3.5 percent annually and poverty rates declined from about 65 to 60 percent of the population. Furthermore, by protecting macro-economic stability and reducing the likelihood of fiscal crises at the national and subnational levels, the SFAL will help to prevent the social and political instability that negative macro-economic shocks could engender.

- **Social Sector Adjustment Loan** (SSAL). In order to alleviate the impact of the economic crisis on the poor, the government asked the Bank and the IDB to support programs targeted to segments of the population most impacted by the crisis. In this context, the Bank is currently financing the Community Works and Employment project which provides temporary employment to poor unemployed workers in urban areas through small community projects. The Bank is also financing the Human Capital Protection project that funds a conditional cash transfer program to protect children's health, education, and nutrition. To ensure that the impact on poverty and the sustainability of the government's interventions in this area are maximized, the government has asked the Bank to prepare a Social Sector Adjustment Loan to support structural reforms needed in the social sectors. The project would assist Colombia in establishing a social protection system that reacts quickly in response to economic crises and that is better targeted, more transparent and properly evaluated. The project would also assist in the reform of labor regulations that have hindered the employment of the poor, particularly young, female and self-employed workers.

A13.**Key Analytical Work for FY02**. To support the proposed program the Bank is undertaking the following analytical work:

- The *Colombia Policy Notes* will summarize the major challenges in Colombia's social-economic development and will serve as a bridge to the new administration. It will include thematic notes on peace, growth, governance, natural resource management and poverty and inequality. It addition, it will summarize essential sector issues for development in about 33 areas.

- The *Colombia Poverty Report* assesses and reviews (i) the evolution of poverty and inequality in urban and rural areas over the past two decades; (ii) the incidence of crime and violence and related household responses; and (iii) selected aspects of public assistance, including an overview of public social expenditures and a specific review of the subsidized health insurance system.

- The *Social Safety Net Assessment* evaluates reforms to Colombia's social safety net, both for addressing the needs of vulnerable groups during normal times and for developing a counter-cyclical strategy that could be implemented rapidly during future crises. The study (i) assesses vulnerability and risk management in Colombia; (ii) evaluates how the three new emergency *Red de Apoyo Social* safety net programs fit into the broader social safety net over the long-term; (iii) assesses the efficiency, effectiveness and gaps in Colombia's existing social assistance programs; and (iv) proposes technical, program and policy reforms aimed at improving the social safety net.

Risks and Opportunities of the Proposed Program

A14.There are serious risks associated with the proposed program. If security conditions were to significantly deteriorate, implementation of the Bank program would be negatively affected. In addition, the current broad-based support for the reform process could weaken, particularly during the upcoming national elections. However, President *Pastrana* has expressed his commitment to use the final year of his current administration to support the implementation of vital reforms. Moreover, the program has been discussed with the main political parties (which would like to have painful but necessary reforms out of the way before they take office), helping to increase its viability and continuity beyond this administration. There are also several external risks that have been augmented by the events of September 11, namely a further deterioration in the terms of trade and closure of access to international markets. However, the implementation of the fiscal reform program will mitigate these risks by sending positive signals to the market that Colombia is committed to maintaining sound economic management.

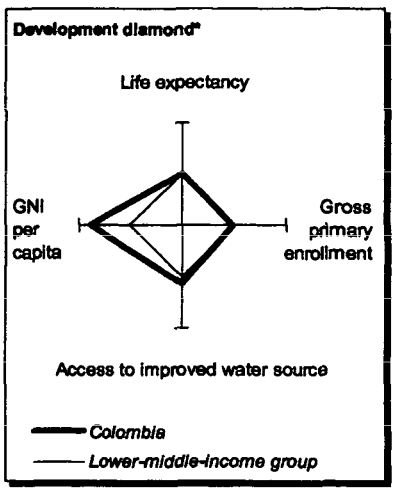
A15.The risks of not proceeding with the program are even higher. First, the possibility of a deterioration in the fiscal situation and growing fiscal deficits, jeopardizing macro-economic stability and growth prospects, which could in turn lead to deepening political and social conflict in Colombia. Second, a missed opportunity to alleviate the impact of economic crises on the most vulnerable citizens and to ensure that key social services are targeted to the poor and delivered efficiently and effectively.

A16.Although this is a high-risk program, its returns could be substantial. Present political and economic circumstances in Colombia, as well as recent performance of the Bank portfolio, do not warrant any significant departure from the strategy outlined in the CAS and reaffirmed in the CAS-PR. Indeed, they confirm the need to focus urgent attention on several important aspects, such as promoting key social and fiscal structural reforms. Under these circumstances, it is management's view that there is no reason to deviate from the high-case scenario for Bank lending at the rate of approximately $450 million per year.

Colombia at a glance

9/7/01

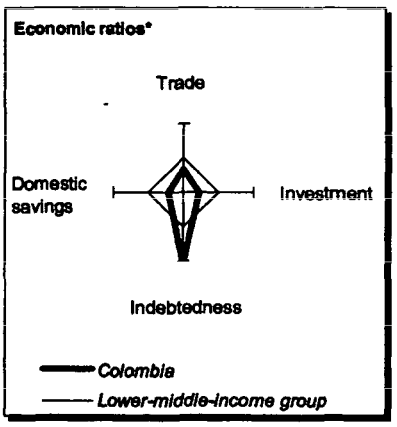
POVERTY and SOCIAL	Colombia	Latin America & Carib.	Lower-middle-income
2000			
Population, mid-year *(millions)*	42.3	516	2,046
GNI per capita *(Atlas method, US$)*	2,020	3,680	1,140
GNI *(Atlas method, US$ billions)*	85.3	1,895	2,327
Average annual growth, 1994-00			
Population *(%)*	1.9	1.6	1.0
Labor force *(%)*	2.7	2.3	1.3
Most recent estimate (latest year available, 1994-00)			
Poverty *(% of population below national poverty line)*	55	..	..
Urban population *(% of total population)*	74	75	42
Life expectancy at birth *(years)*	70	70	69
Infant mortality *(per 1,000 live births)*	23	30	32
Child malnutrition *(% of children under 5)*	8	9	11
Access to an improved water source *(% of population)*	91	85	80
Illiteracy *(% of population age 15+)*	8	12	15
Gross primary enrollment *(% of school-age population)*	113	113	114
Male	113	..	116
Female	112	..	114



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

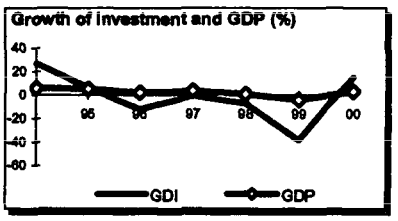
	1980	1990	1999	2000
GDP *(US$ billions)*	33.4	40.3	84.8	81.3
Gross domestic investment/GDP	19.1	18.5	12.5	12.2
Exports of goods and services/GDP	16.2	20.6	18.6	21.9
Gross domestic savings/GDP	19.7	24.2	12.5	13.7
Gross national savings/GDP	19.6	21.6	10.5	11.9
Current account balance/GDP	0.3	1.3	-0.2	-0.2
Interest payments/GDP	0.9	3.9	2.8	2.5
Total debt/GDP	20.8	42.8	40.7	44.3
Total debt service/exports	15.1	40.9	43.5	47.9
Present value of debt/GDP	..	..	39.7	..
Present value of debt/exports	..	..	221.8	..

	1980-90	1990-00	1999	2000	2000-04
(average annual growth)					
GDP	3.6	3.0	-4.1	2.8	4.7
GDP per capita	1.5	1.1	-5.7	1.0	2.9
Exports of goods and services	7.5	5.3	4.7	5.3	4.4

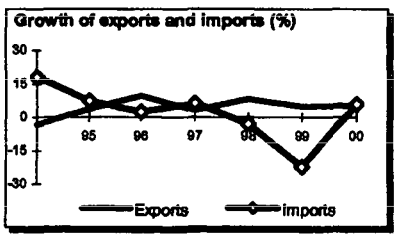


STRUCTURE of the ECONOMY

	1980	1990	1999	2000
(% of GDP)				
Agriculture	19.9	16.7	13.8	13.8
Industry	32.5	37.9	28.1	30.5
Manufacturing	23.9	20.6	13.7	13.8
Services	47.6	45.4	58.1	55.7
Private consumption	70.2	66.4	64.4	68.1
General government consumption	10.1	9.4	23.1	18.2
Imports of goods and services	15.6	14.8	18.6	20.4



	1980-90	1990-00	1999	2000
(average annual growth)				
Agriculture	2.9	-2.2	0.2	5.2
Industry	5.0	1.7	-9.0	3.8
Manufacturing	3.5	-2.3	-10.2	9.3
Services	3.1	4.3	-1.1	1.9
Private consumption	2.6	2.6	-4.5	6.5
General government consumption	4.2	9.5	3.9	-14.5
Gross domestic investment	1.4	2.1	-39.3	15.2
Imports of goods and services	0.4	9.4	-22.3	5.8



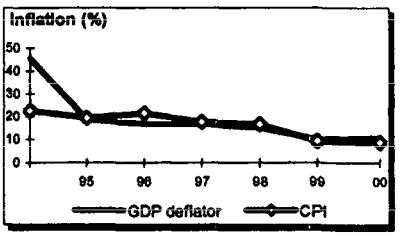
Note: 2000 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Colombia

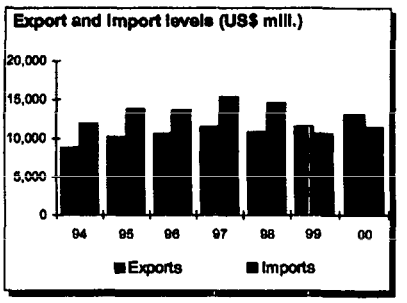
PRICES and GOVERNMENT FINANCE

	1980	1990	1999	2000
Domestic prices				
(% change)				
Consumer prices	26.4	32.4	9.2	8.8
Implicit GDP deflator	27.6	28.6	10.2	10.7
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	15.8	12.7	12.1
Current budget balance	..	6.8	-4.9	-5.3
Overall surplus/deficit	..	3.9	-7.5	-6.1



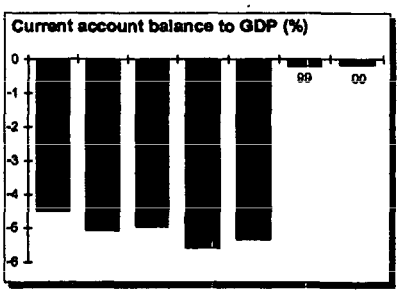
TRADE

	1980	1990	1999	2000
(US$ millions)				
Total exports (fob)	4,255	7,139	11,569	13,115
Coffee	2,361	1,415	1,324	1,069
Petroleum	101	1,951	3,757	4,569
Manufactures	973	1,759	3,947	5,190
Total imports (cif)	4,663	5,589	10,659	11,538
Food	296	245	1,426	1,428
Fuel and energy	564	330	252	234
Capital goods	1,616	2,034	3,651	3,414
Export price index *(1995=100)*	7	61	194	243
Import price index *(1995=100)*	5	56	161	201
Terms of trade *(1995=100)*	126	110	121	121



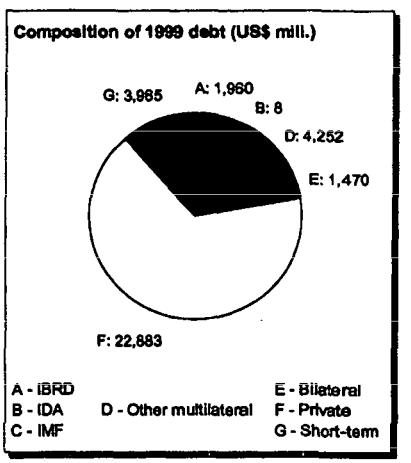
BALANCE of PAYMENTS

	1980	1990	1999	2000
(US$ millions)				
Exports of goods and services	5,747	8,687	13,866	15,608
Imports of goods and services	5,597	7,089	13,408	14,301
Resource balance	150	1,597	457	1,307
Net income	-211	-2,080	-1,422	-2,429
Net current transfers	166	1,026	785	990
Current account balance	105	544	-180	-132
Financing items (net)	-430	53	502	-737
Changes in net reserves	325	-597	-322	869
Memo:				
Reserves including gold *(US$ millions)*	..	..	8,103	9,006
Conversion rate *(DEC, local/US$)*	47.3	502.3	1,756.6	2,087.6



EXTERNAL DEBT and RESOURCE FLOWS

	1980	1990	1999	2000
(US$ millions)				
Total debt outstanding and disbursed	6,940	17,222	34,538	35,968
IBRD	991	3,859	1,960	1,920
IDA	21	15	8	7
Total debt service	951	3,889	6,611	7,888
IBRD	144	751	390	370
IDA	0	1	1	1
Composition of net resource flows				
Official grants	8	35	103	..
Official creditors	280	-40	970	275
Private creditors	531	-155	2,502	-415
Foreign direct investment	157	500	1,109	2,247
Portfolio equity	0	0	25	17
World Bank program				
Commitments	351	536	591	350
Disbursements	218	213	511	265
Principal repayments	66	435	271	244
Net flows	152	-221	241	21
Interest payments	79	318	121	127
Net transfers	73	-539	120	-105



Annex A2. Key Economic & Program Indicators—Change from Last CAS

As Of Date 11/12/2001

	Forecast in Last CAS				*Actual*		*Current Forecast*			
Economy (CY)	*1997[a]*	*1998[b]*	*1999[b]*	*2000[b]*	*1999[c]*	*2000[c]*	*2001[b]*	*2002[b]*	*2003[b]*	*2004[b]*
Growth rates (%)										
GDP	2.4	4.2	4.0	3.2	-4.3	2.8	2.0	2.5	3.0	3.5
Exports	4.7	12.4	10.6	1.1	7.2	3.0	2.9	0	4.7	3.3
Imports	5.9	3.0	4.2	1.7	-25.4	8.0	12.2	3.5	3.8	8.2
Inflation (%)	18.5	18.0	17.0	16.0	9.2	8.8	8.0	6.0	4.0	4.0
National accounts (% GDP)										
Current account balance	-4.8	-4.2	-3.7	-4.1	-0.2	-0.2	-2.7	-2.6	-2.9	-2.8
Gross investment	20.5	19.6	18.8	19.2	13.9	14.5	14.0	16.5	18.3	19.1
Public finance (% GDP)										
Central Administration balance	-3.6	-2.4	-1.7	-1.4	-6.7	-5.9	-4.0	-3.9	-3.7	-2.8
International reserves (as months of imports)	6.1	5.2	4.7	4.4	6.8	6.9	6.6	6.8	6.8	7.1
Program (Bank's FY)	FY97[a]	FY98[b]	FY99[b]	FY00[b]	FY99[c]	FY00[c]	FY01[a]	FY02[b]	FY03[b]	FY04[b]
Lending ($ million)		345.0	375.0	550.0	140	930	190	630	665	
Gross disbursements ($ million)		265.0	372.0	404.0	238	471	183	490	450	

a. Estimated year
b. Projected year
c. Actual outcome

Annex A3
Selected Indicators* of Bank Portfolio Performance and Management
As Of Date 11/12/2001

Indicator	1999	2000	2001	2002
Portfolio Assessment				
Number of Projects Under Implementation *a*	20	26	22	23
Average Implementation Period (years) *b*	3.3	3.4	3.2	3.1
Percent of Problem Projects by Number *a, c*	0	7.7	4.5	4.3
Percent of Problem Projects by Amount *a, c*	0	6.9	5.5	5.7
Percent of Projects at Risk by Number *a, d*	0	7.7	4.5	4.3
Percent of Projects at Risk by Amount *a, d*	0	6.9	5.5	5.7
Disbursement Ratio (%) *e*	33.3	36.6	24.6	6.5
Portfolio Management				
CPPR during the year (yes/no)	YES	YES	NO	YES
Supervision Resources (total US$)	1,033	1,245	1,240	1,594
Average Supervision (US$/project)	51.65	47.88	59.04	83.89

Memorandum Item	Since FY 80	Last Five FYs
Proj Eval by OED by Number	86	7
Proj Eval by OED by Amt (US$ millions)	6176	698.1
% of OED Projects Rated U or HU by Number	25.9	28.6
% of OED Projects Rated U or HU by Amt	23.7	20

a. As shown in the Annual Report on Portfolio Performance (except for current FY).
b. Average age of projects in the Bank's country portfolio.
c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
d. As defined under the Portfolio Improvement Program.
e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: Investment projects only.

* All indicators are for projects active in the Portfolio, with the exception of Disbursement Ratio, which includes all active projects as well as projects which exited during the fiscal year.

Annex A4. IBRD/IDA Program Summary

As Of Date 11/12/2001

Proposed IBRD/IDA Base-Case Lending Program [a]

Fiscal year	*Proj ID*	*US$(M)*	*Strategic Rewards* [b] *(H/M/L)*	*Implementation* [b] *Risks (H/M/L)*
2002	Magdalena Medio II	5.0	H	H
	Water Sector Reform Assistance Project	40.0	H	M
	Judicial Reform	5.0	H	H
	Structural Fiscal Adjustment Loan	400.0	H	H
	Social Sector Adjustment	150.0	H	H
	Productive Partnerships	31.5	M	M
2003	Agricultural Technology Development	35.0	M	M
	Labor/Tax SAL	400.0	H	H
	Higher Education Financing Reform	150.0	H	H
	Colombia-Bogota Urban Services	80.0	M	M

a. This table presents the proposed program for the next three fiscal years.

b. For each project, indicate whether the strategic rewards and implementation risks are expected to be high (H), moderate (M), or Low (L).

Annex A5. IFC & MIGA Program Summary

FY 1999-2002

	1999	2000	2001	2002
IFC approvals (US$m)	55.10	21.60	176.38	
Sector (%)				
COLLECTIVE INV VEHICLE			11	
FINANCE & INSURANCE	65		79	
NONMETALLIC MINERAL			10	
OIL, GAS AND MINING	35			
Total	100	0	100	0
Investment instrument(%)				
Loans	45		4	
Equity	9		33	
Quasi-Equity	45		6	
Other			57	
Total	99	0	100	0
MIGA guarantees (US$m)	155.42	155.42	0.00	

Annex A6. Summary of Nonlending Services

As Of Date 11/12/2001

Product	*Completion FY*	*Cost (US$000)*	*Audience*[a]	*Objective*[b]
Social Sector CEM	FY02	87.5	G, B	KG, PD
Agro-Ecology	FY02	60.0	G, B	KG, PS
Improv Pub Expend EF	FY02	45.0	G, B	KG, PS
Colombia Rural Finance	FY02	100.0	G, B	KG, PD, PS
Poverty Selected Topics	FY02	100.0	G, B, PD	KG, PD, PS
Social Sector Review	FY02	150.0	G, B, PD	KG, PD, PS
Environment, Land & Poverty	FY02	120.0	G, B	KG, PS
Policy Notes	FY02	100.0	G, B	PD
Labor Reform Agenda	FY03	80.0	G, B, PD	KG

a. Government, donor, Bank, public dissemination.

b. Knowledge generation, public debate, problem-solving.

Annex A7. Colombia Social Indicators

	Latest single year			Same region/income group	
	1970-75	1980-85	1994-00	Latin America & Carib.	Lower-middle income
POPULATION					
Total population, mid-year *(millions)*	25.4	31.7	42.2	515.6	2,046.0
Growth rate *(% annual average for period)*		2.1	1.8	1.8	1.0
Urban population *(% of population)*	60.7	67.0	74.9	75.3	42.4
Total fertility rate *(births per woman)*				2.6	2.1
POVERTY					
(% of population)					
National headcount index			21.0		
Urban headcount index					
Rural headcount index					
INCOME					
GNI per capita *(US$)*	560	1,150	2,460	3,680	1,140
Consumer price index *(1995=100)*	1	11	215	152	149
Food price index *(1995=100)*					
INCOME/CONSUMPTION DISTRIBUTION					
Gini index					
Lowest quintile *(% of income or consumption)*			3.1		
Highest quintile *(% of income or consumption)*			61.5		
SOCIAL INDICATORS					
Public expenditure					
Health *(% of GDP)*				3.4	2.7
Education *(% of GNI)*				3.5	4.7
Social security and welfare *(% of GDP)*				7.4	
Net primary school enrollment rate					
(% of age group)					
Total				91	99
Male					100
Female					99
Access to an improved water source					
(% of population)					
Total	64	91	75	85	80
Urban	86	100	90	93	95
Rural	33	78	32	62	69
Immunization rate					
(% under 12 months)					
Measles				90	87
DPT				87	87
Child malnutrition *(% under 5 years)*		17	8	9	11
Life expectancy at birth					
(years)					
Total	62	67	70	70	69
Male				67	67
Female				73	72
Mortality					
Infant *(per thousand live births)*	62	37	24	30	32
Under 5 *(per thousand live births)*				38	40
Adult (15-59)					
Male *(per 1,000 population)*				207	192
Female *(per 1,000 population)*				122	133
Maternal *(per 100,000 live births)*					
Births attended by skilled health staff *(%)*					

10/05/01

Note: 0 or 0.0 means zero or less than half the unit shown. Net enrollment ratios exceeding 100 indicate discrepancies between the estimates of school-age population and reported enrollment data.

Annex A8. Key Economic Indicators

Indicator	Actual 1997	1998	1999	Estimate 2000	2001	2002	Projected 2003	2004
National accounts s % GDP at current market prices)								
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture[a]	13.7	14.2	13.8	13.8	16.0	15.9	15.9	15.8
Industry[a]	29.4	28.3	28.1	30.5	28.3	28.9	29.1	29.2
Services[a]	56.9	57.5	58.1	55.7	55.7	55.2	55.0	55.0
Total Consumption	85.0	86.2	87.5	86.3	85.4	85.5	85.8	86.0
Gross domestic fixed investment	21.3	19.6	13.9	14.5	14.0	16.5	18.3	19.1
Public investment	..	8.0	8.7	7.5	7.0	8.2	8.3	8.3
Private investment	..	11.6	5.2	7.0	7.0	8.3	10.0	10.8
Exports (GNFS)[b]	14.8	15.1	18.6	21.9	18.9	19.9	19.2	18.7
Imports (GNFS)	20.8	21.0	18.6	20.4	20.8	20.8	20.6	19.7
Gross domestic savings	15.0	13.8	12.5	13.7	14.6	14.5	14.2	14.0
Gross national savings[c]	15.6	14.2	13.4	14.9	15.0	15.5	15.4	15.2
Memorandum items								
Gross domestic product (US$ million at current prices)	106719	98806	84845	81290	82285	85151	89150	94697
Gross national product per capita (US$, Atlas method)	3450.0	2600.0	2200.0	2020.0	1870.0	1900.0	1960.0	2030.0
Real annual growth rates (%, calculated from 1994 prices)								
Gross domestic product at market prices	3.4	0.6	-4.3	2.8	2.0	2.5	3.0	3.5
Gross Domestic Income	3.6	-1.1	-3.8	4.2	1.8	3.9	2.6	4.2
Real annual per capita growth rates (%, calculated from 1994 prices)								
Gross domestic product at market prices	1.5	-1.3	-5.7	1.0	0.3	0.9	1.4	1.2
Total consumption	3.3	-1.7	-4.2	-0.8	2.6	0.4	0.4	0.3
Private consumption	0.5	-2.7	-6.2	4.6	3.4	0.5	0.3	0.4

Key Economic Indicators

Indicator	Actual 1997	1998	1999	Estimate 2000	2001	2002	Projected 2003	2004
Balance of Payments (US$m)								
Exports (GNFS)[b]	14195.0	13560.0	13865.5	15608.0	15511.8	16204.2	16473.6	17255.4
Merchandise FOB	11529.3	10944.3	11556.1	13619.7	13722.3	13520.0	13655.2	13928.3
Imports (GNFS)[b]	18410.9	17539.5	13408.3	14301.4	16515.5	16978.1	17657.2	18112.3
Merchandise FOB	14371.4	13691.9	9899.5	11076.9	12162.4	12537.9	13039.5	13561.0
Resource Balance	-4216.0	-3979.5	457.2	1306.6	-1003.7	-773.9	-1183.6	-856.9
Net current transfers (including official current transfers)	613.6	444.0	785.4	989.8	382.2	887.9	1056.6	1105.0
Current account balance (after official capital grants)	-5952.9	-5270.3	-179.8	-132.4	-2665.0	-2524.0	-2514.0	-2602.0
Net private foreign direct investment	4829.6	2432.5	1011.6	1181	1218	1233	1798	1810
Long-term loans (net)	2199.8	932.1	504.7	-294.0	607.0	1383.0	986.0	1386.3
Official	-452.1	103.6	969.5	274.6	-73.5	-618.7	-928.3	-589.0
Change in reserves[d]	277.4	-1390.1	-321.8	869.0	296.0	278.0	234.0	310.0
Memorandum items								
Resource balance (% of GDP at current market prices)	-4.0	-4.0	0.5	1.6	-1.2	-0.9	-1.3	-0.9
Real annual growth rates (YR94 prices)								
Merchandise exports (FOB)	5.7	9.1	7.2	3.0	2.9	0.0	4.7	3.3
Primary	-3.7	3.2	24.3	-0.6	-0.6	-8.3	4.3	1.5
Manufactures	4.2	19.3	1.1	5.4	5.2	5.9	4.3	4.3
Merchandise imports (CIF)	-4.5	0.3	-25.4	8.0	12.2	3.5	3.8	8.2
Public finance (as % of GDP at current market prices)[e]								
Current revenues	12.6	11.9	12.7	13.2	14.9	14.7	14.1	14.0
Current expenditures	12.4	13.9	15.0	16.1	16.2	15.9	15.0	14.4

Key Economic Indicators

	Actual			Estimate			Projected	
Indicator	1997	1998	1999	2000	2001	2002	2003	2004
Current balance, surplus (+) or deficit (-)	0.2	-2.0	-2.3	-2.9	-1.3	-1.2	-0.9	-0.4
Monetary indicators								
M2/GDP (at current market prices)	36.0	34.4	36.0	33.1	34.7	34.9	35.3	35.5
Growth of M2 (%)	25.8	10.9	10.5	4.7	12.0	6.0	4.0	4.0
Private sector credit growth / total credit growth (%)	79.2	76.5	-49.2	20.1	66.2	78.0	110.7	195.3
Price indices(YR94 =100)								
Merchandise export price index	108.4	93.5	92.9	102.2	97.7	100.1	98.1	97.5
Merchandise import price index	86.0	81.5	79.6	115.9	78.8	81.6	83.0	84.8
Merchandise terms of trade index	126.1	114.7	116.6	88.2	124.0	125.7	122.3	126.5
Real exchange rate (US$/LCU)[f]	119.1	113.6	102.7	98.9	96.2	93.4	93.4	93.4
Consumer price index (% growth rate)	17.7%	16.7%	9.2%	8.8%	8.0%	6.0%	4.0%	4.0%
GDP deflator (% growth rate)	16.8%	15.2%	10.2%	10.7%	11.1%	7.5%	6.2%	5.7%

a. If GDP components are estimated at factor cost, a footnote indicating Data-YR' fact should be added.
b. "GNFS" denotes "goods and nonfactor services."
c. Includes net unrequited transfers excluding official capital grants.
d. Includes use of IMF resources.
e. Data refer to the Central Administration
f. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

Annex A9. Key Exposure Indicators

	Actual			Estimate		Projected		
	1997	1998	1999	2000	2001	2002	2003	2004
Total debt outstanding and disbursed (TDO) (US$m)[a]	31800	33338	34678	34081	35958	38403	41990	46307
Total debt service (TDS) (US$m)[a]	6960	6584	7117	7974	7947	8986	9112	10280
Debt and debt service indicators (%)								
TDO/XGS[b]	224.0	246.0	250.0	218.0	232.0	237.0	255.0	268.0
TDO/GDP	29.8	33.7	41.0	41.9	43.7	45.1	47.1	48.9
TDS/XGS	49.0	48.6	51.3	51.1	51.2	55.5	55.3	59.6
IBRD exposure indicators (%)								
IBRD DS/public DS	21.0	11.9	8.2	10.4	9.2	9.5	9.2	8.4
Preferred creditor DS/public DS (%)[c]	42.1	24.7	21.1	25.7	26.200	24.8	22.3	21.1
IBRD DS/XGS	4.0	2.6	2.8	2.4	2.3	2.3	2.4	2.2
IBRD TDO (US$m)	1723	1740	1961	1920	2090	2340	2350	2220
IDA TDO (US$m)	10	9	8	7	6	5	4	3

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

Annex A10. Operations Portfolio (IBRD/IDA and Grants)

As Of Date 11/12/2001

Closed Projects 141

IBRD/IDA *

Total Disbursed (Active)	616.50
of which has been repaid	35.16
Total Disbursed (Closed)	7,567.30
of which has been repaid	7,646.40
Total Disbursed (Active + Closed)	8,183.82
of which has been repaid	7,681.56
Total Undisbursed (Active)	678.56
Total Undisbursed (Closed)	0.00
Total Undisbursed (Active + Closed)	678.56

Active Projects

Project ID	Project Name	Last PSR Supervision Rating: Development Objectives	Last PSR Supervision Rating: Implementation Progress	Fiscal Year	Original Amount in US$ Millions: IBRD	Original Amount in US$ Millions: GRANT	Cancel.	Undisb.	Difference Between Expected and Actual Disbursements[a]: Orig.	Difference Between Expected and Actual Disbursements[a]: Frm Rev'd
P057692	2nd Magdalena Medio Project	#	#	2002	5			5		
P006880	AGRICULTURE TECHNOLO	S	HS	1995	51			11.8	11.8	-5.7
P044140	CARTAGENA WATER SUPPLY & SEWERAGE ENVIRO	S	S	2000	85			68.8	23.9	
P040109	CO PUBLIC FINANC. MANAGEMENT PROJECT II	S	S	2001	35.5			35.2	-0.2	
P006861	CO URBAN INFRASTRUCTURE	U	U	1998	75			57.3	29.5	
P006891	CO- ANTIOQUIA EDUCATION	S	S	1998	40			26	18.3	1.6
P068762	CO- COMMUNITY WORKS (MANOS A LA OBRA)	S	S	2000	100			96	28	
P069964	CO- Human Capital Prot.- Cash Transfers	S	S	2001	150			150	0	
P046112	CO- PASTO EDUCATION	S	S	1998	7.2			3.6	2.9	0.3
P050578	CO- RURAL EDUCATION	S	S	2000	20			18.8	4.2	
P050576	CO- YOUTH DEVELOPMENT	S	S	1999	5			3	3	
P063317	COLOMBIA HIGH ANDES	S	S	2001		15.4		14.7	0.7	
P065263	EARTHQUAKE RECOVERY	HS	HS	2000	225			104.2	55.9	
P006893	ENERGY TECHNICAL ASSISTANCE	S	S	1995	11			0.5	0.5	
P006884	FINANCIAL MARKETS DEVELOPMENT	S	S	1997	15		5.5	3.2	8.7	
P054125	ODS-PHASE OUT	S	S	1999		8.7		8.3	0	
P053243	PEASANT ENTERPRISE Z	S	S	1998	5			2.7	2.4	
P006887	POWER MARKET DEVELOPMENT & ENERGY (TA)	HS	S	1996	249.3			1	1	1
P040102	REG.REF.TA	HS	S	1997	12.5			5.3	5.3	
P006894	SANTAFE I (Water/Supply)	S	S	1996	145			39.9	39	
P057326	SIERRA NEVADA SUSTAINABLE DEVELOPMENT	S	S	2000	5			4.4	-0.6	
P039291	URBAN ENVIRONMENT TA	S	S	1996	20			1.9	1.9	-0.4
P065937	WATER SECTOR REFORM ASSISTANCE PROJECT	#	#	2002	40			40		
Overall result				Result	1301.5	24	5.5	701.5	236.1	-3.2

a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.

Annex A11. Statement of IFC's Held and Disbursed Portfolio

As of 7/31/2001
(In $US Millions)

		Held				Disbursed			
FY Approval	Company	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1969/85/88/93/95	CF del Valle	0	0	0	0	0	0	0	0
2001	CHMC	0	0.21	0	0	0	0.21	0	0
1974/01	Cementos Caribe	4.05	10	0	12.95	4.05	10	0	12.95
1963/90	Coltejer	6.02	0	0	0	6.02	0	0	0
1995/99	Corfinsura	25	0	25	0	0	0	25	0
1987	PRODESAL	0	0.59	0	0	0	0.59	0	0
1977/89/92/94/96	Promigas	6.25	0	0	12.5	6.25	0	0	12.5
1994/95	Promisan	0	0.2	0	0	0	0.2	0	0
1996	Proyectos	0	5	0	0	0	5	0	0
1997	Suleasing	9.1	0	0	0	3.8	0	0	0
1999	Surenting	0	5.1	0	0	0	2.5	0	0
2001	Tolcemento	3.33	0	0	10.67	0	0	0	0
	Total Portfolio:	53.75	21.1	25	36.12	20.12	18.5	25	25.45

Approvals Pending Commitment

	Loan	Equity	Quasi	Partic
2001 CHMC	100000	0	0	0
2001 CCGF	0	19000	0	0
Total Pending Commitment:	100000	19000	0	0

External Financing Requirements

In 2001, the government obtained its net deficit financing from both domestic and external sources. Domestic financing accounted for 40 percent of net financing, and external sources for about 60 percent. In gross terms, Colombia successfully placed about US$5 billion in international bonds to cover its privately provided financing for the year, including US$1 billion backed by a World Bank policy-based guarantee operation. Of this amount, US$1.9 billion represent pre-financing for 2002. The remainder of Colombia's gross financing needs, came from privatizations and multilateral institutions.

The government has a general strategy of decreasing its reliance on domestic financing, and this is expected to be maintained over the coming years in order to decrease the crowding out of the private sector and to set the stage for sustained investment and growth. Negative net domestic financing is envisioned from 2002 onward, with limited recourse to privatization.[6]

Projections of Colombia's external financing requirements and sources of finance are presented in Table B1. Total public and private sector gross external financing requirements are estimated at US$7.2 billion, US$7.8 billion, and US$8.4 billion for 2001, 2002, and 2003, respectively. These external financing requirements are expected to be financed largely through public and private debt from both multilateral and private sources, including bond placements. Net capital inflows are projected to increase slightly in 2002, as the public sector draws on its external portfolio built up in 2001. A positive net inflow of private capital is also projected, as direct investment would continue its moderate increase. Private direct investment is initially projected at a level of about US$2 billion. A small accumulation of reserves is forecast in the next three years, mostly as a result of interest income.

The public sector will continue a strategy of refinancing external public debt to improve its cost and maturity structure if international market conditions allow. Maintaining adequate access to longer-term financing as provided by the World Bank and other international financial organizations will continue to be essential for improving the structure of Colombia's external public debt.

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[6]. Domestic debt restructuring has already improved the government's domestic debt profile. In early June, 2001 the authorities swapped US$2.4 billion of domestic debt due in 2001–05 with paper of longer maturity. As a result of this swap, the average maturity of domestic debt increased from 3.5 to 4.5 years; projected domestic debt redemptions fell 22 percent in 2001, 34 percent in 2002, and 40 percent in 2003.

Table 3. Colombia: External Financing Requirements, 2000–03
(US$ Millions)

	2000	2001	2002	2003
Financing Requirements (1+2+3)	5,285	7162	7,799	8,400
1. Current Account Deficit	132	1709	2,524	2,514
2. External Debt Amortization	4,284	5,157	4,997	5,652
a. Public and Publicly Guaranteed	1,464	2,401	2,717	3,602
b. Private	2,820	2,756	2,280	2,050
3. Change in Reserves	869	296	278	234
Sources of Financing (5+6)	5,170	7162	7,799	8,400
5. External Debt	3,989	6,900	6,566	6,602
a. Public Sector	3,395	3,303	4,503	4,377
Multilateral and Bilateral	1,703	1,424	1,850	1,702
Gross Disbursements				
Private Creditors	1,692	1,879	2,653	2,675
b. Private Non-Guaranteed	594	2,044	2,063	2,225
6. Net Private Investment	1,181	1815	1,233	1,798

Source: World Bank Staff projections

Annex C

Presidential Letter of Commitment and GOC Request for Financial Assistance

Andrés Pastrana Arango
Presidente de la República de Colombia

Bogotá, D.C., 8 de agosto de 2001

Doctor
OLIVIER LAFOURCADE
Director Subregional
Colombia, México y Venezuela
Banco Mundial
Washington,D.C.,U.S.A.

Estimado doctor Lafourcade:

Recibí con agrado su comunicación en la que hace referencia a su reciente visita a Colombia en la que pudo conocer más de cerca la situación social y económica del país.

Para mí es verdaderamente gratificante recibir esta manifestación de apoyo de parte suya, mas aún cuando afirma que usted y su equipo pudieron apreciar en su visita el constante esfuerzo del Gobierno Nacional por mejorar la calidad de vida de los colombianos.

En su mensaje también hace alusión a las múltiples oportunidades que tuvo de hablar con personas que están verdaderamente agradecidas con este esfuerzo. Son esas personas las que nos animan para continuar con esta importante labor que, sin lugar a dudas, está contribuyendo eficientemente al desarrollo del país.

Andrés Pastrana Arango
Presidente de la República de Colombia

Le reitero nuevamente mi agradecimiento y le confirmo una vez más mi firme decisión de continuar con las reformas que se han iniciado, pues estamos logrando, como usted mismo pudo constatar, la transición de una sociedad castigada por la inequidad a una sociedad en vías de mejorar la distribución de su ingreso y de dar mejores oportunidades a su gente.

Reciba un cordial saludo,

Unofficial ENLISH TRANSLATION
Presidential Letter of Commitment and GOC Request for Financial Assistance

Bogota, August 8, 2001

Mr. Olivier Lafourcade
Country Director
Colombia Mexico and Venezuela Country Management Unit
World Bank
Washington DC, USA

Dear Dr. Lafourcade:

It was glad to receive your communication in which you make reference to your recent visit to Colombia, when you had the opportunity to familiarize yourself more closely with the social and economic situation of the country.

I is really gratifying for me to receive this manifestation of support from you, even more when you affirm that you and your team were able to appreciate in your visit the constant effort of the National Government to improve the quality of life of the Colombian people.

In your message, you also made reference to the multiple opportunities you had to talk to people who are truly grateful of this effort. These are the people who encourage us to continue with this important work that, without any doubt, is efficiently contributing to the country's development.

I reiterate my gratefulness and confirm once again my firm decision to continue with the reforms we have initiated, since we are achieving, as you could see for yourself, the transition from a society punished by inequity to a society on its way to improving its income distribution and providing better opportunities for its people.

Best regards,

Andres Pastrana Arango
President of the Republic of Colombia

Bogotá, D.C 22 ENE. 2002
DIFP-SC-03-007 - 2002

Señor
OLIVIER LAFOURCADE
BANCO MUNDIAL
Washington D.C.

Estimado Señor Lafourcade:

Como es de su conocimiento en la actualidad se está llevando a cabo la preparación de un crédito sectorial para la reforma social.

En el marco de esta operación, el Banco ha planteado varias inquietudes que podrían presentarse dentro del proceso de preparación, las cuales se relacionan principalmente con la justificación de la necesidad de financiamiento y las políticas que se plantean en la matriz.

Si bien es cierto que el Gobierno tomó la decisión de prefinanciar US$ 1900 millones del presupuesto del 2002 en los mercados de capitales externos, el Plan Financiero de 2002, que es el encargado de precisar el monto y la composición del financiamiento público dada una meta de déficit, estableció unas necesidades de US$ 2.439 millones de créditos externos. De este monto, US$ 1.939 millones deben provenir de créditos de destinación específica y libre destinación con la banca multilateral, de acuerdo con la distribución del siguiente cuadro:

Financiamiento Externo Banca Multilateral 2002		
Crédito	**Monto**	**Estado**
Sectorial de Reforma Fiscal Territorial -BID	US$ 200 millones	Firmado
Sectorial de Reforma Social-BID	US$ 215 millones	Firmado
Sectorial de Ajuste Fiscal-BIRF	US$ 220 millones	Firmado
Créditos con destinación específica	US$ 604 millones	Firmado
Préstamo Multisectorial –CAF	US$ 200 millones	Por presentar al Directorio
Crédito Sindicado con garantía parcial de la CAF hasta por el 30%	US$ 250 millones	Por presentar al Directorio
Sectorial de Reforma Social – BIRF	US$ 250 millones	En preparación
Total	US$ 1939 millones	

Teniendo en cuenta el cuadro anterior, el Gobierno Nacional requiere financiación por parte del Banco Mundial con el crédito de Reforma Social, con el fin de financiar sin sobresaltos las apropiaciones presupuestales del 2002.

Son varias las razones que justifican esta operación para el Gobierno de Colombia:

1. Para la Nación es importante contar con este crédito sectorial, considerando las ventajas financieras que ofrece sobre otro tipo de financiación como el mercado de bonos, tales como una mejor tasa de interés (Libor + 0.55%), mayor plazo de amortización (14 años) y período de gracia (5 a 9 años).

   De esta manera, si la Nación tuviera que salir al mercado de bonos, el costo del servicio de la deuda sería un 40% más elevado. Esto en términos presupuestales implica una reducción significativa anual en la inversión social flexible durante toda la vida del crédito, debido a que una mayor cantidad de recursos se destinarían a cubrir el servicio de la deuda. Lo anterior iría en contravía del espíritu del crédito de reforma social al restarle recursos al sector que busca fortalecer.

2. Existen riesgos asociados a la incertidumbre del entorno internacional y nacional. Por un lado, hay restricciones que se presentan en los mercados de capitales internacionales, tales como los temores sobre una recesión en las economías internacionales tras los ataques terroristas en Estados Unidos ocurridos el 11 de septiembre de 2001, y los efectos de la crisis argentina en los países latinoamericanos. Esto puede limitar el acceso a los mercados externos de capitales, e incrementar los costos en la emisión y colocación de bonos externos.

   Además de los factores externos, a nivel interno, hay dos fuentes de incertidumbre para este año. La primera tiene que ver con las elecciones presidenciales dado que en época electoral crece la incertidumbre sobre el desempeño económico futuro y por lo tanto el apetito por los papeles colombianos puede reducirse. La segunda se relaciona con el proceso de paz, el cual está atravesando uno de los momentos más cruciales de los últimos años.

Finalmente, en cuanto a las políticas que se plantean en la matriz, es necesario mencionar que, teniendo en cuenta la importancia de los ajustes en los arreglos institucionales y las reformas de carácter social, el Gobierno se compromete a cumplirlas cabalmente en los términos y plazos estipulados.

Por todo lo anterior, el Gobierno de Colombia reafirma su intención de continuar con esta operación, de acuerdo con los términos discutidos con los miembros de la misión, en las últimas dos visitas a Colombia.

Cordialmente,

TOMAS GONZALEZ ESTRADA
Subdirector DNP

CATALINA CRANE
Viceministro Técnico MHCP

GOVERNMENT OF COLOMBIA
LETTER OF DEVELOPMENT POLICY
(June 24, 2002)

República de Colombia
Ministerio de Hacienda y Crédito Público
Despacho del Ministro

Bogotá, Colombia
June 24th, 2002

Mr. James D. Wolfensohn
President
The World Bank Group

Dear Mr. Wolfensohn:

1. This letter summarizes the achievements that Colombia's social and economic program has secured over the past four years, outlines key issues that will be faced by the next administration, and highlights social sector reforms that should be addressed by the incoming administration that will take office in August 2002. The discussion provides a context for the proposed World Bank- financed Social Sector Adjustment Loan, underscoring how the measures proposed in the loan build upon existing reforms and are critical to maintaining progress in the social sectors. The policy measures proposed in the loan are also reflective of ongoing consultations and actions taken in coordination with line ministries, social sector program administrators and Congress. This concerted action provides a solid foundation for the policy reforms achieved and proposed, enhancing their long-term sustainability.

COLOMBIA'S ECONOMIC PROGRAM

2. The Government of Colombia has demonstrated a strong and continued commitment to prudent macroeconomic management and structural reform, underscoring our commitment to macroeconomic stability and the recovery of growth after Colombia suffered its largest recession in over 70 years in the period 1998-1999.

3. Economic conditions improved in 2000 with real GDP recovering from a drop of 4.2% in 1999 to a growth of 2.7% based on a renewed exports and some rebound in domestic demand; and with manufacturing outputs expanding by more than

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10%. Inflation ended the year at 8.7%, well under the 10% target and had declined to about 7.6% by December 2001. In 2001 economic growth slowed down to approximately 1.3%, reflecting the weakening of external and internal demand. The slower growth in external markets and the decline in commodity prices has affected coffee, oil and manufacturing exports. Colombia has also suffered supply shocks: Oil exports were disrupted by sabotage in the first half of the year and strikes affected economic activity. The unemployment rate has remained high, around 18%.

4. Despite these challenges, policy implementation under our economic program has progressed well – all quantitative performance criteria agreed with the IMF have been observed up to June 2001, and indicative criteria for September and December 2001 also appear to have been met. In addition, a number of significant reforms have been implemented under the government's reform agenda.

5. The government's reform agenda includes ambitious measures to increase economic efficiency, stimulate economic growth, and foster social progress. On the economic front, the reform agenda began with the floating of the peso in 1999. Other important reforms have included: the territorial fiscal adjustment reform (Law 617); the adoption of an inflation targeting framework for monetary policy; the restructuring of the financial sector; two revenue enhancing tax reforms; the establishment of funds to support territorial government pensions; privatization/liquidation of public enterprises and banks; and actions to deepen domestic financial markets and develop longer-term financial instruments for the private sector.

6. These reforms have allowed the fiscal deficit to be reduced by close to 50% since the onset of the recession and have laid a foundation for sustainable economic growth. This objective is fundamental to poverty reduction and the long-term improvement of living standards of the poor. The core of this strategy is set out in the December 1999 agreement reached with the IMF establishing a 2.7 billion dollar, three-year Extended Fund Facility. Under the agreement reached with the IMF, the government set new macroeconomic targets through 2002 that include declining inflation, a reduction of the current account and fiscal deficits and a resumption of growth.

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COLOMBIA'S SOCIAL PROGRAM

7. In addition to the progress achieved on the macroeconomic front outlined above, this government has also made considerable progress in the social sectors.

8. Education, health and social protection are key to improving economic competitiveness and growth, reducing poverty and inequity in income distribution, and in building a peaceful society. The Government of Colombia has prioritized these areas by focusing on: (i) increasing the quality of basic education and basic health; (ii) improving the efficiency and equity of resource distribution in education; (iii) increasing fairness of financial contribution and financial risk protection in health; and (iv) alleviating the impact of the current crisis on the most vulnerable and develop a better social protection system. Undoubtedly among the biggest successes of these policies are found in the relatively good quality of basic education as compared with other Latin American countries; in the increase in health insurance coverage, especially in rural areas; and the implementation of social assistance programs to mitigate the effect of the crisis.

9. In health and education, many of these achievements have been made possible through the enactment of key reforms that have had congressional backing. In mid-2001, Congress approved a Constitutional Reform (*Acto Legislativo*) changing the system of revenue transfers to territorial governments. These reforms now have a legal foundation in the recently approved Law 715 that introduces reforms to Law 60 .

10. In the area of education, these reforms seek for the creation of an institutional structure that would allow an effective increment of educational coverage with quality, through the establishment of clear definitions of the responsibilities between regional and municipal governments for providing education services; introduction of a more efficient and equitable enrollment-based education resource allocation system, replacing the former teacher-based allocation system; incorporation of performance indicators for learning; and establishment of limits on current spending.

11. In health, these reforms have allowed our government to initiate a restructuring of the public health system through the reorganization of the public hospitals and the cost adjustment to guarantee the financial viability of public hospitals and improve the productivity in health service delivery; the allocation of additional resources product of the real growth of the health transfers to new affiliation of poor people to health

insurance; and the restructuring of the Social Security Institute (ISS) which is facing a difficult financial position as a result of rapidly rising costs and stagnating revenues. The ISS restructuring includes renegotiation with the health workers union reducing wage and pension benefits; streamlining the operations of the ISS; restructuring ISS debt and achieving a more equitable distribution of the financial burden related to high-cost illnesses among health service providers. These reforms should allow the system to eliminate its deficit by 2005 and expand health insurance coverage.

12. In social protection, acknowledging the urgency of alleviating the social consequences of the economic crisis and fiscal adjustments, our government launched a temporary social assistance safety net called the *Red de Apoyo Social* (RAS) to cushion the impact of the crisis on the welfare of the poor and vulnerable population. The RAS complements the objectives and social policies established in the *National Development Plan* 1999-2002, which seeks economic and social changes that would promote the establishment of peace in Colombia. The RAS is also supported by the aforementioned IMF agreement which provides for public spending of an *additional* 0.3 percent of GDP per year (about US$250-$300 million annually), over and above current public social expenditures, to be targeted to the provision of social safety net programs during through 2004. Implementation of the RAS programs began in 2001 and the programs are expected to reach full capacity by the end of the year.

13. The RAS safety net is composed of three principal programs: (i) the *Empleo en Acción* community works program (formerly known as *Manos a la Obra*) which aims to provide temporary employment to poor, unemployed, low skilled workers by employing them in labor intensive social and economic investment projects such as school expansion and road repair; (ii) a conditional cash subsidy program for poor families, *Familias en Acción*, that provides cash assistance aimed at protecting investments in children's health, education and nutrition by providing cash conditional on keeping children in school and providing them with basic preventive health care; and (iii) *Jovenes en Acción*, a training/apprenticeship program for young adults based on competitive bidding among private firms and public entities. Colombia has committed itself to administering these programs for three years (2001-2004) and to review the results of the impact evaluations at the projects' conclusion to assess the desirability of their continuation as part of a broader safety net strategy.

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LOOKING TOWARD THE FUTURE – MACROECONOMIC PROSPECTS AND CHALLENGES

14. Looking ahead, Colombia's economic prospects look strong, despite internal and external risks. As discussed above, this government's successful restoration of macroeconomic stability in the wake of a profound recession has allowed Colombia to avoid falling into the same trap as Argentina. Nonetheless, significant challenges remain for the next administration in addressing a series of risks.

15. With regard to internal risks:

- Colombia's economic recovery remains fragile, although Colombia's economic performance in 2001 still remains higher than the Latin America average. Prospects for an acceleration of growth are hampered by weak domestic demand, high unemployment, and low rates of private investment.
- The recent collapse of peace negotiations with the FARC, the country's largest guerrilla group, and the return to open hostilities compounds the downside, particularly in terms of the investment climate and the impact on the fiscal program.
- Upcoming presidential elections in May add a further element of uncertainty regarding the new Administration's policies, both with respect to the economy and to the conflict.
- The Government, however, has remained committed to its adjustment and reform program despite difficult domestic conditions. The significant reduction of the fiscal deficit (by nearly 50 percent) since the onset of the recession and the passage of the bulk of its program of structural reforms are evidence of this, as described above. Nevertheless, a few important reforms, e.g., the pension system, fiscal responsibility and territorial tax reforms, have yet to be approved by Congress. Their approval process may be further delayed due to the impending elections. This Administration has also worked hard to build consensus and support for its reform package and for the fiscal adjustment efforts which will need to be consolidated by the new Government elected in May.

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16. On the external front:

- The main risk is posed by a further deterioration in the external macroeconomic environment led by a deeper slowdown or recession in the world economy. The most important transmission channels are (a) a further deterioration in the terms of trade, particularly resulting from continued unfavorable coffee prices and volatile oil prices; and (b) the closure of access to international financial markets due to crises in major markets and/or emerging market countries. In the event of (a), the government intends to continue its flexible exchange rate policy to encourage nontraditional exports and foreign direct investment. With regard to (b), the government has committed itself to sound fiscal management (as supported by the World Bank-financed Sectoral Fiscal Adjustment Loan and the IMF program) and retains access to financing from international financial institutions.

- More specifically, developments in the US economy, Colombia's main trading partner and the largest importer of Colombian goods, are particularly important, as are conditions in Venezuela, Colombia's second largest export market. The recent Venezuelan devaluation and political instability adds an element of uncertainty to the future path of exports to that country.

17. Future macroeconomic stability will depend on addressing the above internal and external issues as well as maintaining the current pillars of the macroeconomic program: (a) sound fiscal management, including the implementation of fiscal reforms; (b) an inflation-targeting monetary policy; and (c) a flexible foreign exchange regime. If this macro-economic policy mix is maintained, and given a stable economic environment, average real economic growth is projected for the medium term (2002-2003) at about 2.5-3 percent per year, and for the long-term (2004 and on) at about 3-3.5 percent annually, fueled mainly by investment expansion. As a result of the implementation of the forthcoming fiscal reforms and the continuation of sound macroeconomic management, Colombia's net total public debt would stabilize at about 50 percent of GDP by 2005. Inflation is projected to continue its downward trend, and to stabilize at about 4 percent in 2003 and beyond. Finally, the external current account deficit would reach about 2-3 percent of GDP, and gross international reserves are projected at about seven months of goods and services imports.

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FUTURE CHALLENGES AND PROPOSED ACTIONS – SOCIAL SECTORS

18. Several challenges will need to be addressed by the next administration to ensure continued progress in the social sectors.

19. **The Quest for Peace.** The main challenge facing the incoming administration will be to address the internal conflict that has ravaged Colombia for the past 40 years, but has acquired new proportions through financing from the illegal drug trade which has been adopted by Colombia's main guerilla groups as their primary source of funding. About 40,000 people have died in clashes during the last decade alone. After three years of concerted attempts to negotiate a peace with the FARC and the ELN, Colombia's main armed guerilla groups, the peace process was suspended in February 2002 and replaced by a strategy that forcefully upholds the rule of law. Colombia will continue to need the assistance of the international community to fight terrorism and to address the socio-economic determinants of violence in order to construct the underpinnings for peace and development. These needs are particularly acute in light of the attacks of September 11, 2001 and the regional instability.

20. **Enhancing Good Governance through Improved Accountability and Transparency.** Through the establishment of the National System for Evaluation of Results of Public Sector Performance (SINERGIA) Colombia has established an excellent base for monitoring public sector performance. This base needs to be expanded by ensuring that selected impact evaluations of key programs are carried out to complement the monitoring data; by engaging Colombia citizens oversight of public sector performance through active dissemination of the data and consultations with civil society; and through the application of the data to operationalize performance-based management through the implementation of the recently-signed efficiency agreements linking program funding to specific outputs.

21. **Improving the Efficiency and Effectiveness of the Social Safety Net.** The advances made over the past four years in reforming the social safety net, namely by launching the RAS programs as a counter-cyclical response to the recent recession, need to be consolidated over the next four years. Four main challenges will face the incoming administration.

22. *Establishing a counter-cyclical safety net.* Over the past 50 years, social assistance has shown the strongest pro-cyclical spending patterns of the various

components of social sector expenditures. In the face of the recent recession, we made considerable advances in building a base for counter-cyclical safety net response through the establishment of the *Red de Apoyo Social*. Nonetheless, this remains a temporary program. Looking ahead to the need to respond counter-cyclically to future crises, Colombia needs to improve the state of readiness of its social protection system, both respect to its ability to respond quickly to vulnerable groups and in terms of ensuring adequate financing for safety net programs that have traditionally suffered from pro-cyclical funding. In this sense, the Government has created the Social Risk Management System (SSR) which seeks for an articulated and flexible supply of social programs provided by the State and the strengthening of its capacity to prevent, mitigate and overcome risks resultant from economic crisis.

23. *Institutional reform to address rigidities, coverage gaps, and overlapping mandates*: After years of relative neglect, the overall social protection system needs reform to better address the needs of the chronically poor and vulnerable during normal times. The relative emphasis on children under 18 years of age implied by the dominance of social assistance budget by the Colombian Institute for Family Welfare remains an appropriate focus given the vulnerabilities of this specific age group and the use of household labor as a social risk management strategy in Colombia. Although ICBF has began a descentralization process to make more flexible its programs according to regional circumstances, still it is constrained by poor monitoring and evaluation systems. An overall reform of the social safety net should be planned under the next administration to address these issues related to existing programs, as well as to decide how the new RAS programs should be incorporated into the overall safety net.

24. *Addressing the special needs of the Internally Displaced Population*. The legal and programmatic foundation for addressing the needs of the Internally Displaced Population as embodied in Law 387 and the activities of the *Red de Solidaridad Social's* programs call for the prevention, protection, consolidation and economic stabilization of this population; these programs and policies also call for ensuring that this population has direct access to the national government's social programs. Although the State's investment has increased five times in the last three years to attend the displacement problem, resources are still insufficient to attend the needs of this vulnerable population. Besides, IDP's face barriers to accessing some social programs. Given the lack of resolution to the internal conflict, one of the key challenges in the medium term will be to address the needs of the IDP ensuring not only their access to the social programs provided by

the State, but also attention focused on their particular vulnerabilities. These actions will need to carried out in a coordinated fashion between central and local authorities, and in collaboration with the NGO's that have spearheaded many of the efforts to assist the IDP.

25. *Raising the budget for the social safety net through cost-recovery and re-allocation.* Colombia's social assistance budget is inadequate for meeting the needs of vulnerable populations, even during normal times. By redirecting funds away from less well-targeted programs (including non-social sector programs), instituting cost-recovery and ensuring adequate targeting Colombia could make important advances in the expanding the coverage of the social safety net. This issue will be particularly critical when the financing for the emergency RAS programs – equivalent to 0.3% of GDP – expires in 2004.

26. **Improving Health Status and Reducing the Financial Risk of Illness.** The crowning achievement of Colombia's far-reaching health reform launched in 1993 creating a mandatory universal health insurance system has been the large increase in health insurance coverage, even among the poor. Coverage rose from 24 to 57 percent of the population between 1993 and 1997. However, the recent fiscal crisis and the rise in unemployment has limited the system's ability further expand coverage in both the subsidized and contributory regimes. Moreover, the system is underperforming due to a range of problems, including the insolvency of the *Instituto de Seguridad Social* (ISS) which is responsible for managing health insurance (EPS) and health service (IPS) providers; the competitiveness and financial problems of the public hospitals; health financing issues stemming mainly from evasion; and systemic problems with accountability, information and transparency. In addition to these structural problems, Colombia has experienced a dramatic decline in vaccination coverage rates. Since 1995, when Colombia established itself as the Latin American leader with over 90% coverage rates for all routine vaccines, rates have fallen to below 80%.

27. To address these health issues, the next administration will need to continue what this administration has begun. First, the next administration needs to give priority to the continued expanded coverage of the health insurance regime, particularly among poor and independent workers through: (i) full implementation of Law 715 mandating transformation of supply to demand subsidies for health care; (ii) reducing evasion and underpayment of health insurance contributions; (iii) providing for the exclusive use of the FOSYGA Solidarity Account resources for subsidizing health insurance coverage; and (iv) improving communications

programs informing the public in general and the poor in particular about the affiliation process, eligibility rights, and allocation of resources to territorial entities for demand and supply subsidies. Second, Colombia will need to focus on full implementation of Law's 715 mandate on quality assurance, promotion of public accountability of insurers and health care providers with the support of a strengthened Health Superintendency and development of citizens' oversight (*Veeduria Ciudadana*) of the use of public health resources. Third, optimization of the financial flow of health sector resources, including, prevention of illegal use, retention or use for other purposes. Finally, restructuring of the network of public hospitals in order to operate as efficient providers of health care services with limited direct government subsidies and adoption of a new health care model focusing on primary health care.

28. With respect to recovering immunization coverage rates, the next administration should consider full implementation of the measures to strengthen the Expanded Program of Immunization based on the recommendations of the National Evaluation, including the completion of activities related to recommendations for strengthening the cold chain.

29. **Improving Efficiency and Equity in the Allocation of Education Resources.** In spite of considerable advances in the resources dedicated to education, the launching of a number of innovative education programs, and Colombia's leadership position in measuring achievement, Colombia's education sector is plagued by inequitable coverage rates, poor internal efficiency and achievement, and weaknesses in the design and implementation of educational decentralization efforts. Many of these problems stem from a financial system linked to paying teacher's wages without considering quality and coverage issues. Furthermore, the education sector is caught in the maelstrom of Colombia's growing violence and social unrest. On the demand side, unemployed, out of school youth constitute a disproportionate number of both the perpetrators and victims of crime and violence, calling for a concerted response from the education sector to bring these youth back into the educational system. On the supply-side, violence has come to the classroom posing challenges for teachers and administrators, with the recognition that schools may be one of the few community spaces where many of the problems of crime and violence can be effectively addressed.

30. In addressing the problems in the education sector the incoming administration should concentrate on: full implementation of the Law 715 formula for allocating education resources to territorial entities; continued implementation of the *Matriz*

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de Seguimiento al Plan de Reorganización to the year 2003; implementation of assessment of student learning achievement; development of a well functioning information system for resource allocation in the educational sector; completion of impact evaluation of pilot pedagogical models for rural areas by 2004 and their dissemination nationwide; and promotion of the use of private delivery mechanisms to provide education services.

31. This brief review underscores Colombia's achievements in securing macroeconomic stability, shoring up gains in health and education in the face of the recent economic crisis, and establishing a solid foundation for the reform of the social safety net. The support of the World Bank has been a decisive factor in achieving some of these gains and will continue to be important in the future, particularly in securing a solid foundation for economic growth and social stability in the face of challenging internal and external risks. In conclusion, Government endorses the macroeconomic and social strengthening programs supported by the Social Sector Adjustment Loan and the medium term framework laid out in its Policy Matrix.

Sincerely yours,

Federico Renjifo
Viceminister of Finance and Public Credit
In charge of the Functions of the Minister

Bank's Medium Term Social Sector Strategy for Colombia

Background

In spite of the recent economic and social difficulties[7], much of Colombia's population enjoys a higher standard of living than average for Latin America. Advances in many social indicators have been achieved over the past years. For example, life expectancy at birth has increased significantly in the last two decades; infant mortality rates have been slashed by a factor of four in the last four decades; and enrollment in basic education has increased. These advances, however, mask serious problems of inequities, and poverty remains a critical problem. The poverty gains reduction achieved in the early 1990s were unexpectedly reversed by the current crisis. Consequently, the rates of poverty and extreme poverty in urban areas are currently about the same level as in the early 1990s, while in rural areas they remain almost 10 percentage points higher than at the beginning of the 1990s. At the same time, there has been a rising trend of inequality, which reduced the potential welfare gains of Colombians up to 1995 and aggravated the welfare losses during the recession.

Sharp regional disparities in the quality of life continue to contribute to social disintegration. For example, poverty incidence is much higher in rural than in urban areas; infant mortality rates in *Chocó* are similar to the national average of more than twenty years ago; child malnutrition is 50 percent higher in households in which the mother has no education; and vaccination rates, which declined significantly during the last couple of years as a whole, are still much lower in households with head of household without education. Furthermore, high and pervasive levels of violence, guerrilla warfare and narco-trafficking have become critical barriers to improving living conditions and contribute to the displacement of a large number of people mainly from the rural areas.

Education, health and social protection are key to improving economic competitiveness and growth, reducing poverty and inequity in income distribution, and building a peaceful society. In this context, Colombia is trying to develop human capital as an important element towards further economic growth and development. Among its priorities, the Government has focused on efforts to: (i) increase the quality of basic education and basic health; (ii) improve the efficiency and equity of resources use in education; (iii) increase fairness of financial contribution and financial risk protection in health; and (iv) alleviate the impact of the current crisis on the most vulnerable and develop a better social protection system. Undoubtedly, the notable successes of these policies are found in the relatively good quality of basic education, as compared with other Latin American countries; in the increase of health insurance coverage, especially in rural areas; and in the implementation of social assistance programs to mitigate the effect of the crisis.

Issues

The country faces the following challenges and issues in the social sectors, *inter alia*:

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[7] Colombia is currently experiencing one of the most difficult periods in its history, and it is just recovering from one of the most severe economic crises in over 60 years. In 1999 economic activity declined 4.5 percent, and the fiscal deficit surpassed 6 percent of GDP. All productive sectors have been affected and the living standard of Colombians, especially the poor, has plummeted. This raises important issues for the social sectors.

Education. Five distinct avenues of effort are proposed for Colombia: (a) continuing and intensifying the focus on the poor to address inequalities in access and completion at all levels, in particular at post-secondary; (b) improving the quality and relevance of education at all levels; (c) supporting the financing, governance, and management of education at the central and local levels through a rationalization and deepening of the decentralization process under way, involving public–private partnerships; (d) increasing higher education opportunities, in particular for the underserved populations; and (e) building social capital through education for peaceful coexistence.

Health. The Colombian health system needs to deal with the following five priority issues: (i) efficient distribution of available resources to achieve full coverage of the poor in the subsidized regime and to effectively deliver basic health services and control of communicable diseases; (ii) elimination of evasion, the transformation of supply to demand-based subsidies and the use of the accumulated reserves of FOSYGA (*Fondo de Solidaridad y de Garantía* - Solidarity Fund) for increasing coverage[8]; (iii) restructuring of public hospitals, which are currently financed by direct government subsidies rather than through the sale of their services[9]; (iv) reform of the Institute of Social Security (ISS)[10]; and (v) the implementation of information and education campaigns regarding the health sector reform, which is crucial for increasing coverage as well as access to health care.

Social Protection. The main issues here are: (i) effective monitoring and evaluation of the *Red de Apoyo Social*, which includes a workfare program (*Empleo en Acción*), a conditional cask transfer program (*Familias en Acción*); and a youth training program (*Jovenes en Acción*); (ii) lack of information on coverage, efficiency and effectiveness of all social assistance programs in Colombia; (iii) financing for these programs in 2004 and beyond; (iv) existing programs' lack of a strategic focus; (v) lack of flexibility to respond rapidly during a crisis and need for counter-cyclical financing; (vi) improvement of poverty targeting; and (vii) poor budgetary data.

Social Sector Strategy in the Context of the Country Assistance Strategy

The last full CAS, discussed by the World Bank Board in November 1997, presented two main objectives covering poverty reduction and sustainable growth, and specifying six strategic areas: (a) promoting peace and development, (b) promoting rural development, (c) developing human capital, (d) attaining public sector responsiveness and efficiency, (e) improving infrastructure services, and (f) ensuring sustainable development. The basic objectives and strategies of the CAS remain valid, although, in reviewing the recent political, economic, and financial developments in the county and examining the progress achieved since the CAS, a CAS Progress Report in November 1999 recommended certain adjustments in the lending program. These changes in strategy were considered necessary because of the need to respond to several international economic crises, particularly the crisis in international credit markets, and the sharp drop in oil and coffee prices that resulted in the deterioration of the general economic conditions and the domestic financial sector in the country (these conditions are still valid today).

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[8] This would mean the expansion of the subsidized regime by 6.2 million individuals or 65 percent of the population already affiliated to the subsidized regime

[9] This will accumulate, in 10 years, a net savings of US$2 billion -in 2000 dollars- equivalent to 3 percent of 2000's GDP depending on the type of the reform

[10] This can provide, in 10 years, a fiscal savings varying between 1.2 to 2.4 percent of 2000's GDP, depending on the type of the reform

The CAS Progress Report took into consideration the many changes that had taken place both internationally and domestically, and attempted to align Bank strategy and instruments with the priorities of President Andres Pastrana's government. The CAS Progress Report confirmed the "basic objectives and overall thrust" of the existing CAS in focusing on poverty reduction, social development, and sustainable growth. However, the Progress Report proposed intensifying the assistance strategy to include two adjustment operations in response to the need to cushion the adverse social impact of the economic recession on the poor and vulnerable groups. In this way, the report responded to the deteriorating conditions in the country in which financial instability and internal conflict were affecting the poor and vulnerable groups particularly. The adjustments in assistance strategy also supported the government in its commitment to undertake a serious fiscal adjustment program, in implementing structural reforms supported by a formal IMF program, and in advancing the developmental aspects of the peace process.

The objectives outlined in the 1997 CAS and its subsequent update in 1999 were fully consistent with the priorities articulated by the current Administration. The government prepared a four-year National Development Plan outlining a national development strategy for 1998–2002. Areas covered are good governance, social capital, peace and development, and macroeconomic growth and employment. The emphasis on social capital is seen as key to resolving the internal conflict and violence in the country by devolving power to the communities, improving access to basic goods and services, promoting universal access to education and health services, ensuring gender equality, and achieving peace. As a means of implementing the National Development Plan, the government has also developed a comprehensive strategy, the *Plan Colombia*, in which various initiatives are presented to strengthen the peace process, control drug traffic, and reactivate the economy. The CAS goals and priorities of expanding coverage and improving the quality of basic education and basic health were reinforced by the CAS Progress Report.

The goals of the Bank's social sector strategy by sector in Colombia are:

Education:
(i) To bridge the considerable equity gaps that exist in access to education, including higher education, while improving completion rates (these gaps affect the most vulnerable population groups, such as those in the rural areas, the poor, the indigenous, the Afro-Colombians, and the displaced. Such inequities are widening because of the current economic, social, and security situation in the country);
(ii) To increase access to quality of education in rural and urban schools by promoting the expansion of proven cost-effective models;
(iii) To raise efficiency in the use of resources by promoting demand-side financing as an important complement to purely supply-driven investment and improving the financing and management of education, making it more responsive to local needs, and accountable to the governance structures at all levels; and
(iv) To learn from the country's educational experiences to date, distilling good practices for future policy and implementation.

Health:
(i) To improve distribution and use of available resources for health through the exclusive use of the funds of the Solidarity account of FOSYGA for the financing of the subsidized regime, as well as the further transformation of supply to demand subsidies as defined by Law 715 (favoring demand subsidies will provide strong incentives for hospitals and the ISS-Health to achieve greater efficiency and competitiveness);
(ii) To restructure public hospitals, which are currently financed by historical budget-based subsidies rather than sale of services;
(iii) To improve access to basic health delivery and control of public health threats;
(iv) To reform the Institute of Social Security (ISS);

(v) To provide more effective information and education to the population to increase insurance coverage, as well as access to health services[11]; and
(vi) To reduce evasion of health insurance contribution, which would have a positive effect for both the contributory and the subsidized regimes. (Development of vigilance and control strategies with high capacity to detect and punish evasion will add resources into the system and support the solidarity principle mandated by the health reform. In particular, elimination of evasion would increase the resources entering the Compensation Account by CCOP$1,881,000 million (US$767 million), equivalent to 56 percent of the size of the Compensation Account in 2000 and expand affiliation to the subsidized regime by 1.2 million individuals.)

Social protection:
(i) To expand the budget for social assistance (redirecting funding to social assistance and combining targeting with cost-recovery from less poor groups) while avoiding duplication;
(ii) To reform planning and budgeting to remedy the lack of accurate information on coverage, costs and effectiveness;
(iii) To improve the efficiency of the social safety net (better targeting and elimination of excessive program overlap and fragmentation) in close coordination with the institutions that formally deliver public services like ministries, ICBF, etc.; and
(iv) To develop an integrated Social Risk Management System.

Implementation of the social sector programs has been limited in part because of the continued weakness of the social sector ministries, including among others the high turnover at the ministerial level, complex budgeting process, the inadequate operation of the national co-financing system, the lack of effective monitoring and evaluation instruments, and complications from the decentralization process.

The Bank can play a catalytic role in bridging the gap between strategies and policies and implementation. To do it, the Bank needs to redirect its efforts in the social sectors, mainly to facilitate the decentralization process while ensuring the strengthening of social service delivery at the local level within a sustainable fiscal framework. In the education sector the Bank will continue supporting projects both at the local and central levels to: (i) improve coverage and quality across all levels; (ii) identify specific strategies for reaching vulnerable populations and opening up opportunities for those who traditionally have been excluded so that inequity will be reduced; (iii) improve the quality of life of the youth; (iv) provide administrative tools for the implementing agencies, including MOE, to strengthen their capacity; and (v) change some incentives in the system (for example, resources should follow students and not teachers; sector information should be disseminated to the community as a whole). In the health sector support should be provided to: (i) expand the coverage of health insurance among the poor; (ii) push the transition from a supply to demand side financing of public health facilities; (iii) support autonomy of public health facilities; (iv) promote facilitation of private organization in the provision of health services; and (v) improve vaccination levels and control of communicable diseases. In social protection, the situation in Colombia calls for a two-staged approach to be carried out on both the macro and the microeconomic fronts: a short-term crisis response action plan and a medium-term reform strategy. As an immediate response to the crisis, the Bank has supported two of the *Red de Apoyo Social* (RAS) programs: Community Works and Employment project (Empleo en Acción), which aims to

[11] The health care system of Colombia is currently defined by complex legislation, which makes the workings of the system even more difficult to understand for the regular citizen. As a result, there is lack of knowledge regarding issues such as the affiliation process, the content of the health care benefit package and the free choice of insurer and health care provider. The implementation of communication and information campaigns will be an important element in guaranteeing the reform's success as a means for individuals to understand both their rights and their obligations. Furthermore, the definition of rights and obligations both for affiliates and the state will be further assisted by the approval of a *Ley Estatutaria* for the health sector.

provide temporary employment to the poor, unemployed and unskilled workers; and a family assistance program for poor families (*Familias en Acción*) to give cash assistance to the poor on condition that they keep their children in school and provide them with basic preventive health care. The medium-term reform should focus on the development of a Social Risk Management System.

Vehicles for Bank Assistance

Lending services. To manage the risks in the sector the Bank needs to maintain flexibility in its operations. Although lending will mainly include investment loans, programmatic lending will be considered as an instrument in the social sectors, combining investment with adjustment loans to promote needed structural reforms. To complete the set of operations in support of the social protection sector, the technical teams of the presidential candidates have requested technical cooperation in the form of Technical Assistance (TA). A follow up TA for the SECAL will help to link the policies implemented under the present operation with actions to be taken during the next Administration. In education the plan is to continue with the Rural Education APL (Phase 2 in FY03) and support a new investment project to improve equity and quality in higher education (FY03). Furthermore, to deepen education decentralization, the Bank will support a decentralized human capital development project (probably in the Department of *Cundinamarca* in FY04). In the health sector the Bank will provide investment support to the health reform in FY04. And in social protection, in addition to the proposed SECAL for this FY, a programmatic operation is being considered to support further reform in the social sector, including development of a Social Risk Management System and promotion of decentralization. The Youth Development LIL will also be expanded during FY03.

Non-lending Services. In addition to several policy notes done in this FY on basic education, higher education, social protection, health, and science and technology, sector work will be proposed on social sector program efficiency and on hospital management and restructuring in FY03. The Bank will continue to support activities related to education and peace. In particular, in alliances with other partners, it will conduct two studies in this regard: one, to assess education models that improve tolerance, democratic values and social cohesion; and the other, to evaluate the impact of the current conflict on the delivery of education services.

With a combination of these services, the Bank will help the GOC improve access to quality social services and reduce the disparities (mainly urban-rural) in standard of living. Progress benchmarks will include indicators showing increases in: primary education in rural areas to about 75 percent by 2005; the intake of students in six grade in rural areas; the probability that poor students have access to higher levels of education; the coverage of the subsidized health care scheme for the poorest population; the number of hospitals converted into semi- or autonomous units (all by 2005); and the number of municipalities certified to manage autonomously government financial transfers. Finally, it is expected that the efficiency of programs like the National Training Service (SENA) and the Colombian Institute for Family Welfare (ICBF) will be monitored regularly.

The Consultation Process in Colombia and Actions Related to the Adjustment Loan

This annex provides an overview of the consultation process that the Bank has promoted in Colombia, with a particular reference to social sector policy. Colombia has a rich array of civil society organizations and private sector associations involved in the crafting and implementation of social policy. In many cases these groups have assumed a social service delivery role as important of equal – and in some cases greater – importance than the state. Beyond these non-government organizations, the Bank has also developed an active dialogue and relationship with local governments and a variety of political actors.

Below, the consultation process that the Bank has supported in Colombia is outlined, highlighting: the participatory process used to develop the Country Assistance Strategy (CAS), the consultation process applied to the development of the proposed Social Sector Adjustment Loan (SECAL), the *Policy Notes* presently being developed, and elements of the SECAL supporting a continued consultation process.

With respect to the proposed SECAL, although a systematic consultation could not be conducted with all relevant stakeholders, this annex highlights both the overall consultation process and the specific activities that were conducted with selected stakeholders more directly related to the SECAL.

1) Participatory Country Assistance Strategy (CAS) process

The most recent Country Assistance Strategy (CAS) was prepared using a new, participatory approach being piloted in the World Bank which included extensive consultations with civil society and workshops in Bogotá with government and civil society representatives. The process used to develop the CAS resulted not only in a shared assessment of the actions required to meet Colombia's development needs, but also a strengthened relationship between government, civil society and the World Bank.

The consultations carried out in the preparation of the CAS concentrated mostly on diagnosing areas of needed action, which was used to develop six strategic areas in the CAS. This proposed SECAL responds directly to three of the six strategic areas identified during this consultation process: (i) promoting peace and development; (ii) developing human capital; and (iii) attaining public sector responsiveness and efficiency. Furthermore, it does so by promoting reforms in the areas identified by the Government, the Bank and civil society as being particularly important and challenging, namely implementation and institutional change.

In *promoting peace and development*, the process used to develop the proposed SECAL as well as several of the SECAL components support a number of the CAS recommendations, including: using recent sector work exploring the impact of violence, inequality and vulnerability to inform the SECAL strategy; engaging civil society in the development and implementation of the SECAL; and supporting increased information access and dialogue through specific conditions in the SECAL related to health, education and public monitoring of government performance.

In *developing human capital*, the proposed SECAL supports key elements of the CAS strategy including: expanding health insurance and education coverage among the poor; increasing the involvement of private providers in education; enhancing consumers' awareness of the performance of the health and education sector; introducing cost-control mechanisms in health; and enhancing the quality of education. The modalities supported by the SECAL for implementing these reforms also directly supports the Government of Colombia's efforts at decentralizing key social services, another area identified in the CAS.

In *attaining public sector responsiveness*, the proposed SECAL supports: strengthening the responsiveness of public sector institutions, by building upon efforts established in SINERGIA and supported by the World Bank financed Public Sector Management Project; increasing social control and enhancing transparency in health, education and social protection; and promoting effective decentralization and enhancing participation of the private sector.

2) Consultations supporting the preparation of the Social Sector Adjustment Loan

Several consultation undertaken recently are closely related to the preparation of the SECAL, including:

- Fieldwork for the "Social Dimensions of the Economic Crisis" study carried out as part of World Bank *Social Safety Net Assessment* sector work on that included: focus group and structured interviews with groups in rural and urban areas affected by the recent recession (internally displaced populations, micro-entrepreneurs, construction workers, day laborers, and middle-income debtors caught by rising mortgage rates) regarding their perceptions of vulnerability, use of social risk management and recommendations for social sector reform.
- Consultations with presidential candidates and their policy advisers. In preparing for the 2002 elections and presidential transition, consultations on the policy initiatives in the proposed SECAL were held in January, March and May 2002 with advisers to the three main presidential candidates.
- A series of workshops in three cities (Bogotá, Cali and Medellín) held in May 2002 conducted broad consultations on social sector policy using the results of the 2002 *Poverty Assessment* and *Social Safety Net Assessment* studies recently concluded by the Bank in collaboration with the Government of Colombia and the IDB. These workshops included an off-the-record discussions of social sector policy and were attended by academics, government policymakers at the national and local levels, civil society leaders and staff from bilateral and multilateral development institutions.
- Roundtables were held in Cali and Bogota with stakeholders at the central and local government level to review the policy matrix for the proposed SECAL.

3) Policy Notes

The Colombia *Policy Notes* compendium presently being prepared will summarize the major challenges in Colombia's social-economic development. Although primarily designed to serve as a bridge to the new administration by providing a basis for policy discussion with the transition team, the *Policy Notes* also serve an important function in providing a transparent foundation for discussing key policy issues with civil society. The compendium will include thematic notes on peace, growth, governance, natural resource management and poverty and inequality. It addition, it will summarize essential sector issues for development in over thirty areas, including education, health, social protection, gender, violence and the internally displaced population. Many of the *Policy Notes* have been drafted by the team members involved in the preparation of the SECAL.

These *Policy Notes* will be discussed with the advisers to the newly-elected president and will help to ensure a smooth transition in the Bank's work from one administration to another.

4) Elements of the SECAL supporting a continued consultation process

Several initiatives in the SECAL support a continued consultation process with civil society, building transparency and accountability in the public sector, including:

- The establishment of a public monitoring system based on regular, ongoing consultations with civil society on public sector performance in the social sectors.
- A pilot for increasing citizens' oversight of ICBF, the largest social assistance program in Colombia.
- Internet dissemination on the performance of health services providers
- Improved quality and availability of public information on student achievement results and promising pedagogical models.

Taken as a whole, the actions and elements reviewed above have provided a solid foundation for dialogue regarding the main policy issues addressed by the SECAL and will serve to strengthen an ongoing dialogue, particularly between the state and civil society, on key social sector issues. The SECAL team will look to continue the dialogue as the reforms are implemented, particularly after the loan is effective to ensure the future sustainability of the social sector reforms promoted by the SECAL.

REPUBLIC OF COLOMBIA
SOCIAL SECTOR ADJUSTMENT LOAN

Specifications, Definitions, and Evidence for Tranche Release Conditions

Tranche release conditions	Specifications and definitions	Evidence
A. General Condition of the SECAL The macroeconomic framework of the Republic of Colombia is consistent with the objectives of the program.	The fact that the macroeconomic framework of the Republic of Colombia is consistent with the objectives of the program (as described in the government's Letter of Development Policy sent to the Bank) implies that the macroeconomic program supported by the IMF's three-year extended arrangement facility (approved in December 1999) is on track. The macroeconomic program is considered to be on track if the quarterly performance criteria—namely, the overall fiscal deficit of the combined public sector, the inflation targets, the net international reserves, the increase in medium- and long-term debt, and the issuance of guarantees by the public sector for private external debt—were observed; and the Bank staff is satisfied with the overall progress of the program as defined in the Letter of Development Policy.	The Bank staff, in consultation with the IMF and the government, will exchange views on the macroeconomic performance, and will assess progress in the program's implementation through exchange of information via e-mail and missions to Colombia.

B. Specific Conditions of the SECAL		
Transparency and citizens' oversight of social programs 1. Introduction of a system of impact and performance evaluations and public monitoring of Colombian Government's (GOC) main social sector programs. Approved CONPES establishing: (i) periodic impact and performance evaluations of the main social sector programs financed by the national government; and (ii) public monitoring to improve social sector transparency and accountability. The system will be launched through: (i) impact and performance evaluations of the main ICBF family welfare, RAS safety net transfer and SENA training programs; and (ii) the establishment of a system of public monitoring of social sector programs to improve transparency and accountability through the dissemination of monitoring and evaluation results and consultation with civil society. [A CONPES is an authoritative statement of government policy and guidelines issued by the Legislature's National Council of Social and Economic Policy.]	1i. With respect to the periodic impact and performance evaluations, the Government of Colombia will have issued a CONPES defining the norms for the periodic evaluations, including (i) which programs will be subject to impact evaluations; (ii) the scope and content of the performance assessments; (iii) how often the evaluations will take place, (iv) what elements will be considered in the evaluations, and (v) norms and responsibilities for carrying out the evaluations, particularly in order to ensure objectivity and policy relevance. Initially the periodic evaluations will be conducted on Colombia's main social assistance and training programs: the *Red de Apoyo Social* (RAS) safety net programs (conditional cash transfer, workfare and youth training), the main ICBF nutrition and day care programs, and the main SENA training programs, with results to be produced in 2004. The results should provide information on not only reforms to the individual programs under evaluation, but also to the network of social assistance and training programs as a whole. 1ii. With respect to the public monitoring activities, a CONPES will have been issued defining (i) the form and content of the public monitoring activities, building on the information established by SINERGIA (the system of public sector results monitoring); and (ii) norms and responsibilities for managing the dissemination and consultation activities. The public monitoring activities will be launched through regular, specific dissemination (websites, press releases, etc.) and consultation (town hall meetings, opinion polls, etc) measures outlined in the time-bound action plan included in the CONPES. Public information campaigns to make citizens aware of the resources should also be included.	1i. Official copy of approved CONPES. 1.i. Official copy of a document showing resource allocation in the 2003 proposed budget and terms of reference for: impact and performance evaluation work of the 3 RAS safety net, the main ICBF (Colombian Institute for Family Welfare), and SENA (National Training Service) programs. 1.ii. Official copy of a document (DNP) showing resource allocation in the 2003 proposed budget and terms of reference for: dissemination and consultation activities for public monitoring activities.

Social Safety Net 2. Development of a comprehensive Social Risk Management System, including: norms for its role in normal and crisis periods, including a system for maintaining/expanding the coverage of pre-qualified programs during crisis periods using emergency financing; and the function of and relationship between social assistance and insurance programs. 3. Improving the coverage, effectiveness and efficiency of ICBF through (i) a pilot decentralizing and separating financing from provision in 10 municipalities; (ii) ICBF board approval and implementation of a cost-recovery policy based on sliding-scale fees graduated by income from users of CAIPs formal day-care centers; (iii) improved monitoring through the launching of a citizens' oversight plan in each ICBF regional office; and (iv) a technical review of the management information system. 4. Attention to the internally displaced population (IDP) though (i) adoption of a common methodology for characterizing the IDP; and (ii) development and launching of a time-bound action plan for eliminating barriers to IDP's access to social programs.	2. The SRM system will be detailed in either a CONPES or decrees ('*decretos regalmentarios*'). The discussion of the SRM in times of crisis should specify: (i) characteristics of the crisis that would trigger the expansion of the SRM; (ii) norms governing the expansion of pre-qualified programs during crisis periods using emergency financing (either from the social protection stabilization fund or alternative sources such as international lending if the stabilization fund is undercapitalized); (iii) rules governing the protection of pre-identified social programs during crises; and (iv) guidelines governing how to target populations affected by the crisis. The discussion of the SRM during normal times should include: (i) incentives for improving the targeting of social programs, including incentives for the regular and effective application of SISBEN, the prioritization of expansion of program coverage among SISBEN 1 and 2 populations, and norms for targeting the non-structural poor; (ii) steps to be taken in the future to achieve a more efficient and effective SRM system, outlining areas to build on current reform efforts. The discussion of the SRM will recognize (i) the inclusion of both social assistance and social insurance programs in a comprehensive SRM that function in both crisis and normal periods and (ii) the role of subsidized health insurance and the pension solidarity fund that are social insurance programs with a safety net role. The document will specify and assign areas of action and investigation for the development of a comprehensive SRM system. 3. To meet this condition, ICBF will have (i) developed a pilot to decentralize and separate financing from provision of ICBF services in 10 municipalities; (ii) received ICBF Board approval of cost-recovery norms to be applied in CAIPS formal day care program and holding of workshop with regional offices concerning new norms; and (iii) launched a policy established by the ICBF Board requiring each ICBF regional office to submit an analysis of what has been done and time-bound action plan for the strengthening of citizens' oversight actions (*Veeduria Cuidadana*), with an accompanying ICBF central office led evaluation of the implementation of action plan; and (iv) developed terms of reference and launched a technical review of the management information system. 4. This would include: (i) adoption of a common methodology for estimating the size and characteristics of internally displaced population (IDP); (ii) a time-bound action plan for eliminating barriers to access that would include the following components: (a) the possible use by displaced persons of their SISBEN cards from their municipality of origin to have access to public services; (b) a signed agreement ('*convenio*') between RSS (the Social Solidarity Network responsible for IDP policy), the Office of the Presidency (responsible for the RAS safety net programs) and DNP outlining time-bound steps for eliminating IDP's barriers to access to *Red de Apoyo Social* (RAS) safety net programs; and (iii) proposed allocation in the 2003 budget for implementing the action plan for eliminating barriers to access.	2. Official copy of approved CONPES on the design and implementation of a Social Risk Management System, with a time-bound action plan. (3i) Official copies of agreements ('convenios') between ICBF and each participating municipality concerning the establishment of the decentralization pilot project; copy of evaluation reports approved by the National Planning Department (DNP) regarding physical and financial progress relative to targets established for separating financing from provision; (3ii) Official copies of a letter from ICBF Board stating adoption and describing implementation (physical and financial progress) of new cost-recovery policy; (3iia) Official copy of ICBF directive to the regional offices to present plans for improvement of social control; (3iib) Official copy of citizens' oversight plans from at least 65% of ICBF regional offices; corresponding letter from ICBF Board outlining strategy for the evaluation of the plans and follow-up actions concerning improvements in citizens' oversight activities. (3iv) Official copy of terms of reference and a signed contract for the technical review of the management information system. (4i) Establishment of a council composed of DANE (the National Statistical Institute), RSS, Codhes and Pastorial Social to validate the methodology to be applied to estimate the characteristics and size of the IDP population. (4i) Copy of sign (4ii) Official copy of the action plan signed by RSS and DNP. (4iii) Official copy of a document showing resource allocation in the proposed 2003 budget including financing for the implementation of the action plan.

Health 5. Expansion of health insurance coverage and improvement of resource use through: (i) expansion of the subsidized health insurance coverage (*Régimen Subsidiado*) by 350,000 additional individuals belonging to SISBEN levels 1 and 2 by December 31st, 2001; (ii) approval of new resource allocation model for territorial entities according to the number of affiliates, number of *vinculados* and public health coverage targets (e.g. vaccination rates); (iii) approval of CONPES (legal document of the National Council of Social Policy) defining the implementation rules for the distribution of health transfers pursuant to Law 715 of 2001; (iv) agreement to use the FOSYGA Solidarity Account resources exclusively for subsidizing health insurance coverage; (v) enactment of regulations (*decretos reglamentarios*) for the implementation of Law 715 with respect to the assignment of responsibilities for public health and the methodology and information for the distribution of health transfers pursuant to said law; and (vi) allocation in the 2003 proposed budget of necessary resources to inform eligible poor population about the subsidized health insurance regime rights and affiliation procedures. 6. Strengthening of the operation of the National Health Superintendency through: (i) approval of the necessary decrees requiring fee payments by EPSs, ARSs, territorial entities and hospitals to the National Health Superintendency and establishing the fee level; (ii) signed contract for a business study, financed by the Program Support to the Reform (*Apoyo a la Reforma*), regarding the operation of the Superintendency and the ways that its role can be re-enforced; and (iii) internet dissemination of information on the performance of EPSs, ARSs, territorial entities and hospitals by the National Health Superintendency. 7. Strengthening of the Expanded Program of Immunization (EPI) through: (i) budget allocation to finance year 2002 immunization needs to achieve	(5v) Law 715 mandates that the responsibility for public health should be removed from the Health Promoting Entities of the contributory regime (EPSs) and assigned to the Nation (article 46 of said law). The resources financing components of public health which under Law 100, which were received by the EPS, should now be received by the territorial entities (municipalities and departments). The National Council of Social Security in Health (CNSSS) is responsible for defining the amount of resources subtracted from the Risk Adjustment Premium (UPC) of the Contributory Regime, which will now be used by territorial entities for the financing of public health activities. (6i) Law 488 of 1998 establishes that the National Health Superintendency has the right to charge a fee to the entities that are under its supervision (e.g., EPSs, ARSs, public hospitals and territorial entities). According to said law, the Ministry of Finance (MOF) is responsible for the definition of the methodology used in the calculation of the fee. The MOF has regulated the above-mentioned issues through two decrees; (i) Decree 1405 of 1999 which regulates the system and the methodology employed for fee definition and (ii) Decree 2787 of 2001 which establishes the level of the fee for the various entities supervised by the National Health Superintendency. (6ii) A business study financed by the Program *Apoyo a la Reforma* will have been contracted with respect to the different aspects of the operation of the Health Superintendency. The study aims to assist the Health Superintendency identifying actions that will increase vigilance and improve control. The study can draw lessons from the experience of other Superintendencies in Colombia. (7ii) The Colombian Government (GOC) will have carried out the following actions to improve the immunization system: (i) budget allocated to finance year 2002 immunization needs to achieve at least 95% vaccination coverage; (ii) development of detailed Action Plan to strengthen the EPI immunization program and initiation of certain key measures; and (iii) allocation of resources for executing the action plan. The Ministry of Health (MOH) and the National Institute of Health (INS) will have finalized the above-mentioned Action Plan, including short and medium-term activities to strengthen the EPI program. The Plan uses the Final Report of the National EPI Evaluation as a basis and covers all components in the evaluation. Emphasis is placed on: (a) financing, (b) strengthening management, (c) infrastructure and staffing development, (d) strengthening information systems, (e) cold chain, and (f) enhancing coordination between providers by assigning necessary funds to ensure the adequate coordination and flow of information. The government will have assigned funds for the National Plan of Action and	(5i) Official copy of PAC (MOF budget authorization document) of 2001 showing that a budget (85,000 million pesos) has been programmed to finance health insurance coverage of 350,000 additional individuals of SISBEN level 1 and 2 (done) (5ii) Official copy of Law 715 as published in Official Gazette (*Diario Oficial*) (done) (5iii) Official copy of CONPES 057 'Distribution of the General System of Participations, Year 2002' (done) (5iv) Official copy of a letter of commitment duly signed by the Minister of Finance certifying that the use of resources in the FOSYGA Solidarity Account will be dedicated exclusively to financing the subsidized health insurance regime (5v) Official copies of (i) Decree 159 of 2002 providing information and defining the methodology for the distribution of health transfers pursuant to Law 715 (done) and (ii) accord of the CNSSS defining the amount of resources destined to territorial entities for the financing of public health. (5vi) Official copy of time-bound communication action plan informing eligible poor population about subsidized health insurance rights and affiliation procedures; and official document showing resource allocation in the 2003 MOH budget proposal needed to carry out said plan (6i) Official copies of (i) Decree 1405 regulating the system and methodology employed for the definition of the National Health Superintendency's fee (done) and (ii) Decree 2787 establishing the fee level (done) (6ii) Official copy of contract for business study of the National Health Superindentency (6iv) Actual availability of information in the Internet (7i) Official copy of PAC 2002 showing that a budget has been programmed to finance year 2002 immunization needs to achieve at

to finance year 2002 immunization needs to achieve at least 95% vaccination coverage; (ii) development of detailed Action Plan based on the recommendations of the National Evaluation to strengthen the EPI immunization program and initiation of certain key measures; (iii) allocation of resources for executing the EPI plan; and (iv) clarification of the assignment of responsibilities at the central level regarding immunization.	will have begun implementation of the plan. Initial priorities for immediate initiation include steps for adequate staffing, national vaccination guidelines will be under development and training scheduled, surveillance workshops will be scheduled, a Supervision Plan will be in place, and evaluation activities to monitor vaccination coverage levels and surveillance sensitivity will be ongoing. Installation of computer software for disease surveillance (e.g., MESS and PESS) at the Department level will be ongoing. The government will have contracted (the first phase in all capitals of the 33 Departments and in the 4 Districts of a study) to conduct an inventory of the national cold chain system and will have estimated the cost of its renovation. As a first step, Supervisory and training activities should be initiated. The national inventory should be underway and purchase orders will have been placed for needed equipment. Assuming that the results of the pilot testing of PAISOF-2 are acceptable, the government will have assigned funds for, and will have begun, the implementation of PAISOF-2 at different levels within the health care sector. Training activities will have been initiated. The MOH/INS will be monitoring vaccination coverage levels at the municipal level and by health plan using the following indicators: • 95% coverage for DTP3 (and/or, pentavalent), OPV3, MMR, BCG, Hepatitis B, at the appropriate ages, e.g., 1-year of age for MMR and less than 1-year of age for the other vaccines. • Proportion of children living in municipalities with 95% coverage levels by vaccine and by the appropriate age • Proportion of municipalities with 95% coverage levels by vaccine and by the appropriate age Performance target indicators will include DTP3 coverage over time among children less than one year of age, measles coverage over time among children 1-year of age, and the proportion of children living in municipalities with coverage of 95% for DTP3 and measles vaccine. Finally, a mechanism will have been identified, formalized and implemented that permits a child to receive needed vaccination from any vaccination center, regardless of affiliation. Based on this activity, missed opportunities to vaccination will be minimized. (7iii) Both the MOH and INS are responsible for the implementation of the EPI program. Decisions at a policy level are taken by the MOH, while at an operational level by the INS. Resolution 228 of 2001 of the MOH delegates the operational execution of the EPI program to the INS and Resolution 537 of 2001 mandates the creation of Special Group of Technical Support for the execution of the agreement (*convenio*) between the MOH and the INS.	year 2002 immunization needs to achieve at least 95% vaccination coverage (7ii) Official copies of (i) the Action Plan developed and signed by both the MOH and INS, presenting the activities described in Specifications and Definitions, cost estimates and a chronogram; (ii) a report signed by MOH and the INS on the initiation of the above-mentioned selected key measures and other activities underway; (iii) official document from MOH showing allocation of resources for executing the EPI plan; and (iv) a contract for the first phase of a study to conduct an inventory of the national cold chain system. (7iii) Official copies of: (i) Resolution 228 of 2001 of the MOH delegating to the INS the implementation of the EPI program at an operational level (done) and (ii) Resolution 537 mandating the creation of a Special Group of Technical Support for the execution of the agreement between the MOH and the INS (done).

Education 8. Improving public education regulatory framework through: (i) approval of a new resource allocation model for territorial entities according to number of students, population to be attended, and poverty indicators; (ii) approval of CONPES defining the implementation rules for the distribution of the educational transfers pursuant to Law 715; and (iii) enactment of regulations (*decretos reglamentarios*, ministerial directives, resolutions and circulars) for the implementation of Law 715 in regard to information system, including regulations strengthening the capacity of the Ministry of Education to assist territorial entities develop their education information systems for resource allocation, and guidelines for public education institutions contracting with private providers for the delivery of educational services; and (iv) allocation in 2002 budget of resources to strengthen the Ministry of Education's capacity to assist territorial entities develop their education information systems. 9. Ten performance agreements (*Matriz de Seguimiento al Plan de Reorganizacion*) signed between the authorized representatives of both the National Government and Territorial Entities to rationalize the teaching force and extend education system coverage. 10. Signing of a Monitoring Agreement (*Convenio de Seguimiento*) between authorized representatives of the national government and the Mayors of selected districts receiving educational transfers according to the Law 715 formula. Said agreement will allow the Ministry of Education to monitor compliance of the following measures that the districts agreed to undertake: (i) improve the reliability of the information on the number students; (ii) streamline the administrative structure of the Education Secretariats (*Secretarias de Educacion*); and (iii) increase investment in non-salary education inputs and universal assessment of the educational achievement of children. 11. Public dissemination of information through, *inter alia*, national media, publications and press releases regarding: (i) student learning achievement of the last SABER assessment and (ii) the updating of the "Portfolio of Education Services" (Portafolio de Ofertas Educativas) and its inclusion of unit cost estimates. [The Portfolio is a brochure on pedagogical models local authorities should consider for increasing both enrollment and quality.] 12. Development of a methodology and shortlist for selection of consultants to evaluate models for expanding basic and middle education using education technology (e.g. SAT, telesecundarias, postprimaria and accelerated methodologies) 13. $5 million will be aside set for technical assistance (TA) and added to the 2002 budget and/or 2003 budget Proposal..		(8i) Official copy of Law 715 as published in the Official Gazette (Diario Oficial) (done) (8ii) Official copy of CONPES 057 'Distribution of the General System of Participations, Year 2002' (done) (8iii) Official copy of regulations (decree, ministerial directives, resolutions, and circulars) duly signed by authorized representatives. (8iv) Offical copy of Budget Law 2002 (done). (9) Official copies of the duly signed agreements (done). (10)Official copies of the duly signed agreements (11i) Physical evidence of dissemination, e.g., press releases, brochures, and internet. (11ii) Offical copies of updated drafts of the Portafolio de Ofertas Educativas (12) Official copies of the methodology, terms of reference and shortlist of consultants

Relationship with IDB Social Sector Adjustment Loan and IBRD Structural Fiscal Adjustment Loan (SFAL)

This annex outlines the relationship between the proposed Social Sector SECAL, the existing IDB (Inter-American Development Bank) Social Sector Loan, and the IBRD Structural Fiscal Adjustment Loan (SFAL). The IDB and IBRD social sector loans are being carried out under parallel financing; shared policy conditionalities with the IDB loan are highlighted in the SECAL matrix. Many of the other conditionalities in the IDB matrix are complementary to those in the IBRD matrix. The proposed SECAL shares no conditionalities with the SFAL beyond macroeconomic framework objectives, but reforms in the SFAL matrix supported by the proposed SECAL are highlighted in the SFAL matrix.

I. IDB Social Sector Adjustment Loan

(T1 = Tranche 1; T2 = Tranche 2)

I. Macroeconomic Stability

T1 and T2 Compliance with IMF Extended Fund Facility Agreement and the macroeconomic program in the policyletter.

II. Social Safety Net

Reform of SISBEN proxy means testing instrument

T1 Reform of SISBEN approved by CONPES, including:
- Adjustments of the instrument to capture regional differences and dynamic aspects
- Quality control and centralized monitoring
- Strengthening of its administration and supervision at the local level

T2 Put into effect SISBEN reform, including at least:
- Re-survey and training undertaken in at least 4 municipalities
- Launching of the supervision and monitoring system

Reform of Social Assistance programs

T2 Establishment of a pilot scheme for the decentralization and separation of financing and provision functions of ICBF
- Implementation of the above ICBF pilot scheme in 10 municipalities **[JOINT WITH IBRD]**

T1 CONPES approved plan for consolidating, improvement, and adjustment of existing social assistance programs
T2 Implementation of the above-mentioned plan in regard to:
- Suspension of overlapping RSS programs
- Reform of the assistance to old indigents
- Institutionalization of selected programs of the Department of the Presidency

Countercyclical safety net financing program

T1 Fund for the stabilization of social assistance spending approved by CONPES, including:
- Countercyclical financing for expanding targeted social assistance programs during crisis
- Objective and transparent rules regarding funds accumulation, investment, and spending
- Recommendation regarding the creation of the above fund by Law

T2 Put into effect the stabilization fund, which implies:
- Approval of a law creating the fund
- Establishment of regulations enabling its implementation
- Call for bidding for the selection of a firm to manage the resources of the fund

III. Health

T1 Permanent expansion of the subsidized health insurance coverage (*Régimen Subsidiado*) to 350,000 persons and extension of SGSSS to the SISBEN III and IV population. **[JOINT WITH IBRD]**

T2 Widening of health insurance membership of the self-employed with capacity to pay and effectiveness of the extension of SGSSS to the SISBEN III and IV population.

T1 Budget allocated to finance 95 % of next year's immunization coverage target **[JOINT WITH IBRD]**
T2 Execution of budget programmed to finance 95 % of the immunization target of the current year.

IV. Education

T1 Ten performance agreements signed by the Ministries of Finance and Education, the DNP and ten departments to rationalize the teaching force and extend education system coverage. **[JOINT WITH IBRD]**
T2 Five additional performance agreements as above and progress achieve in regard to the efficiency indicators stipulated in the ten performance agreements mentioned in the first tranche
T2 Approval of enabling decrees (*decretos reglamentarios*) for the reform of Law 60 in regard to national regulation, information system, and certification of municipalities

V. Employment and Training

T1 Presentation to Congress of draft legislation (*normativa*) for reducing labor costs, including among others:
- Reduction of payroll taxes (*aportes parafiscales*)
- Creation of work opportunities for the young through the amendment of the *"contrato de aprendizaje"*
- Reduction of none-wage labor costs

(Floating tranche) At least two of the three measures included in the above condition are in effect.

III. IBRD Structural Fiscal Adjustment Loan

First Tranche

A. General Condition of the SFAL

The macroeconomic framework of the Republic of Colombia is consistent with the objectives of the program.

B. Specific Conditions of the SFAL

Intergovernmental Fiscal Relations

1. The constitutional amendment (*Acto Legislativo* No. 1, of July 30, 2001) reforming the transfer of resources from the central government to subnationals has become effective, limiting the rate of growth of fiscal transfers to subnational governments and the rate of growth of the central administration operational expenditures for 2002 and there-after.

2. The government has submitted to Congress a draft law reforming the tax system of territorial entities (*Estatuto de Ingresos Territoriales*) to increase subnational tax revenues by more than 20 percent in real terms in the first year of its application term compared to realized tax revenues in 1999.

3. The government has issued a decree to regulate debt and borrowing of territorial entities that will contribute to halting unsustainable borrowing, limiting bailouts, and eliminating discretionality in the treatment of debt. Since July 1, 2001, the territorial entities have received no bailouts or guarantees of their debt in accordance with Law 617/00.

Health

4. The Ministry of Health, the Department of National Planning, and the Ministry of Finance have defined and approved a national public hospital restructuring policy and an implementation program for the next five years, and have begun the implementation of the first phase, including the selection of at least 10 departments. For the year 2002, the implementation program has covered more than 15 percent of the total public hospital budget included in the FY01 budget.

ISS

5. The government has initiated a restructuring plan for ISS Health, including negotiating with ISS unions about labor costs and benefits, and has implemented the first phase, including the completion of renegotiating 50 percent or more of ISS's total outstanding debt to health service providers and the reduction in at least 30 percent in the waiting list for elective surgeries (as of June 30, 2001).

Pension

6. The government has created a new social security department in the Ministry of Finance for improving social security system control. Improved control has generated fiscal savings equivalent to more than US$100 million in 2001.

Public Sector Reform

7. The government's approved budget for FY02 has included a reduction in total central government current expenditure (net of interest payments and transfers to subnational entities and to social security) of more than 4 percent in real terms in relation to the same expenditures in the approved budget for FY01.

8. The government's approved budget for FY02 has included a reduction in central government's general expenditures (*gastos generales*) of more than 15 percent in real terms in relation to the same expenditures in the FY00 executed budget.

Second Tranche

A. General Condition of the SFAL
The macroeconomic framework of the Republic of Colombia is consistent with the objectives of the program.

B. Specific Conditions of the SFAL

Intergovernmental Fiscal Relations

1. The government is implementing the Constitutional amendment (*Acto Legislativo* No. 1, of July 30, 2001) in accordance with its terms, limiting the rate of growth of (a) total transfers to subnational governments to last year inflation plus 2 percentage points; and (b) the central administration's operational expenditures to last year inflation plus 1.5 (percentage points)—as both were included in the FY02 budget, approved by Congress.

2. The decree governing debt and borrowing by territorial entities (referred to in condition 3 of the first tranche) is being implemented in accordance with its terms.

Education

3. (a) Law 60, 1993 has been amended to provide for certification of municipalities that, together with districts, represent at least 40 percent of the country's school enrollment enabling such municipalities to autonomously manage the provision of education services (including teacher payroll) and to establish education performance monitoring mechanisms; or (b) the central government has certified municipalities that, together with districts, represent at least 14 percent of the country's school enrollment enabling such municipalities to autonomously manage the provision of education services (including teacher payroll) and intergovernmental performance agreements have been signed between the Central Government and such certified districts and municipalities. In either case, no extra budgetary transfers for education to certified districts or municipalities have taken place. **[COMPLEMENTED BY SECAL]**

Health

4. The government has signed contracts with at least three subnational governments to finance the restructuring of public hospitals, and the implementation thereof has started. These contracts have included specific annual targets for (a) productivity increases in inpatient and outpatient services and (b) labor cost reductions. The resulting fiscal savings are equivalent to at least 5 percent in real terms per month, on average among those participating subnational governments, compared to the previous year in a manner satisfactory to the Bank.

5. The government has transformed 60 percent or more of the 2001 budgeted health *situado fiscal* (after legal mandatory deductions) to demand subsidies. **[COMPLEMENTED BY SECAL]**

ISS

The government and the ISS have reached agreement to generate annual savings in ISS' total costs over a 10-year period which will, in the opinion of the Bank, make ISS financially and economically viable.

Pension

7. The government is carrying out and controlling the transfers of public pension regimes into a single agency, reducing payments of ineligible pension claims. Ongoing controls generate fiscal savings of, on average, at least US$10 million per month.

Public Sector Reform

8. The central government's total actual current expenditures (net of interest payments and transfers to subnational governments and to social security) that are being incurred in 2002 are generating average savings of more than 4 percent in real terms in relation to the same expenditures incurred during the same period in 2001.

9. The budget approved for FY02 has included general expenditures (*gastos generales*) that in real terms are not higher than those executed in the FY01 budget.

Floating Tranche

A. General Condition of the SFAL

The macroeconomic framework of the Republic of Colombia is consistent with the objectives of the program.

B. Specific Conditions of the SFAL

Intergovernmental Fiscal Relations

1. Congress has approved the law referred to in condition 2 (first tranche), substantially in accordance with the proposal submitted by the government.

Pension

2. Congress has approved a law to reform the general pension system to put it on a sustainable path; or Congress has approved a law to reform at east one of the exempted pension regimes to bring it/them, in the opinion of the Bank, in line with the general pension regime.

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