Chapter 1

Contextual factors influencing governance in Colombia

Colombia is Latin America's third largest economy as measured by GDP (2012) and is endowed with abundant natural resources. Significant political reform since the early 1990s, beginning with the adoption of the Political Constitution of 1991, has facilitated the modernisation of economic activity. While the country has weathered the recent economic crisis well, its GDP growth rates may stabilise over the medium term, inequality remains acute, severe regional disparities persist, productivity remains stubbornly low and its fiscal environment could become tighter over time. This chapter provides an overview of Colombia's economic, demographic, policy and fiscal challenges and opportunities, themselves influenced by the country's history and its recent political evolution. It highlights the need to improve its governance capacity to enhance the country's prospects of achieving "prosperity for all", the current government's medium-term strategic priority.

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Introduction

Colombia's socioeconomic performance reflects a strengthening of its political institutions and of its governance framework. Colombia is now Latin America's third largest economy as measured by GDP (2012); the country's national output reached a 5.9% annual growth rate in 2011 (OECD 2013). This performance was spurred by significant political reforms begun in the early 1990s following the adoption of the Political Constitution of 1991. These reforms have facilitated the modernisation of economic activity and more efficient royalty-sharing from the country's abundant natural resources. Together with the improved security situation and the on-going Peace Process, rising mining activity and strong world commodity prices, governance reform is supporting robust growth that may well be sustained over the medium term.

Colombia's current governance arrangements are based on the full separation of the three branches of government, a commitment to a liberal-market economy, and the leadership role played by the Executive branch in articulating and implementing reform to improve the responsiveness of government to the needs of citizens. The policy reforms that are currently being carried out by the national government as presented in the government's 2010-14 National Development Plan *Prosperidad para Todos* (Prosperity for All), raise significant governance implications for the government itself and its relations with sub-national authorities and civil society, including citizens and the business community. Good governance is about enhancing trust in government, its institutions, the quality of its services and decisions, because they are perceived to be made in the general, public interest. Indeed governance reform is not an end in itself; it is a means to achieve public-policy results for citizens and businesses efficiently and effectively.

Colombia is a complex country that faces specific challenges related to its recent history, its topology and its ethno-cultural composition, and to current macroeconomic and fiscal trends. Accordingly, this introductory chapter focuses on three main axes:

- The political history that forged Colombia's current approach to public governance – including its emphasis on strong, centralised presidentialism under the aegis of the country's Political Constitution – whose aim is to heighten the efficiency and effectiveness with which the country can achieve prosperity for all its citizens;
- The specific regional and demographic composition of the country that sheds light on why effective control over the country's territory has traditionally been so challenging, why successive governments have focused on improving transportation infrastructure to meet this challenge, and why the current government is focussing on decentralisation as a means to address persistent poverty, inequality and regional disparities to achieve prosperity for all Colombians; and
- The current economic context in which the government has defined and is implementing its development strategy. The OECD's 2013 Economic Assessment of the country offered policy advice in addition to analysing the internal and external economic factors affecting growth and development. This chapter summarises them in an effort to highlight their governance implications – implications that frame the remaining chapters in this Review.

History's influence on present-day governance in Colombia

Colombia's recent progress has been remarkable considering the roots of the country's political culture: that of a strong, centralised presidentialist form of government whose capacity to integrate political opposition into national decision-making was until the end of the twentieth century decidedly limited. The country's history illustrates a political path-dependency that did not necessarily point to the outcome of the liberal, market-driven democracy that is Colombia today. That said since its independence from Spain, Colombia has demonstrated an unflagging commitment to constitutional supremacy. This commitment to the rule of a Basic Law and to the legitimacy of the institutions of the Colombian State is deeply engrained in Colombia's national political psyche and has helped define it from the beginning: Colombia remains the only country in South America never to have been governed for any meaningful period by a military dictatorship. Indeed on the occasion of the promulgation of Colombia's first Constitution, General Francisco de Paula Santander, a military leader of the independence movement who dedicated his efforts to creating the institutions of the emerging republic and ultimately served as President of Colombia (1832-37), famously stated: "*Colombianos, las armas os han dado la independencia, las leyes os darán la libertad*" ("Colombians, arms have given you independence, laws will give you freedom").[1]

Colombia has faced dramatic challenges related to its capacity to govern its own territory. Until recently, Colombia's State was perceived as struggling in its efforts to maintain effective control over its geography and fight armed guerrillas and drug cartels. Efforts by recent Colombian governments to improve capacity to fix these scourges have framed national development priorities and shaped current approaches to modernise the country's governance arrangements to implement these priorities effectively. This next section outlines those elements of Colombia's political evolution that help explain the country's strong Presidentialist form of government as well as the political reckoning that led to the 1991 Constitution and the instauration of a market-driven liberal democracy.

Roots: a Constitution, strong Presidentialism and the exclusion of opposition from decision-making

In 1819, the Battle of Boyacá ended Spanish rule over what was known as the *Virreinato de Nueva Granada*. The period between 1820 and 1830 marked the emergence of *Gran Colombia*, the nation envisioned by Simon Bolívar and comprised of present-day Colombia, Venezuela, Ecuador and Panama. However, great differences in the economic and social structures of the various components of Gran Colombia caused it to fall apart by the end of 1830: Ecuador proclaimed its own independence, as did Venezuela with the establishment of its own Constitutional Congress.

The 1821 Constitution set the pattern for Colombia's basic laws throughout the 19th and 20th centuries:

- The Constitution established the office of President to serve a renewable four-year term, a bicameral legislature and a judiciary whose members were appointed by the executive and legislative branches of government. Although partly based on the United States Constitution, it did not adopt a federal structure of government. The heads of regional administrations were appointed by the President; these regions had no autonomous legislatures.
- The Constitution of 1832 established the Republic of Colombia after the secession of Venezuela and Ecuador, and with it rules of citizenship, civil and political

rights, and the separation of the three branches of power. This Constitution further centralised executive power, thus creating the strong presidential tradition that has survived in one form or another to this day.

Over the first half of the nineteenth century the country's economy and social structure did not change significantly, accentuating the conservatism of the governing classes. Two main factions, Liberals and Conservatives, emerged in the 1830s and 1840s. Political discourse did not divide over economic policy where there tended to be bipartisan consensus, or over the centralised nature of the state apparatus, upon which views were also generally shared across the spectrum. Rather, division emerged on matters related to the power and influence of the Catholic Church. Liberals favoured the separation of Church and state, freedom of religion, secular education and the reduction of the Church's economic power. Conservatives, on the other hand, considered Catholicism and the Church to be the elemental foundation of the country's social order. This division led to civil war between 1839 and 1842.

Having emerged victorious, Liberals then dominated Colombia's political life for the next thirty years – and excluded their political opponents from all forms of national decision-making. During this period, the Liberals implemented a more federalist political structure. The Constitutions of 1853 and 1863 reduced the power of the executive and established permanent elections and the supremacy of parliament. Indeed the Constitution of 1863 consolidated popular sovereignty in its preamble. It established federalism with autonomous, elected regional legislatures, reduced the term of the President to two years, and consolidated individual civil rights including absolute freedom of speech.

The Liberal Era brought about an increase in foreign trade and a rise in exports. Indeed growth in exports of the country's natural resources – especially gold and agricultural products – created the optimism and material resources that reinforced the Liberals' dominion over the country's national political life. Large coffee farms emerged along with the colonisation of Colombia's indigenous peoples, particularly in Antioquia and the western regions of the country.

By 1885 however, Colombian exports were decreasing dramatically and the national economy was faltering. Significant growth in imports contributed to a liquidity crunch and high domestic interest rates, causing a severe recession. Spikes in unemployment led to social unrest and riots in cities and regions across the country. Division within Liberal ranks deepened, while an emerging national élite representing different interests from the Liberals, from landowners to businessmen, began to impose itself, arguing in favour of consolidating and recentralising power.

The economic crisis created the Conservative-led Regeneration movement, first elected in 1885 and in power uninterrupted until 1930, whose economic and administrative programme was implemented through the Constitution of 1886, which survived until 1991. This period, like the Liberal period before it, was characterised by the exclusion of political adversaries from national discourse and decision-making. However, unlike the previous period, the 1886 Constitution restricted individual rights and the guarantees established in the 1853 and 1863 Basic Laws. Freedom of the press was curtailed, opponents of the government were imprisoned and suffrage, although reserved on paper for literate citizens with economic property, in practice was permitted for members of the ruling party only: between 1885 and 1904, the Liberal party elected exactly two officials to the House of Representatives, and none to the Senate. The 1886 Constitution:

- Re-centralised the State by replacing the 1853 federal structures with centrally-administered sub-national units called *departamentos* (from now on referred to as departments) whose heads were appointed by the President of the Republic;

- Greatly strengthened the office of the President and the Executive branch, and centralised the Armed Forces. The State was given legal instruments to intervene in economic life. The term "administrative decentralisation" was used to describe a strong central power exercised through the State's regional structures;
- Restored the power of the Church, leading to the signing of a Concordat between Colombia and the Holy See in 1887. This would have a significant impact on public policy and politics in general for generations: the Concordat placed the Church (and not the State) in charge of regulating birth, education, marriage, culture and death.

This political environment sparked a second civil war (the War of a Thousand Days, 1899-1902), greatly slowing economic growth and the pace of the country's modernisation at the dawn of the new century. While no clear winner emerged, the war established the precedent for what turned out to characterise Colombia's national political life well into the twentieth century: "political exclusion as a catalyst for armed conflict" (LaRosa and Mejía, 2012, p. 125).

The Thousand Days war culminated with the secession of Panama. On November 3, 1902, the Panamanian elite, reacting to a deepening separation from its counterpart in Bogotá, declared their region's independence from Colombia. Perceiving Panama's secession as an indicator of Colombian vulnerability, both Conservatives and Liberals focussed on the need for bipartisan compromise. The loss of Panama thus ushered in a new era in Colombia's development. Between 1903 and 1946 the country integrated into world markets as coffee production was consolidated. New political actors (in particular labour unions) appeared, resulting in a broadening of political and social rights (Palacios and Safford, 2002). From 1930 to 1946, unions and workers' rights received greater recognition, which led to significant changes to the 1886 Constitution and more balanced power-sharing between the executive and legislative branches of the state.

That said this particular brand of centralised presidentialism sustained a political environment in which "party-led management of the state became the factor that most directly contributed to chronic violence" (LaRosa and Mejía 2012, p. 85). The two parties each saw monopolising control over the functions of the state as the most effective way to run the government. Thus, holding on to power meant excluding the other party from national decision-making, a tradition now a century old. Even though formal civil war had disappeared by the middle of the twentieth century, party-driven political violence continued to characterise the Colombian political system well into its second half. This played out over the entire mid-century period, known as *La Violencia*. And the centralised presidentialist model survived the to-and-fro of Liberals and Conservatives struggling to keep power:

- The event that sparked *La Violencia* was the assassination of a popular Liberal leader on April 9, 1948 in Bogotá, along with the violent riot that followed, with citizens believing that the wealthy conservative establishment was preventing the people from having a real voice in politics and society. This period of sporadic political violence in Bogotá and in the regions was also characterised, perhaps not surprisingly, by the disintegration of intra-party unity in both camps.
- Although the *Violencia* defines the period 1948-60, its roots go back to the 1930s and the onset of agrarian conflict resulting from central-government policies that favoured large-scale land-owning producers over agrarian and indigenous groups (LaRosa and Mejía 2012). The limited reach of the ruling political class in Bogotá could not prevent social and political conflicts in the remote regions of the country. The *Violencia* demonstrated the enormous gap between urban and rural Colombians, as well as between the wealthy and the poor.

Out of this chronic instability was born the *National Front* in 1958, a political arrangement between Liberals and Conservatives to implement a National action plan to stop the violence. The *National Front* lasted till the mid-1970s. During this period:

- The presidency would simply alternate between the two parties. This arrangement also reflected an institutional agreement between "the political and business elites and the Catholic Church hierarchy to overcome by measured steps the authoritarianism and violence of the preceding period" (Palacios 2006);
- Relations between the State and the business elite were strengthened. The presidency grew stronger while the legislative branch lost credibility;
- The State became the key source of patronage. Throughout the country, all positions in the three branches of government would simply be distributed between the two parties.

By the mid-1970s, notwithstanding (or perhaps because of) the centralised nature of political authority, Colombia's entire political system had reached a crisis of legitimacy. The denial of political participation to groups falling outside liberal and conservative orthodoxy paved the way for groups on the left to pursue political relevance by taking up arms to achieve power outside the electoral system. This in turn led to the emergence of armed paramilitary militias on the right, in opposition to the insurgents. This crisis of legitimacy was exacerbated by financial scandals and the emergence of drug trafficking. The clientelist and corrupt political dynamic of the *National Front* and the impact of the Cuban revolution on the left's consciousness in Bogotá and around the country contributed to the wide-spread legitimisation of left-wing guerrilla movements, two of which, the FARC[2] and the ELN,[3] still exist today. The ELN was created in the early 1960s by a group of university students, while 1964 marked the birth of the FARC, a rural-based agrarian movement borne out of frustration with the failed struggles of the 1930s and 1940s.

By the late 1980s, Colombia was a failing state. Actors populating the country's national political stage included drug traffickers, paramilitary groups and corrupt public officials (LaRosa and Mejía 2012). Indeed the power of the paramilitary was growing, with an agenda that went beyond controlling local activity. Drug cartels were winning political power with seats in Congress and consolidating influence among business people, politicians, and government officials (LaRosa and Mejía 2012).

The push for fundamental reform and greater socio-political inclusion in Colombia was driven by the country's student movement. In 1989, three opposition candidates for the presidency were murdered, including the Liberal candidate who likely would have won. As a result, popular pressure for constitutional reform dramatically increased. Students organised themselves into a movement known as the Seventh Ballot, so called because they campaigned during congressional elections at the end of that year in favour of the election of a Constituent Assembly to draft a new constitution. Support for this was to be expressed using an unofficial "seventh" ballot that would be attached to the six ballots for parliamentary and municipal elections to be held early the following year.

Even though that ballot held no legal weight, the students managed to garner approximately two million votes in favour of summoning this National Constituent Assembly (LaRosa and Mejía, 2012). The result served as a striking indicator of public discontent with the political regime. The ballot result had turned into an official plebiscite: it led to an official election in December 1990 to designate the Constituent Assembly (Cárdenas, Junguito and Pachón, 2006).

The drive for a new Constitution was framed by three elements: the exacerbation of clientalism and the fragmentation of party representation; the deterioration of public order due to the violence generated by delinquency, illegal armed groups and drug trafficking; and Colombia's now-oppressive economic structure that had generated huge disparities in income and high levels of poverty. In addition to students, academics and representatives from business and the traditional political élites, this elected Constituent Assembly ended up including "indigenous peoples, unionists, former guerrillas, and spokespeople of the new social religious movements" (Palacios, 2006). From it emerged a new Constitution designed to "legitimise the state through a system that was more participative and decentralised; more oriented toward social justice; more transparent and less corrupt" (Palacios and Safford, 2002).

1991: The break from path-dependency and the democratisation of Constitutional Presidentialism

It would be difficult to overstate the momentous nature of this watershed moment in Colombia's history. The change that the passage of this constitution wrought in the country's political elites caused the country as a whole to stare down the political decision-making patterns of its past and in one fell swoop adopt pluralistic democratic institutions, liberalise the national economy to ensure the primacy of markets, and engage in meaningful decentralisation to give voice to citizens in every region so that all can contribute to national development. The resulting Political Constitution of 1991 proposed a social state based on guaranteed rights and the Rule of Law:

- It emphasised the participation of social sectors that had previously been marginalised by the bipartisan system along with a renewed dynamic between the three branches of government. The excesses of centralised presidentialism were tempered through a strengthening of the legislative branch and of the judiciary. The creation of new political parties was encouraged.
- The new Constitution focused on addressing the then-endemic corruption and clientalism that characterised relations between the public sector and civil society. It recognised ninety-nine specific rights and introduced the importance of protecting the environment. The right of redress against administrative and judicial decisions was enshrined. Access to citizenship was made easier, with citizenship identified as the most important criterion for the right to vote, be elected and hold public office.
- The reform transformed Colombia's national territorial make-up, turning large portions of land with low population density into departments. Fiscal support for municipal autonomy and decentralisation was enshrined. Indeed the Constitution legally recognised the ethnic and cultural diversity of the nation with the creation of indigenous territorial units under the *Law of Afro-Colombian Communities* that established a national electoral district for this group.

The 1991 Constitution established the Constitutional Court with judicial-review powers to ensure policy and legislative compatibility with the Constitution. In Colombia, this institution plays a crucial role since many policy issues have been elevated to the rank of constitutional law, including public-sector wages, mortgage interest rates, and pensions, among others. The 1991 Constitution established socio-economic rights and a series of judicial mechanisms and institutions to give effect to them including, in addition to the Constitutional Court, the Office of the Inspector General (the *Procuraduría* – see Chapters 2 and 3), the right to writ of protection, and the right of popular action.

Importantly, the 1991 Constitution reduced in relative terms the traditional powers of the president. Prior to 1991, the president could avoid Congress altogether by declaring states of exception, during which he could rule by executive decree and suspend laws he considered incompatible with his policy direction for the country. The 1991 Constitution regulates and restricts the president's use of these states of exception; it gives Congress a more prominent role in law-making. Likewise, it establishes that department governors are to be popularly elected instead of being appointed by the president.[4] The Office of the National Attorney General is now an autonomous entity that no longer operates under the direction of the government.

Although Congress and the Constitutional Court are now central to determining which policy becomes law and whether legislation conforms to the Constitution, the president's power and independence remain nonetheless considerable given his first-mover advantage, his influence over individual members of Congress and Colombia's tradition of personality-driven presidential elections (Eslava and Meléndez, 2009). Cabinet members and the heads of all autonomous agencies are designated by the President as head of the Executive branch. And while the 1991 Constitution focuses on generating a balance of power between the Branches, it confirms the right of the Executive to introduce legislation related to the structure of ministries, salaries of public employees, foreign exchange, budget, external trade and tariffs, and national debt, among other areas (Cárdenas, Junguito and Pachón, 2006).

The 1991 Constitution signalled a change in the role of the State in regulating economic activity. The State abandoned its interventionist role as the sole service-provider and opened vast sectors of the national economy to private-sector participation, thereby increasing domestic consumption. From that point onwards, the government focused on designing and implementing policies and regulations to frame private-sector activity, establishing more a predictable, coherent and transparent regulatory environment to encourage private, market-based economic activity.

The first decade following the adoption of the 1991 Constitution was marked by initial reforms that focused on giving legislative effect to its new public-governance framework. Thus, the first waves of reforms focused on strengthening the role of the Legislative branch and clarifying the role of the President and the Executive branch, introducing major regulatory reform and privatising many key areas of the economy, while beginning the process of streamlining government. This first decade also saw initiatives to modernise and extend the reach in the provision of basic public services to Colombians, initial initiatives to decentralise the public administration as a whole by strengthening regional and local democratic decision-making and providing revenue-generating capacity to sub-national authorities, and establishing internal and external audit and control institutional arrangements within the central government to fight corruption.

The political history of Colombia can thus help frame an assessment of the central government's current governance-reform agenda – an agenda that has been articulated and is being implemented against the backdrop of a strong, centralised Presidentialist system – albeit a fully democratic one. So too can an understanding of the country's geographic and demographic characteristics. This next section highlights the key elements in these areas that can help explain the government's current priorities for governance reform.

The impact of geography and demography on Colombia's governance

Colombia's geography and its demographics also influence the central government's national governance-reform agenda as it seeks to achieve its development objectives for the country. For instance, Colombia's geography can explain why exercising control over the country's entire territory has been such a challenge, whether in addressing the impact of natural disasters on citizens and communities, or in the fight against the insurgencies and the drug cartels, and why transportation infrastructure is so critical both to ensuring this control today and encouraging growth and development in all of the country's regions. Indeed Colombia is ranked at the top of the global list of countries whose geography makes them the most challenging to govern.[5]

A disconnected geographic space affects territorial control and service-delivery

Colombia is located in the north-western portion of South America and has coasts on both the Atlantic (Caribbean) and Pacific oceans. It ranks fourth in the world in terms of biodiversity and its climate ranges from tropical to glacier. Colombia's five regions – the Caribbean (north), the Pacific (west), the Andean (centre), the Amazonic (south) and the Oriental Plains (east) – are distinct and disconnected geographically from each other due to mountains and jungle. Nearly 33% of the territory is mountainous due to the Andes range running down the centre of the country. The other 67% is constituted by valleys, high plateaus, and low plains (Muñóz Cardona, et al., 2007, p. 19). This topology restricts connectivity within the country.

Population is unevenly distributed across Colombia, and there are large parts of the country with very low densities (Figure 1.1). While this highly diverse geography has enriched the country from an environmental and biodiversity perspective, it has played a key role in limiting communication between populations, and in making it difficult for the central government to reach certain regions. This geography defines the government's transportation-infrastructure agenda, as it has for generations, and materially affects the quality and quantity of key public-services, including education and healthcare, due to the high cost of building such infrastructure as hospitals and schools in remote areas. This geography also limits the central government's capacity to meet the needs of local populations affected by natural disasters – earthquakes or floods – in remote areas cut off from transportation infrastructure.

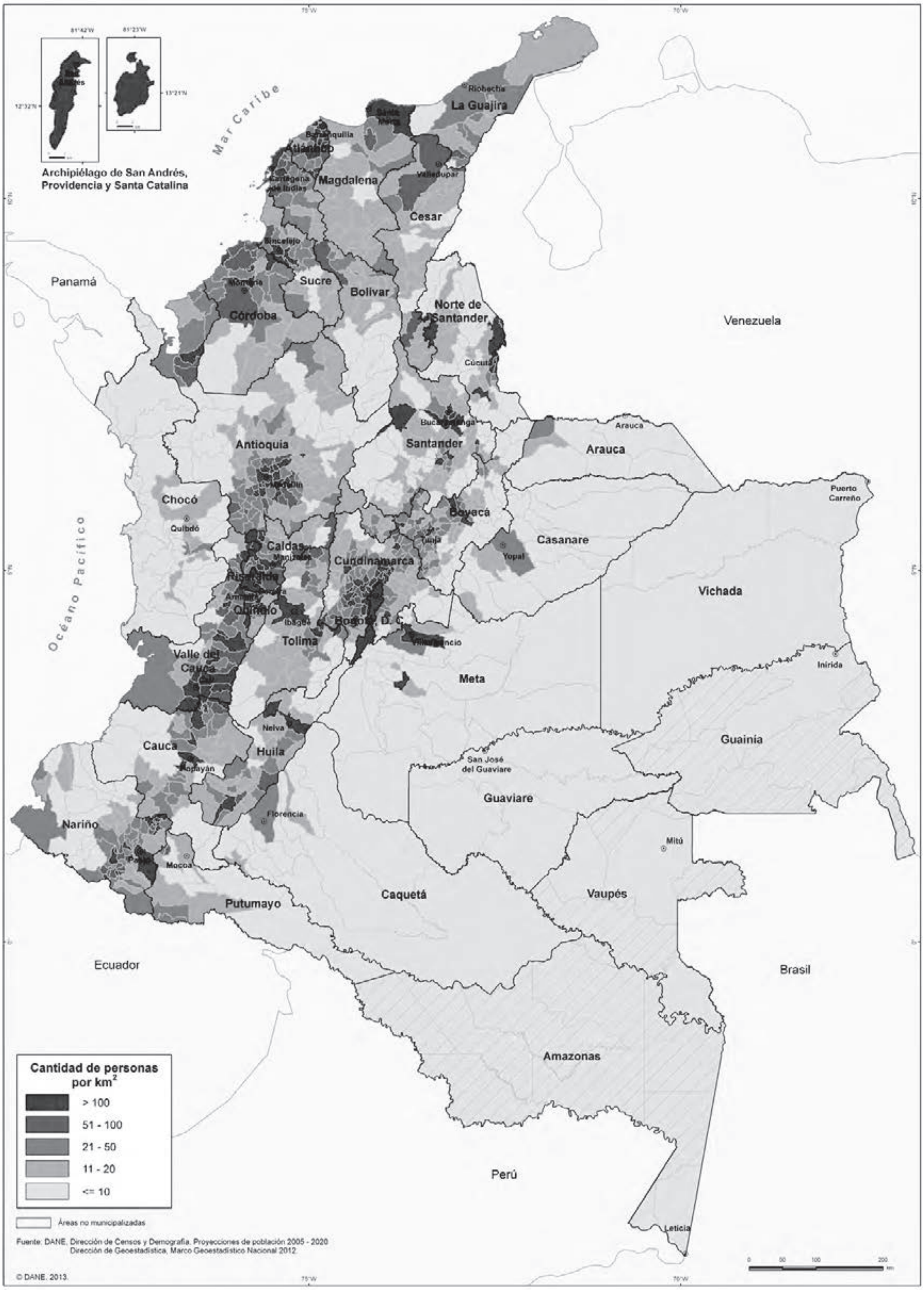
Place-based ethno-cultural diversity highlights the focus on reducing regional disparities

The specifics of Colombia's regional structure and the ethno-cultural concentration of minorities in certain regions of the country – and the correlation of these factors with poverty, inequality and pronounced regional disparities – explain in part why the government of Colombia has defined as a national priority in its fight against inequality the need to decentralise decision-making and give voice in national discourse and decision-making to minority groups and economically disadvantaged regions.

In demographic terms, Colombia is a young, pluri-cultural and multilingual country. The 2011 census reports Colombia with a population of over 46 million people. A high percentage of the country's population is under the age of fifteen (28.2%), compared to the OECD average of 18.4% (OECD 2013). Colombia counts 87 indigenous ethnicities, including three differentiated groups of Afro-Colombians. The 2005 census reported Afro-Colombians as representing about 10.6% of the total population, and indigenous people at about 3.4%. There are 64 Amerindian languages spoken as well as *bandé*,[6] *palenquero*,[7] and *Romaní*.[8]

Indigenous peoples are grouped into over eighty different ethnicities living in 754 indigenous reserves, concentrated in the south-eastern and north-eastern parts of the country as well as in departments along the Pacific coast. After independence, some of

Figure 1.1. **Population density in Colombia**



Source: DANE 2013.

the indigenous communities adopted farming, grew economically dependent on small parcels of land or became tenant farmers. The twentieth century was thus marked by the indigenous peoples' struggle against rural poverty and their political mobilisation to defend their land and farming traditions. The expulsion of indigenous peoples from their lands in the Andean and Caribbean regions, exacerbated by large-scale farming and mining projects, spurred the migration of indigenous communities to regions such as the Orinoco and Amazon River basins in the south-east, the rainforest areas of the Pacific, and the eastern plains (LaRosa and Mejía 2012).

Colombia has the third largest population of African descent in the Americas after the United States and Brazil, a legacy of the colonial slave-trade. Following the abolition of slavery by Congress in 1851, freed slaves settled in the mining areas of the Pacific and in the Caribbean cities along the north coast (see Figure 1.1). Today, the Afro-Colombian population is concentrated in the departments of Chocó, Valle and Cauca on the Pacific coast, the Archipelago islands of San Andrés, Providencia and Santa Catalina in the Atlantic Ocean, and in Bolívar on the Caribbean. In recent years, this group migrated toward urban centres not only as a result of the country's general urbanisation process but as a consequence of forced displacement caused by confrontation with guerrillas and the expansion of illicit crops in the south-western regions of the country.

Colombia today remains fragmented in four populated regions: the Caribbean coast, Antioquia, the Cauca, and the Andean region (see Figure 1.1). Ethno-cultural differences continue to define the country's inhabitants and their degree of attachment to the country's political culture and institutions. This fragmentation dates from the first days of the republic. It is accentuated by the geography of the national territory; it also paved the way to strengthening regionalisms and regional identities that were the source of traditional internal conflict.

The traditional urban-rural split illustrates an ethno-cultural overlay…

In the first half of the 1800s, most of the population was rural, yet urbanisation began accelerating in the 1930s. At that point no Colombian city had half a million inhabitants. By 1958, two cities had more than two million people, and two had over one million. The growth of cities created new urban hierarchies and new oligarchies, while weakening the links between the regional ruling classes and the *notable* of smaller towns (Palacios, 2002). As cities became centres of power, wealth and culture, gaps in living conditions increased within them, as well as between regions, between classes, and between cities and the countryside. The consolidation of the state and of capitalism in urban centres greatly enriched a few people and impoverished many others. Yet, a significant increase in the size of the middle class occurred due to the development of the service sector and waged labour, along with the professionalisation of white-collar workers.

Today, Colombia's urban population is mainly composed of *mestizos* (mixed-race persons) and whites. This generates a political distance between this majority and the indigenous and Afro-Colombian populations (LaRosa and Mejía 2012). Political struggle for greater recognition for the indigenous and Afro-Colombian population reached its zenith in the second half of the twentieth century. This process culminated in the codification of special rights for these groups in the 1991 Constitution. This codification also illustrates the central government's current focus on ensuring that these groups are treated equitably by the state, notably in terms of access to public services.

… and highlights gender inequality

Women suffer from lower activity rates and earn lower salaries than men, most notably in urban areas. While the participation rate of women in the labour market has been increasing – rising from 47.3% in 2002 to 51.4% in 2010 – it remains inferior to that of men, at 74%; women earn on average 20% less than men for similar work (National Development Plan 2010-14). And there is the need to improve outcomes in such areas as acute and persistent intra-family violence, discrimination in wages, recognition of unpaid work and its contribution to the economy, support for single-mothers as heads of households, and so on. For instance:

- Men and women have been affected similarly by forced displacement caused by conflict. However, since 2005, women have been experiencing higher expulsion rates.[9]
- Although the representation of women in Congress has been rising, it still only averages 15.8%. While this figure is close to the average for women holding elected office in Colombia, it is still below the OECD average of 24.4%. At the regional level for the period 2008-11, figures show that women's participation in governorships was 3.1%, in city halls 9.5%, in departmental assemblies 18.2%, and in municipal councils 14.5%.

The government of Colombia's current National Development Plan (see remaining chapters) emphasises the importance of gender-equity as an integral part of the government's national development strategies aimed at reducing poverty, regional disparities and generating equal opportunities for the population as a whole regardless of where they live. In this connection, the government approved in March 2013 its *National Public Policy on Gender Equity* and its *Comprehensive Plan to Guarantee Women a Life Free of Violence,* and established a Gender Council on Economic and Social Policy (Gender CONPES) to co-ordinate programming efforts across different central-government agencies and ministries in such areas as women's access to income, justice and higher education. This commits an investment of almost USD 2 million on improving the lives of Colombian women. The government is also focussing on establishing zero tolerance toward violence against women.

In addition to the historical, geographic and demographic factors influencing Colombia's governance, key economic challenges affect both the scope and implementation of the government's current governance-reform agenda. This next section presents these challenges as contextual factors affecting this agenda.

Macroeconomic challenges: Poverty, inequality, poor productivity, regional disparities

The OECD Economic Assessment of Colombia (OECD, 2013) found that the Colombian economy weathered the global economic crisis well:

- After a sharp deceleration in 2009, output recovered rapidly to reach a growth-rate of 5.9% in 2011, despite severe flooding in late 2010 and the loss of the Venezuelan export market as a result of a series of disputes between the two countries.
- Growth was sustained by the booming mining sector, with commodity exports and investment boosted by the sharp rise in commodity prices. The mining sector grew by more than 14% in real terms in 2011.
- The non-tradable sectors have also been buoyant, particularly transport, financial services and construction. In contrast, manufacturing and agriculture have lagged

behind, pointing to a three-speed economy, with mining pulling ahead, non-tradable goods faring well and non-mining tradable sectors suffering.[10]

- Inflation has been brought down within the official target range of 2-4% since mid-2009 and, at 3.1% in September 2012, is very close to the 3% long-term central bank target. Core inflation (excluding the most volatile goods and services prices), at 3.7% in September, 2012, now stands above the headline rate (Table 1.1).
- Total employment increased by almost 15% between 2009 and 2012, driven by solid economic growth. More than 2.5 million jobs were created, in particular in services (retail trade, hotels and restaurants as well as finance, insurance and real estate). This is also reflected by a sharp reduction of unemployment rate that went from approx. 15% in 2001 to approx. 10% in 2012.
- On the demand side, private consumption and investment contributed solidly to growth between 2010 and the first half of 2012. The reduction in the unemployment rate has boosted household confidence which, combined with historically low real interest rates and strong credit growth, has supported private consumption.

While economic growth has slowed somewhat, short-term projections remain positive: in 2012 the GDP growth rate was 4%, a substantial figure considering regional and international economic dynamics (Ministry of Finance, Colombia, 2013). Domestic demand should remain buoyant (Table 1.1). Though mining investment has recently weakened in the wake of tumbling commodity prices, large public construction projects should maintain momentum. In particular, the government plans to invest in road, railway and port infrastructure, to continue reconstruction caused by the damage of the 2010 floods, and to build houses for vulnerable households. Consumption will continue to benefit from low real interest rates, job creation and household confidence. Activity will also get a boost from the free-trade agreement with Colombia's largest trading partner, the United States, which came into effect in May 2012. The launch of the Peace Process is also likely to boost consumer and investor confidence over the medium term.

The OECD Economic Assessment found that the Colombian economy faces three main medium-term challenges. First, reducing poverty and pronounced inequality; second, boosting productivity growth, and; third, reaping the benefits of the commodity boom while paying attention to medium-term risk caused by external factors:

- Important sections of the labour force remain underutilised and the informal sector is large. The education system performs poorly in raising human capital and promoting social mobility, which can reduce income inequality.
- Infrastructure and other elements of total factor productivity need to be improved to enhance the quality of life, reduce business costs and expand markets, thereby increasing productivity growth.
- The resource boom is likely to last for some years and is a blessing; however, it poses social, economic and environmental policy challenges. The boom has boosted foreign investment, economic growth and government revenues. Yet, the rising terms of trade and related capital inflows have contributed to a sharp appreciation of the exchange rate, undermining the competitiveness of other sectors. In addition, mining activities put pressure on the environment. They are also often highly capital intensive and tend not to create many jobs, and thus may harm income distribution.[11]

Table 1.1. **Short-term projections for Colombia (main indicators)**

	2010	2011	2012	2013
GDP	4.00	6.60	4.00	2.80[a]
Final consumption	5.12	5.41	4.81	3.46[a]
Gross fixed capital formation	7.70	18.18	5.83	3.9[a]
Consumer price index	3.17	3.73	2.44	2.16[c]
Current account balance (% of GDP)	-3.10	-2.80	-3.10	-3.30[a]
Unemployment rate (average, %)	11.78	10.83	10.37	10.73[b]

Notes: a. First Trimester.

b. Average until May.

c. Annual, May.

Source: Banco de la república, DANE, Banco Mundial. OECD Secretariat calculations based on Colombia's National Statistics Department (DANE), and Bank of the Republic of Colombia and World Bank data.

To ensure balanced growth, it will be crucial to increase the ability of the economy to adjust to the higher terms of trade. This will require a more inclusive economy, where people can benefit from the commodity boom. The key macroeconomic challenges of poverty, inequality, lagging productivity and persisting regional disparities, as well as the medium-term impact of external risk on Colombia's economic performance, are discussed in the following sections.

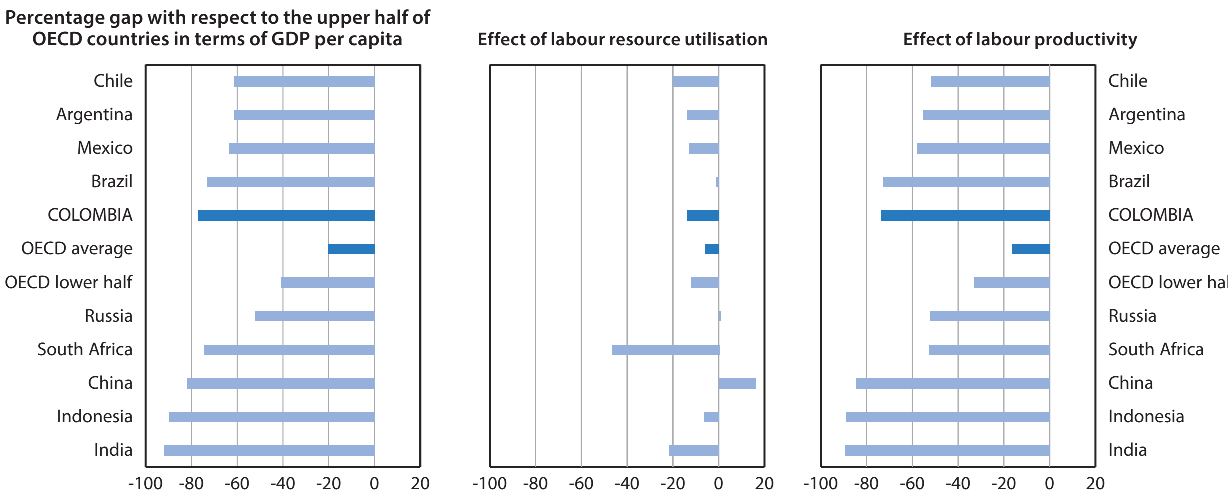
Poverty and Income Inequality

Colombia is an upper middle-income country; however, its per-capita income is 70% below the OECD average and below that of many emerging economies, such as Brazil, Russia and South Africa. The OECD Economic Assessment found that low labour productivity explains most of this gap (Figure 1.2). In particular, low labour productivity connects with the informal economy. The large informal sector has particularly low productivity, and bringing this activity into the formal sector is therefore key to raising aggregate productivity. Raising productivity will thus require reducing informality via labour and product market as well as reforms that reduce costs associated with formal employment and create a more flexible labor market, increasing the quantity and quality of education, developing transport infrastructure and improving access to finance, while making progress towards enhanced security across the country and reducing corruption. These interventions will require strong governance institutions capable of creating integrated policy packages and of leading their effective implementation-co-ordination.

Colombia remains one of the most unequal countries in the world (Figure 1.2). The country has successfully reduced absolute poverty since the mid-2000s, yet large income inequality is still one of the key national challenges, and income redistribution based on the tax and transfer system is very small. That said recent tax reforms aim to improve income distribution, building on progress that is already being made:

- Colombia has become one of the Latin America countries that has reduced poverty most significantly. Since 2012, the government has achieved such progress that Colombia is no longer part of the group of countries with the worst disparities in the region (prior to 2012 Colombia was ranked the third country in the region with the most inequalities). In 2012 the income of the bottom 20% of the population grew by 13.2% while for the top 20% it grew by 2.3%.

Figure 1.2. **The sources of real income differences in Colombia 2008-10**



Source: OECD (2013), *Economic Policy Reforms 2013: Going for Growth*, OECD Publishing, Paris, http://dx.doi.org/10.1787/growth-2013-en, and data provided by Colombia's National Statistics Bureau (DANE).

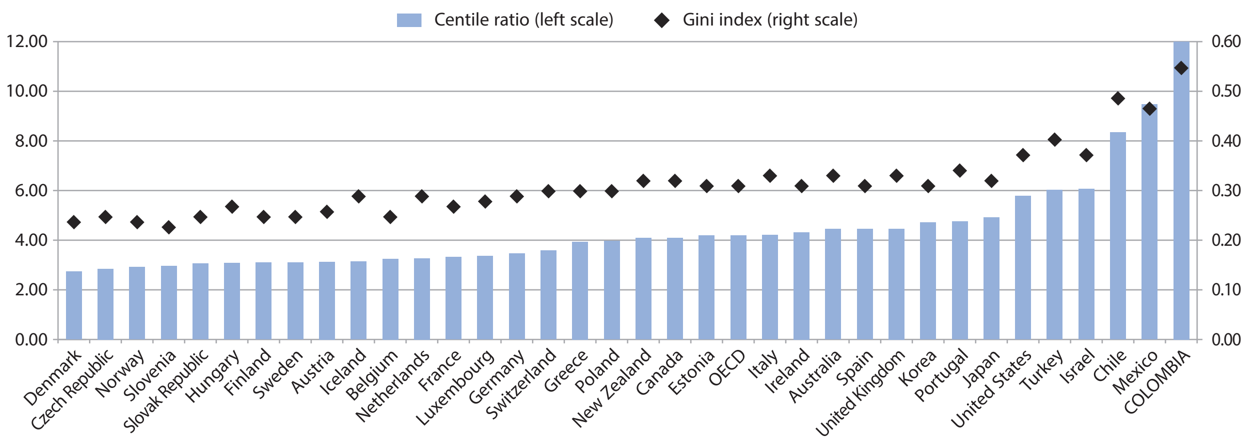
- Since 2010, 1.7 million Colombians have left poverty, including more than 700 000 people that have overcome extreme poverty. Extreme poverty has been reduced by two points between 2011 and 2012. Colombia's Gini coefficient decreased by 2.1 points between 2011 and 2012; the country is ranked second in the region in improving its income distribution after Ecuador.
- With the Oxford Poverty and Human Development Initiative and the United Nations Development Programme, the government of Colombia created the Multidimensional Poverty Index, which integrates indicators for education, childhood and youth conditions with those associated with access to labour and employment, health-care, housing and other public services. This composite index pointed to a reduction of poverty of 3.5 points between 2011 and 2012. According to this Index, during these two years 1.27 million people have overcome multidimensional poverty. These results were achieved thanks to growth in income, reduction in unemployment and the movement of workers into more formal labour arrangements (between 2010 and 2012 more than 2 million jobs were created).

The 2013 OECD Economic Assessment found that in Colombia, labour-market driven income inequality is large, with high unemployment playing a role. In spite of a steady decline since the early 2000s, at 10.8% in 2011, the unemployment rate was well above the OECD average. The majority of those working are employed in informal and low-productivity activities, and a third of the employed declare being under-employed. Women and the young are particularly exposed to the risk of unemployment, and the less qualified account for most of the informal workers. Moreover, the wage dispersion is very wide among those working, reflecting a high education and skill premium. And many of those employed (about one third in 2012) also reported being under-employed. In addition, among those working, many are employed in the informal sector, often occupying low-productivity jobs and benefitting little from social protection. They are thus at a high risk of poverty when losing their job or when ageing.

Labour costs are high in the formal sector, pushing people with low productivity into the informal sector or into unemployment. Colombia has one of the highest minimum wages in relation to the average wage in the world. The ratio of minimum wage to average wage is beyond 70%; this compares with the OECD average of approx. 40%.[12] As regional differences in incomes are high, the uniform national minimum wage is at or above median incomes outside the capital. This is likely to have contributed to the high informality in the poorer regions. Yearly adjustments of the minimum wage are set by the Constitution to match at least the past year's inflation, *plus* productivity gains. Adjustments in the minimum wage have sometimes been used as a political instrument, with very large increases in real terms in some pre-election years. As a result, the minimum wage has increased in real terms by about 20% since the late 1990s.

Figure 1.3. **The divide between the rich and the poor is pronounced**

Household equalised disposable income: gap between the 10th and the 90th percentile and Gini index in the late 2000s



Note: Data for France and Ireland refer to the mid-2000s instead of the late 2000s. Data for Colombia are for 2012.

Source: OECD Income Distribution and Poverty, OECD Social Expenditure Statistics (database), DANE (Colombia's National Statistics Bureau) for Colombia.

Economic growth has helped secure a considerable drop in absolute poverty, whether measured in monetary or broader terms (see Box 1.1). However, declines in disposable-income inequality and relative poverty have been more modest. Income inequality and poverty, measured both in relative and absolute terms, remain extremely high by OECD standards. Reducing them is one of the government's priorities.

Box 1.1. **Poverty: Measures, incidence and recent developments**

Poverty reduction is one of the three pillars of the current government's National Development Plan 2010-14 "Prosperity for All". To monitor poverty, evaluate public policies and assess progress in reaching the Millennium Development Goals, the government has developed improved measures of poverty. Indicators of monetary poverty and multidimensional poverty are the most important.

Alternative poverty measures across OECD countries and in Colombia

- The relative merits of alternative poverty measures have been debated over the past fifty years. Poverty can be measured in absolute terms – a cut-off income line below which individuals are not able to afford a bundle of predefined basic goods – or in relative terms – with the relative poverty line defined as a percentage (usually 50% or 60%)

Box 1.1. **Poverty: Measures, incidence and recent developments** *(continued)*

of median income. In addition, Sen (1983) argues that the right approach for assessing the standard of living is to focus not on basic commodities or utility but on capabilities or functionings. In OECD countries, a consensus has slowly emerged favouring the use of relative poverty measures, the United States being a notable exception (Pisu, 2012). In Colombia, the government has developed various poverty measures which help in understanding and addressing poverty, with a focus on absolute poverty and on multidimensional deprivation, which is close to Sen's approach.

Recent efforts to better measure poverty in Colombia

- In 2011, Colombia adopted a new methodology to measure *monetary poverty*. Recently, new statistics establishing poverty and extreme poverty lines have been published. An individual is considered "poor", if he/she lacks the income required to cover a basic family food basket and other basic needs (e.g. healthcare expenses, education, clothing, etc.), and as "extremely poor" if he/she lacks the income to consume a minimum number of calories. The method is as follows. First, current per capita expenditure is computed, adjusted by a spatial price deflator to account for regional differences in the cost of the family basket.
- Households are then ordered by this measure, and an iterative method is applied to select the reference population (percentiles 30 to 59). This defines the basic family consumption basket. The extreme poverty line is obtained following a normative adjustment to the minimum calorific needs. The poverty incidence is computed using a methodology developed by ECLAC for all Latin American countries to enhance the comparability of poverty measures across the region.

This new methodology offers an up-to-date and more precise measure that allows for better comparability with the measures of other Latin American countries. Its advantages include updating continually consumption habits and using a better measure of income. In Colombia, official statistics show that absolute poverty fell sharply from 49% in 2002 to 34% in 2011. Extreme poverty also decreased, dropping from 18% to 11% over the same period. In spite of these remarkable improvements, rural poverty remains more than twice the urban rate. The government aims to reduce the poverty rate to 32% and the extreme poverty rate to 9.5% by 2014. Yet, income provides only a partial measure of poverty and individual wellbeing (Stiglitz et al., 2009). In an effort to go beyond income, the Colombian government adopted the *Oxford multidimensional indicator of poverty* in 2011. The following 5 dimensions and 15 variables are covered by the National Planning Department (DNP): *i)* household educational background (e.g. educational attainment, illiteracy); *ii)* childhood and youth characteristics (e.g. school attendance, repetition, access to early childhood services, child labour); *iii)* employment (e.g. long-term unemployment, formal labour); *iv)* health (e.g. health insurance, access to health care services conditional on need); and *v)* access to public services and dwelling conditions (e.g. access to treated water, sewage disposal, quality of floor and exterior walls, and overcrowding). An individual is considered poor if deprived of at least 33% of these 15 variables, taking into account their relative weights. The indicator portrays the incidence, intensity, severity, and nature of deprivation. This poverty rate shrank by half, from 60% in 1997 to 29% in 2011, mainly thanks to wider healthcare coverage, increased school attendance among 6-16 year-olds, better access to early childhood services, and reduced long-term unemployment. The rural/urban gap is higher for the multidimensional than the income approach, partly reflecting the critical lack of infrastructure (in particular water provision and sewage), low education achievement and the prevalence of informal employment in rural areas. In 2011, 300 000 people moved out of multi-dimensional poverty and the government aims at reducing the incidence of poverty further from 29% to 22.5% by 2014.

Political violence has contributed to poverty

Political violence, both from guerrillas (especially the FARC) and former paramilitary groups, has contributed to poverty, especially in rural areas. The persistent risk of expropriation has reduced investment incentives and has thus trapped rural households into low-productivity activities and poverty. Political violence has also led to a massive displacement of people – 3.7 million (8% of the total population) over the period 1997-2011 (*Acción Social*, 2012). These people, mostly peasants, have lost their land and income – asset losses represented 3% of GDP (Ibáñez and Velásquez, 2009).

Forced to move to large cities, displaced people face tremendous difficulties in finding employment since their qualifications and education level do not match demand for labour in urban areas (Ibañez and Moya, 2009a and 2009b). The vast majority of displaced people thus suffer from poverty (Fernández et al., 2011). In 2008, 98% of them lived below the poverty line and 74% below the extreme poverty line (Garay, 2008). While policies targeting the displaced population have long been scant, the government is providing increasing support through targeted cash transfers and in-kind support (in particular education and health). The 2011 Victims and Land Restitution Law is a cornerstone in this regard, but will have a high fiscal cost (COP 54 billion over the period 2012-21; or 8.9% of 2011 GDP).

Illiteracy is still high despite spending on education and training

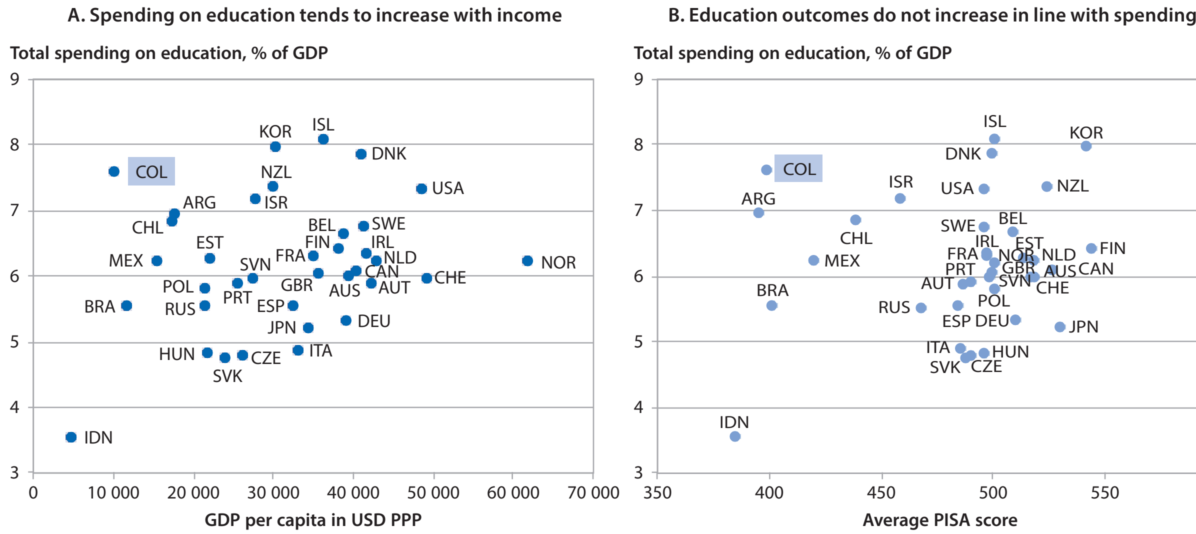
Illiteracy is a key contributor to inequality in Colombia. Universal access to secondary education remains a key challenge in Colombia. Low literacy and poor education reduce social mobility and are factors that contribute to poverty and inequality. In Colombia, the unemployment rate of those with secondary education is lower than for those without (14.2% and 5.8% in 2011, respectively); and those with little or no education are predominantly employed in the informal sector (OECD, 2013).

The coverage, quality and relevance of tertiary education could be enhanced. The gross enrolment rate is low (39% in 2011), the dropout rate is above 40% and overall quality is poor, particularly for technical programmes. Colombia ranks below other Latin American countries, such as Argentina, Brazil, Chile and Mexico, in top world university rankings. Furthermore, tertiary institutions collaborate little with businesses in designing curricula and establishing core competencies, limiting the relevance of the skills developed by their programmes to the needs of the labour market.

Colombia has made significant efforts to address these issues. The government of Colombia is focusing on increasing public expenditure on education. As a result, from 1985 to today, net enrolment in primary schools has increased by over 25%, reaching 97% of Colombian children; the survival rate to Grade 5 has grown from 67% to 88% and gross enrolment in secondary school has risen from 73 to 91% (UNESCO, n.d).

Total private and public spending on education as a share of GDP, at 7.6% in 2011, is higher than the OECD average (6.2%) and higher than in most emerging economies (Figure 1.4). Yet educational outcomes remain poor. PISA scores are well below the OECD average; the unemployment rate of those with secondary education is higher than for those without (14.2% and 5.8% in 2011, respectively); and those with no or little education are predominantly employed in the informal sector. Educational failure imposes high costs on society: it limits the economy's capacity to grow and innovate, damages social mobility, and reinforces income inequality.

Figure 1.4. **Colombia spends more on education but gets less in return than many other countries**



Sources: OECD (2011a), *PISA 2009 Results: What Students Know and Can Do: Student Performance in Reading, Mathematics and Science*, Vol. 1, OECD Publishing, Paris; OECD (2012), *Education at a glance – OECD Indicators*, OECD Publishing, Paris; World Bank (2013), Database, *http://data.worldbank.org.*

Lagging productivity and regional disparities

Poor productivity limits Colombia's growth rates

Colombia's income level is roughly a third of the OECD average, mainly due to differences in labour productivity. Despite growing at twice the OECD rate over the past decade, GDP per capita remains 80% below that of the upper half of OECD countries. This represents the largest gap among the five largest economies in Latin America (the others being Argentina, Brazil, Chile and Mexico). All economic sectors exhibit low labour productivity in comparison to OECD countries, and the least productive sectors, including agriculture and retail, are the ones that generate the most employment (DNP, 2011). There is also a 14% gap in labour utilisation, largely because of the high unemployment rate.

Productivity growth rates have also been among the lowest in Latin American and OECD countries over the past two decades (Agosin et al., 2009), and the explanation for this weak performance is broadly based: in seven of nine sectors average yearly labour productivity growth was lower than in both Latin American and OECD countries.

Low levels of productivity and poor productivity growth rates in Colombia can be explained by a variety of structural factors. A breakdown of the gap in output per worker with respect to the United States shows that it can be explained (Daude, 2012) by differences in human capital, physical capital and total factor productivity (TFP):

- Despite large improvements in education coverage, years of schooling and student performance account for 22% and 15% respectively of the labour productivity gap. Furthermore, 45% of companies refer to an inadequately-educated workforce as a major obstacle to their growth (OECD, 2012a).
- Investment in physical capital has historically been low compared to developed countries, to the point where the inadequate supply of infrastructure is currently considered the second most problematic factor in doing business and investing in Colombia (WEF, 2012). The biggest gap is in the quantity and quality of transport

infrastructure. Moreover, a number of factors have contributed to low overall investment rates over the past decades, which has translated into low productivity. The most important include low and costly access to financing, insecurity and substantial worker and business informality (Meléndez and Harker, 2009; DNP, 2011; World Bank, 2010). Investment in research and development has been particularly low. That said, as a consequence of the recent Royalties System Reform, 10% of royalties from the extractive industries are to finance Innovation and Development investment projects. In 2012 this reached nearly USD 500 million.

- Decreasing total factor productivity (TFP) has been at the heart of slow productivity growth. A long-term breakdown of the growth in GDP per worker in Colombia shows that slow growth since the 1980s is due largely to a deteriorating TFP rather than to a deceleration in the accumulation of physical and human capital. TFP's disappointing performance can be attributed to increases in crime and insecurity rates (Cárdenas, 2007), as well as low innovation, failure to provide essential public goods properly (e.g. infrastructure) and other factors, including corruption and insufficient access to finance (DNP, 2011). These factors more than offset the positive effect of reforms in the early 1990s on productivity, including the reallocation effect of lower barriers to trade (Steiner et al., 2009). That said improvement in the security situation in the 2000s contributed to a recovery of TFP and did provide impetus for investment to increase.

Acute regional disparities exacerbate the effects of low productivity

In addition, differences in per-capita income levels between regions are significant when compared to regional differences across OECD economies. Indeed inequality can be even higher between municipalities in Colombia. For example, the Gini index for the average GDP per capita across municipalities in Cundinamarca, the Department which includes Bogotá and one of the richest in Colombia, is close to 0.5. A reduction in the poverty gap between the poorest and wealthier regions can help address some of the underlying factors that have kept those regions under civil conflict and violence, allowing the country to grow sustainably.

In this regard, the government's recent Victims and Land Restitution Law, which looks to return people displaced by violence to rural areas, can contribute to reducing the pressure on large cities with insufficient employment opportunities and high congestion, and to opportunities for development in other areas. This law aims to establish judicial, administrative, social and economic, individual and collective tools, for benefit the victims so that they receive attention and reparation as a means to contribute to reconciliation.

Most of the regions' GDP per-capita gap is due to low labour productivity. This dispersion across Colombian departments has remained essentially the same over the past decade, with the main exception being commodity-producing departments where highly productive commodity sectors have emerged but have created little employment. Furthermore, regions with low productivity levels suffer from the same bottlenecks that explain Colombia's lag with respect to OECD countries:

Finally, the quality of transport infrastructure differs greatly across regions. High regional discrepancies in the quality of roads mean there are significant opportunities to raise competitiveness simply through the rehabilitation and maintenance of existing roads in low-performing regions. Better access to transport infrastructure in poorly connected areas can promote national and international trade and tourism (CEER, 2007; Ramírez and Parra-Peña, 2010).

Increasing risk of a deteriorating fiscal balance

Fiscal stability is both a priority and a challenge for the government of Colombia. Evidence suggests that Colombia's fiscal policy, while having recently improved significantly in large part due to the adoption of its Fiscal Rule (of a standard that can be deemed an OECD good practice – see Chapter 3), has been at best neutral or even slightly expansionary. According to IMF calculations, Colombia's structural fiscal balance deteriorated in 2011 by about 0.5% of GDP. Existing data on the central government and the non-financial public sector suggest that the commodity boom and the business cycle have boosted tax revenues:

- Central government revenues rose to 15.3% of GDP in 2011, up from 13.8% in 2010. About half of this increase reflects the rise in tax revenues and dividends paid by the public oil company (Ecopetrol).
- The 2010 tax reform, which aimed at improving tax compliance and closed some tax loopholes, and the temporary increase in the wealth tax to finance the consequences of the flood damage have reduced the deficit.
- Overall, the deficit of the non-financial public sector declined from 3.1% of GDP in 2010 to 1.8% of GDP in 2011, despite emergency spending amounting to about 0.5% of GDP in the wake of the late 2010 flood damages.

Prudent debt management practices have reduced exchange and interest-rate risk borne by the government, which has boosted market confidence. In fact, previous commodity booms in Colombia destabilised the economy, resulting in a decline in economy-wide savings and large current-account deficits that were followed by pronounced downturns (Echeverry et al., 2011b). As the commodity boom is likely to last, it is likely that the peso will be permanently stronger, meaning that the private sector – and governments – will have to adjust to it, including its impact on domestic employment, consumption patterns, inflation and income inequality over the medium term. So far, the government has been able to handle these trends. Reliance on foreign markets has declined while debt maturity on the external debt has increased, reducing refinancing risks. As a result, the rating of Colombia's foreign-currency bonds was upgraded to investment grade by all three rating agencies in 2011. In addition, the government's plan to tighten slightly on the fiscal side, as foreseen by its new fiscal rule (see below and Chapter 3), will reduce inflationary pressures somewhat and relieve pressures on the exchange rate.

However, challenges remain. While currently broadly appropriate, monetary policy should remain vigilant to risk associated with the economy overheating, especially if recently adopted macro-prudential measures do not help contain the boom in consumer and housing loans mentioned above. Moreover, coping with future spending pressures from aging, meeting the government's poverty-reduction targets, improving infrastructure and public services – often delivered by sub-national governments – as well as adjusting to potentially volatile and declining commodity resources over the longer term, will require more attention to managing the country's fiscal balance.

The government's fiscal framework projects a decline in the already low public-spending ratio – structural spending by the central government would decline from 18.4% of GDP in 2012 to 16.1% in 2023. This seems extremely challenging given public pressure for more and better services and the government's own policy agenda to reduce poverty and inequality. Indeed achieving the government's objectives of increasing the quality of public services, developing the country's social and physical infrastructure and addressing poverty will require raising the public-expenditure-to-GDP ratio gradually over time.

Meeting spending requirements while reducing the spending ratio will therefore call for ambitious reform to boost public spending efficiency while meeting public service and equity objectives. These issues are of crucial importance over the medium term and are raised again in Chapters 3 and 4.

Conclusion: Governance reform can help Colombia implement its policy agenda successfully

The government of Colombia has identified the need to reduce poverty, inequality and regional disparities as its most important development priorities. Indeed much of the policy-reform agenda outlined in the Economic Assessment figures prominently in the government's 2010-14 National Development Plan. Many of these challenges have significant governance implications: more and better infrastructure in transportation, health and education, improving educational outcomes, strengthening the social safety net and enhancing income redistribution to fight poverty and inequality and meet the needs of the most disadvantaged while paying special attention to the needs of ethno-cultural and regionally-based groups. Good governance – including the state's ability to set, co-ordinate, implement and monitor the performance of strategy to implement the Plan – is therefore key to ensuring that the government of Colombia can achieve its policy objectives efficiently and effectively:

- These meta-challenges are by definition complex; they require a multi-sector, coherent approach to policy design and implantation, which can best be achieved through strong co-ordination by fit-for-purpose centre-of-government institutions that have the capacity – and the legitimacy – to mobilise actors across government at the national and sub-national levels and in civil society in support of designing, implementing and monitoring the performance of strategy that aims to address these challenges.
- Governance reform can also affect the implementation of the policy agenda relating to improvements in services to citizens – whether in health, education or transportation – because these services are delivered by sub-national levels of government. This implies a renewed focus on multi-level governance and the effectiveness with which policy and service-design and delivery are aligned vertically.
- Governance reform can also enhance the government's ability to find fiscal room to pay for these needs, which implies a renewed focus on budgeting for results and decision-making that focuses on maximising value-for-money in the management of public resources.

Good governance includes optimising the use of public resources, including financial resources. New public investments in education, health and transportation infrastructure, along with whatever social-programming and victim-compensation requirements will be needed to implement the Peace Process fully could require additional public spending, even though the Process may also eventually lead to a peace *dividend* – lower defence and security spending over the longer term. The low level of public debt and rising fiscal revenues associated with the commodity boom create some degree of freedom in the short- to medium-term. This may not be enough, however, to cover spending needs, thus placing a premium on ensuring that public money is spent as effectively (in terms of achieving its policy goals) and efficiently (in terms of avoiding losses and waste) as possible.

Optimising fiscal efficiency and effectiveness raises fundamental governance issues, including the need for robust performance-measurement and reporting capacity and the ability to engage in strategic operational reviews of programme spending as means to identify low-priority programming that could be altered or discontinued to create fiscal room to meet high-priority and emerging spending needs (see Chapter 3).

Countries that are meeting macro, national policy challenges successfully have done so by maximising their public sector's resiliency and nimbleness in the face of increasingly complex policy challenges generated by a constantly changing environment. This requires maximising strategic-state capability. This Review thus assesses a cluster of key governance issues as a means to offer advice on ways to enhance the government of Colombia's strategic-state capability – that is its capacity to articulate a broadly-supported long-term vision for the country's development, identify emerging and longer-term needs correctly, prioritise objectives, identify medium- and short-term deliverables, assess and manage risk, strengthen efficiencies in policy design and service delivery to meet these needs effectively, and mobilise central and sub-national government actors and leverage resources across society to achieve integrated, coherent policy outcomes in support of this vision for the country's development and prosperity:

- The government's capacity to set, steer and monitor the implementation of its national development strategy through agile centre-of-government institutions. Chapter 2 assesses the strategic agility of these institutions against the development-policy objectives the government has set for itself in its 2010-14 National Development Plan;
- The government's capacity to measure and otherwise assess performance in implementing its development strategy. Chapter 3 of this Review examines the government's use of sound evidence to measure progress in implementing its policy agenda. In particular, it will assess linkages between budgeting and strategy implementation as well as the nature and scope of its arrangements to audit and control spending and investment aimed at implementing its development strategy, *inter alia* with a view to suggest ways to build greater fiscal room to address emerging national infrastructure and social-programming priorities to reduce poverty, inequality and regional disparities;
- The government's capacity to implement its decentralisation agenda with sub-national authorities in a way that optimises the achievement of its objectives to reduce poverty, inequality and regional disparities across the country. Chapter 4 examines Colombia's multi-level governance arrangements in this light.

Notes

1. Santander was known as the *Hombre de las Leyes* ("the Man of Laws"). His quote is inscribed above the entrance to the building that hosts Colombia's national courts (the Supreme Court of Justice, the Constitutional Court, and the Council of State) in the centre of Bogotá.
2. Revolutionary Armed Forces of Colombia.
3. National Liberation Army.
4. A constitutional reform in 1986 had already removed the president's power to appoint mayors.
5. *Indice mundial de fraccionamiento geografico (2012)*.
6. Language spoken by the Raizal community in San Andrés, Providencia, and Santa Catalina.
7. Language spoken by the community of San Basilio de Palenque in the department of Bolívar.
8. Language spoken by the Rom.
9. *Observatorio Nacional de Desplazamiento Forzado* (2010).
10. The rapid expansion of the mining sector and surging terms of trade are driving important structural changes. The rising terms of trade attract resources into the mining sector, and the change in relative prices squeezes the competitiveness of the non-mining tradable sector (Corden and Neary, 1982; Ismail, 2010). In addition, the rise in income associated with the commodity boom fuels domestic demand, putting pressure on prices, in particular those of the non-tradable sector.
11. The government's recent royalty-distribution reform (see Chapters 3 and 4) aims to generate a more progressive income distribution.
12. Mondragón-Vélez, Peña and Wills (2010) argue that the increases in non-wage labour costs and in the minimum wage between the 1990s and 2006 have both excluded low skilled workers from the formal labour market and triggered a move from the formal to the informal labour market, increasing the relative size of the latter. Furthermore, the deleterious effects on formal employment are reinforced by non-wage labour costs, which, at 82% of wages, are high by OECD standards. Incentives to pay social security contributions are reduced by the universal coverage of core public services, such as health care. Those working in the informal sector now have access to a subsidised system which is as generous as for those in the formal sector, although the latter pay a 12.5% health contribution on their wages.

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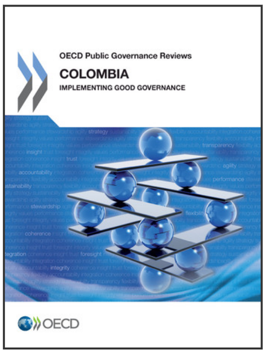

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