Executive summary

Growth is firming up

Growth has been resilient and poverty and informality have fallen. Thanks to sound and credible macroeconomic policies, adjustment to the large oil price shock of 2015-16 has been smooth. Education and social policies have improved social outcomes. Yet, challenges remain to maintain performance and further improve living standards. Productivity growth has followed a declining trend and the still high level of informality is a major economic and social challenge. Regional inequalities remain large. Exposure to global financial conditions has increased.

GDP growth is projected to pick up supported by domestic demand (Table A). Investment will be a key driver of growth, aided by infrastructure projects, recent tax reforms and low interest rates. Inflation will remain near the 3% target, supporting real incomes and consumption.

Table A. Growth is projected to strengthen

Percentage change unless indicated

	2018	2019	2020
Gross domestic product	2.6	3.4	3.5
Private consumption	3.6	4.7	3.9
Government consumption	5.6	2.9	3.5
Gross fixed capital formation	1.5	4.6	5.3
Exports	3.9	4.0	4.0
Imports	7.9	8.8	5.5
Consumer price index	3.2	3.5	3.6
Fiscal balance (% of GDP)	-3.1	-2.4	-2.2
Current account balance (% of GDP)	-4.0	-4.2	-4.2

Source: *OECD Economic Outlook 105 database* updated with most recent available information.

Macroeconomic policies strike an appropriate balance. Fiscal policy is expected to be moderately contractionary to reduce the structural fiscal deficit to 1% of GDP by 2022, in line with the fiscal rule. This strikes an appropriate balance between meeting social needs, supporting gradual recovery, the need to ensure debt sustainability and creating space for dealing with future shocks. Monetary policy remains moderately accommodative, as inflation is near the target and inflation expectations are anchored.

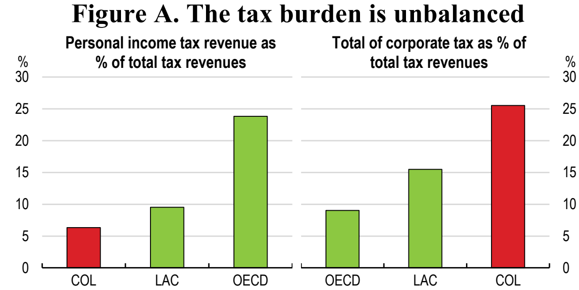
A key downside risk to the outlook is a spillover of financial volatility experienced by some emerging markets. International volatility driven by the trade and political tensions could impact growth. Stronger (weaker) oil or coal prices could boost (reduce) investment. The tourism sector holds potential for upside surprises.

Complying with the fiscal rule requires revenue and spending measures

The dependence on volatile revenues and exposure to global financial shocks requires putting debt on a declining path relative to GDP. Current fiscal plans are expected to achieve this, but the debt trajectory is highly sensitive to interest rates, growth, exchange rate and oil prices. Spending needs, such as those related to infrastructure gaps, social programmes or the peace process, are high. Further measures to improve spending efficiency and the tax mix are needed.

The tax mix could be further improved (Figure A) by broadening the bases of personal and VAT taxes, reducing the corporate tax rate and eliminating its numerous tax exemptions. Further revenue could come from environmental taxes and from strengthening tax administration to reduce tax evasion.

Figure A. The tax burden is unbalanced



Note: OECD refers to year 2016 and the rest 2017.
Source: OECD, *Revenue Statistics database.*

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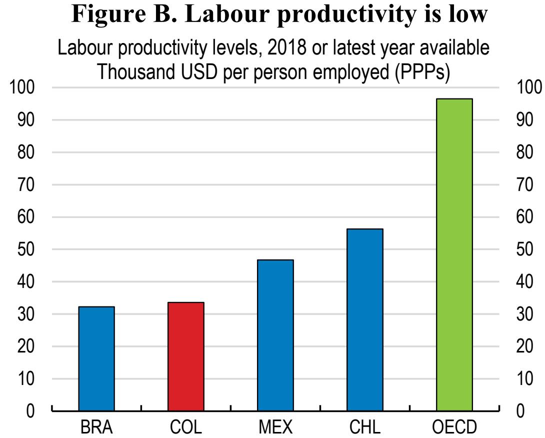
Social programmes and tax exemptions benefiting households and firms contribute little to boost equity or productivity. A spending review would help to identify inefficient programmes with lack of cost-effectiveness in terms of impact on equity or productivity. These should be reformed or phased out.

Making productivity and trade engines of growth

Growth potential has fallen substantially in the last decade, indicating that the traditional drivers of growth, largely capital-intensive extractive industries and favourable terms of trade, have reached their limits. Further advances in living standards will hinge on raising productivity, which in turn requires improvement in the business regulations, more competition and further openness to trade.

Labour productivity is low, even compared to other countries in Latin America (Figure B). Productivity is hindered by lack of competition in key sectors, such as transport or telecommunications. The competition framework has improved but would be reinforced with higher and more dissuasive sanctions against anti-competitive behaviours. Widening the scope of regulatory impact assessments and making a greater use of one-stop shops would reduce high regulatory burden.

Figure B. Labour productivity is low



Source: OECD Productivity database.

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Trade openness is low. Despite efforts to promote trade integration via trade agreements, exports remain low and large parts of the economy are shielded from international competition. The use of non-tariff barriers has increased. Tariffs have fallen but remain higher than in regional peers. There is room to diversify exports and make trade a source of growth and productivity enhancing competition.

Costs to exporting are high due to infrastructure gaps and weak logistics. Good progress is being accomplished to improve primary roads, via the 4G initiative. Yet, gaps in infrastructure remain large. Improving customs and ports logistics would improve competitiveness. Eliminating the trucks scrap scheme and improving regulations in freight transport are also priorities.

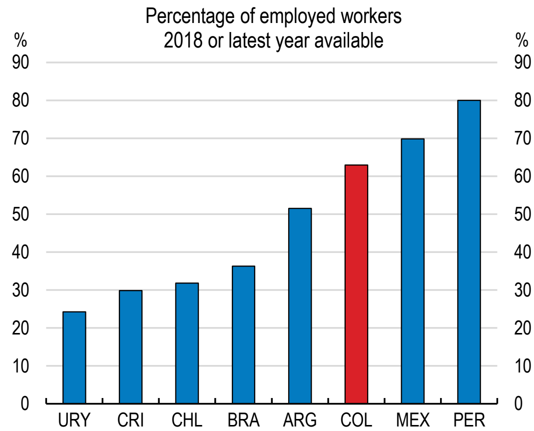
Innovation performance is hampered by low investment in R&D and complex support programmes. Additional funding has become available, but a large part remained unused due to weak governance. Efforts to simplify the innovation system and reduce the fragmentation of support programmes are warranted. Going digital, by promoting further adoption and use of ICT technologies, would also boost firms' competitiveness and the connectivity of regions.

Access to finance has improved but financial markets are less developed than in other countries in the region. Domestic credit to the private sector has increased but interest rate margins are high. Inducing more competition in the banking sector, phasing out the financial transaction tax and reducing regulatory requirements for banks to hold certain instruments, would help to reduce the cost of bank finance.

Curbing informality: win-win for inclusiveness and productivity

Informality has been decreasing but remains high (Figure C). Actions are needed in several policy areas, including reducing non-wage labour costs, still one of the highest in Latin America. Decreasing firms' registration costs and simplifying the registration of workers to social security would facilitate formalisation of firms and jobs. Reviewing the minimum wage to achieve a more job-friendly level and improving quality and relevance of education and training should be also part of the strategy.

Figure C. Informality remains high



Note: Informal workers defined as not contributing to the pension system.
Source: IADB SIMs database.

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Ensuring adequate support for workers to get high-quality jobs

Access to high-quality education and training is a powerful tool to increase access to high-quality jobs. While Colombia has made great progress in increasing attainment, there is still a long way to go to improve access and quality and reduce dropout rates, notably in rural areas.

There is a need to ensure that schools deliver high-quality education to those in need. The Government needs to prioritize increasing coverage and quality in early education to improve student performance and reduce gaps in learning achievement. Improving quality of basic education, especially in rural areas, is needed. Shaping the working conditions and professional opportunities in rural schools and providing adequate supply of high-quality initial teacher education is essential to attract high-quality teachers to rural areas.

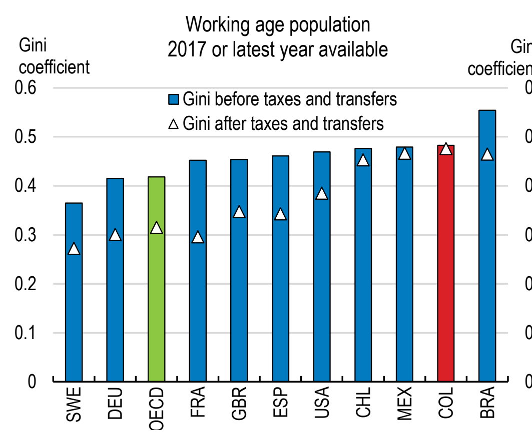
Enhancing the vocational education and training system can improve skills and inclusiveness. Strengthening governance of the vocational and training system would increase quality and relevance. This implies reducing fragmentation and developing a single institutional framework with a coherent and transparent set of objectives. Strengthening quality assurance and accreditation, and implementing the national qualifications framework should also be priorities.

Despite progress, gender gaps at work and education remain sizeable. Actions to strengthen parental leave for mothers and fathers, flexible work arrangements and improving access to childcare, notably in rural areas, would support women to access high-quality jobs.

Social policies could do better to decrease inequality

Social policy is not well targeted (Figure D). Cash transfers to the poor are low and a large share of subsidies, such as those related to pensions and housing, goes to the relatively rich. Coverage in rural areas is low. Higher equity could be achieved by reallocating more spending, such as higher cash transfers, towards vulnerable populations, with a focus on rural areas and ethnic minorities. Concentrating public resources into few well-evaluated programmes, would also help.

Figure D. The tax and transfer system does little to reduce inequality



Source: OECD Income Distribution and Poverty database and OECD calculations.

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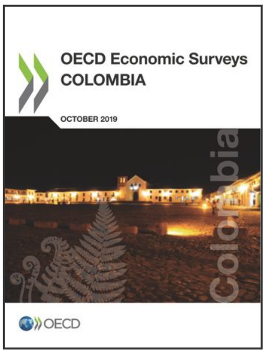
Reforming the pension system is urgent to reduce old-age poverty and ensure sustainability. Increasing the low retirement age, notably for women, and tying it to increases in life expectancy, would foster sustainability. Coverage and the level of benefits of *Colombia Mayor*, the non-contributory component of the system, should be increased. Raising the number of years of earnings on which pensions income are based would help to finance an increase in old-age income support.

MAIN FINDINGS	KEY RECOMMENDATIONS
Further improving macroeconomic policies and governance	
Public debt has increased and fiscal revenues are volatile. Exposure to global financial conditions has increased. Fiscal targets have been revised frequently in recent years.	Adhere to the fiscal rule and aim at a structural deficit of 1% by 2022. Establish an independent fiscal council to monitor fiscal risks and provide additional technical analysis on fiscal targets and its revisions.
Spending efficiency is hampered by rigidities. The government has room to adjust only spending related to investment. Social programmes and tax exemptions contribute little to boost productivity or equity.	Reduce budget rigidities by cutting mandated spending and earmarking of revenues. Evaluate social programmes and tax exemptions and retain only those with a positive impact on productivity or equity.
Non-oil revenues are still relatively low and the tax mix is unbalanced. Taxes are paid predominantly by firms and contribute little to reduce inequality. Tax evasion is widespread.	Broaden the base of the personal income tax by lowering the income threshold where taxpayers start paying income taxes and eliminating exemptions. Replace VAT reduced rates with cash transfers to low-income families. Lower the rate and broaden the base of corporate taxes. Reinforce tax administration and establish a limit for large cash transactions.
Appropriate and timely action by the Central Bank has brought inflation back to the target.	Keep the interest rate around current levels provided inflation remains close to the 3% target. Raise it once the economy starts closing the output gap.
Despite good progress to foster integrity, corruption remains the main concern for citizens.	Introduce whistle-blower protection procedures. Bring all purchases by subnational governments into the central procurement entity (Colombia Compra Eficiente). Regulate the financing of political parties and campaigns.
Boosting productivity and integration in the world economy	
The competition framework has improved but competition remains weak in key areas of the economy and sanctions are modest. Regulatory burden remains high.	Grant the competition authority the ability to impose higher and more dissuasive sanctions. Widen the scope of regulatory impact assessments, including also the stock of regulations. Make a greater use of one-stop shops and online tools for administrative procedures.
Colombia remains relatively closed to trade with high dispersion in tariffs and increasing non-tariff barriers.	Phase out import restrictions and review other non-tariff barriers with a view to reducing them. Reduce tariff dispersion.
Costs to export are high, due to infrastructure gaps and weak trade facilitation and logistics.	Prioritise improving multi-modal transport connectivity of ports and customs, and reduce barriers to entry and competition in transport. Improve customs logistics, including by increasing inter-agency cooperation and making further use of paperless online solutions for permissions and payments.
Improving equality of opportunities and job quality	
Informality is high, hampering productivity, job quality, public finances and access to pensions. Skills gaps are large, driving informality.	Establish a comprehensive strategy to reduce the cost of formalisation, including reducing non-wage costs, reviewing the minimum wage to achieve a more job-friendly level, reducing firms' registration costs and simplifying the registration of workers.
Cash transfers to the poor are small. A large share of social programmes goes to the relatively rich.	Improve targeting and focus spending on social programmes targeted at low-income individuals. Target higher cash transfers towards the most vulnerable, especially those in rural areas.
Education has improved but regional disparities are large. Grade repetition and dropout rates remain high.	Prioritise spending on education that increases coverage in early education. Reallocate more resources to the most vulnerable territories. Make teaching in rural areas more attractive by shaping the working conditions and professional opportunities in these areas.
Demographic trends put pensions sustainability at risk. Retirement age is low, especially for women. Old-age poverty is high. The pension system has low coverage and is very unequal, as it mostly benefits high-income formal workers. Pensions are based on the last 10 years of earnings.	Gradually increase and align the retirement age of women and men. Boost coverage and benefit levels in the non-contributory scheme (*Colombia Mayor*). Extend coverage in the public scheme and finance it by increasing the number of years of earnings on which pensions are based.
Strengthening green growth	
Biodiversity is jeopardized by deforestation.	Ensure technical capacity and resources to allow for proper enforcement and management of forests. Grant the status of protected areas to a greater proportion of the forestland.



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