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Foreword

This Economic Survey was prepared by Paula Garda and Michael Koelle, under the supervision of Aida Caldera Sánchez. Research assistance was provided by Monica Quinza Armenta and Tomas Opazo and editorial support by Gemma Martinez and Laura Fortin.

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Information about this and previous Surveys and more information about how Surveys are prepared is available at https://www.oecd.org/en/topics/economic-surveys.html.

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BASIC STATISTICS OF COLOMBIA, 2023

(Numbers in parentheses refer to the OECD average[1])

LAND, PEOPLE AND ELECTORAL CYCLE					
Population (million, 2022)	51.9		Population density per km² (2022)	46.8	(39.0)
Under 15 (%, 2022)	21.3	(17.2)	Life expectancy at birth (years, 2021)	72.8	(78.7)
Over 65 (%, 2022)	9.0	(18.0)	Men (2021)	69.4	(75.9)
International migrant stock (% of population, 2019)	2.3	(13.2)	Women (2021)	76.4	(81.7)
Latest 5-year average growth (%)	1.4	(0.4)	Latest general election	May-2022	
ECONOMY					
Gross domestic product (GDP)			Value added shares (%, 2022)		
In current prices (billion USD)	365.1		Agriculture, forestry and fishing	9.2	(2.8)
In current prices (trillion COP)	1.572		Industry including construction	29.8	(28.3)
Latest 5-year average real growth (%)	2.9	(1.6)	Services	61.0	(68.8)
Per capita (thousand USD PPP, 2022)	21.1	(60.2)			
GENERAL GOVERNMENT (Per cent of GDP)					
Expenditure (2022, OECD: 2022)	34.1	(41.6)	Gross financial debt (2019, OECD: 2022)	80.1	(113.4)
Revenue (2022, OECD: 2022)	27.2	(39.8)	Net financial debt (2019, OECD: 2022)	36.6	(67.6)
EXTERNAL ACCOUNTS					
Exchange rate (COP per USD)	4307.27		Main exports (% of total merchandise exports, 2021)		
PPP exchange rate (USA = 1, 2022)	1345.66		Mineral fuels, lubricants and related materials	45.8	
In per cent of GDP			Food and live animals	16.5	
Exports of goods and services	17.8	(31.3)	Chemicals and related products, n.e.s.	9.0	
Imports of goods and services	22.7	(31.5)	Main imports (% of total merchandise imports, 2021)		
Current account balance	-2.7	(-0.2)	Machinery and transport equipment	31.0	
Net international investment position (2022)	-51.3		Chemicals and related products, n.e.s.	23.5	
			Manufactured goods	15.7	
LABOUR MARKET, SKILLS AND INNOVATION					
Employment rate (aged 15 and over, %, OECD: 2022)	53.5	(57.5)	Unemployment rate, Labour Force Survey (aged 15 and over, %, OECD: 2022)	10.2	(5.0)
Men (OECD: 2022)	70.4	(65.4)	Youth (aged 15-24, %, OECD: 2022)	20.2	(10.9)
Women (OECD: 2022)	45.9	(50.1)	Long-term unemployed (1 year and over, %, 2022)	1.5	(1.2)
Participation rate (aged 15 and over, %, 2022)	63.6	(60.9)	Tertiary educational attainment (aged 25-64, %, 2022)	28.3	(40.7)
Average hours worked per year (2022)	2,405	(1,735)	Gross domestic expenditure on R&D (% of GDP, 2020)	0.3	(2.9)
ENVIRONMENT					
Total primary energy supply per capita (toe, 2022)	0.8	(3.8)	CO_2 emissions from fuel combustion per capita (tonnes, 2022)	1.5	(7.8)
Renewables (%, 2022)	24.8	(12.0)	Water abstractions per capita (1 000 m³, 2020)	2.0	
Exposure to air pollution (more than 10 µg/m³ of PM 2.5, % of population, 2019)	99.3	(61.7)	Municipal waste per capita (tonnes, 2018, OECD 2020)	0.2	(0.5)
SOCIETY					
Income inequality (Gini coefficient, 2021, OECD: latest available)	0.515	(0.316)	Education outcomes (PISA 2022 score)		
Poverty gap at USD 6.85 a day (2017 PPP, %, 2021)	16.2	(0.0)	Reading	409	(476)
			Mathematics	383	(472)
Public and private spending (% of GDP)			Science	411	(485)
Health care (2022)	8.1	(9.2)	Share of women in parliament (%, 2022)	28.9	(32.5)
Pensions (2021, OECD: 2019)	6.2	(9.5)			
Education (% of GNI, 2021)	4.3	(4.4)			

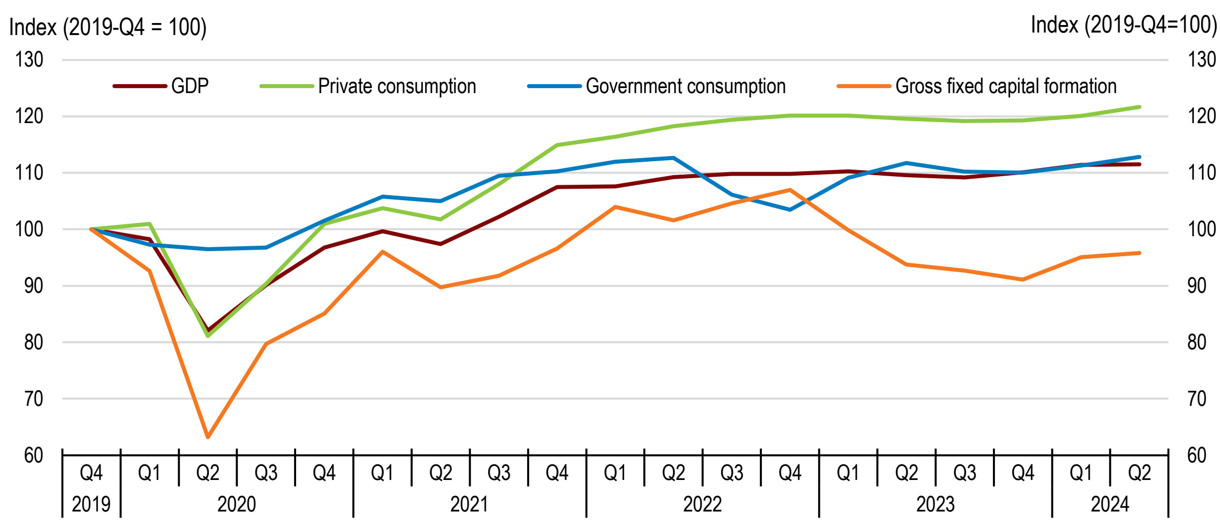
[1] The year is indicated in parenthesis if it deviates from the year in the main title of this table. Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 80% of member countries.
Source: Calculations based on data extracted from databases of the following organisations: OECD, International Energy Agency, International Labour Organisation, International Monetary Fund, United Nations, World Bank.

Executive Summary

From strong recovery to weak growth

After a strong rebound from the COVID-19 pandemic, economic activity has slowed (Figure 1). Headline inflation is gradually receding but remains high. The deceleration in investment that started following the commodity boom in the mid-2010s is hindering potential growth. The government has an ambitious agenda to diversify the economy, promote the energy transition and regional convergence. Medium-term growth prospects hinge on maintaining Colombia's strong macroeconomic framework and reforms to foster a business and investment-friendly environment.

Figure 1. Investment is dragging down growth



Source: OECD Economic Outlook (database).

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Growth moderated sharply in 2023 on the back of tight macroeconomic policies and slowing global growth. However, economic growth rebounded in the first semester of 2024. A tight monetary policy stance has contributed to the decline in headline inflation from its peak of 13.3% in March 2023 to 6.1% in August 2024. Domestic demand started to level off in late 2022, with weak investment adding to sluggish growth in 2023, although investment began increasing in the second quarter of 2024. The labour market has been resilient, with robust job creation, declining unemployment and reduced informality rates, but has slightly deteriorated recently.

The economy is expected to undergo another year of modest growth, at 1.8% in 2024, before picking up by 2.8% in 2025 (Table 1**).** Private consumption will remain solid supported by disinflation, monetary policy easing and significant remittances. Investment will rebound as financial conditions gradually ease but will remain weak. Exports will grow moderately. Inflation is projected to gradually converge to the 3% target by end of 2025. Downside risks persist and include greater global and local uncertainty, weather anomalies, persistent inflation, geopolitical tensions and tighter global financial conditions. The financial sector remains resilient with well-capitalised banks and large liquidity buffers.

Table 1. Macroeconomic projections

	2023	2024	2025
Gross domestic product	0.6	1.8	2.8
Private consumption	0.8	1.6	1.5
Gross fixed capital formation	-9.5	2.3	10.8
Exports	3.4	3.1	3.8
Imports	-15.0	1.9	6.4
Unemployment rate	10.2	10.5	10.0
Consumer price index (Q4-on-Q4)	10.0	5.7	3.6
Core consumer price index (Q4-on-Q4)	8.9	5.1	3.6
Fiscal balance	-4.3	-5.6	-5.1

Source: *OECD Economic Outlook* (database).

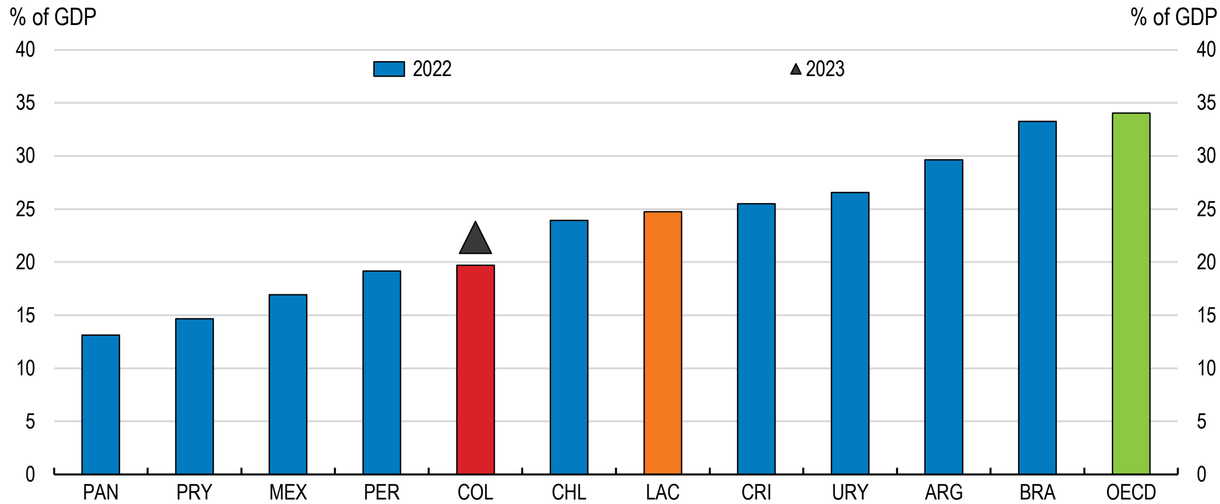
Prudent fiscal policy is key to debt sustainability

Consolidation efforts reduced gross public debt to 57% of GDP in 2023 from pandemic highs of 65%, but borrowing costs have increased since Colombia lost its investment grade in 2021. Continued fiscal prudence is needed for compliance with the fiscal rule and debt sustainability. To finance higher post-pandemic spending and the government's ambitious social and productive transformation agenda, reforms to raise tax revenues and spending efficiency are required.

The government's medium term fiscal plans aim for gradual and prudent fiscal consolidation. The government is committed to adhering to the fiscal rule, even if it requires ad-hoc spending cuts that could harm public investment and long-term growth. Compliance with the current fiscal rule and avoiding cuts in public investment could be achieved by gradually phasing out diesel subsidies, as commendably done with petrol subsidies in 2023, distortive and ill-targeted public utilities subsidies and improving the targeting of social spending.

Colombia has implemented 21 tax reforms in the last two decades, but tax revenues remain low (Figure 2). The 2022 tax reform increased tax revenues and progressivity but frequent piecemeal reforms have heightened uncertainty and complexity. A comprehensive, gradual, well-sequenced and well communicated tax reform is needed, that would rebalance the tax burden from corporate to personal income, reduce tax expenditures, simplify the tax system, and tackle tax evasion. Such a reform would not only increase revenues but also stimulate investment and promote progressivity in the tax system. Enhancing the tax administration to combat tax evasion is also needed. Raising spending efficiency will require better targeting social spending and reducing large budget rigidities.

Figure 2. Tax revenues rose but remain low



Note: LAC-simple average of ARG, BRA, CHL, CRI, MEX, and PER.
Source: *OECD Global Revenue Statistics* (database).

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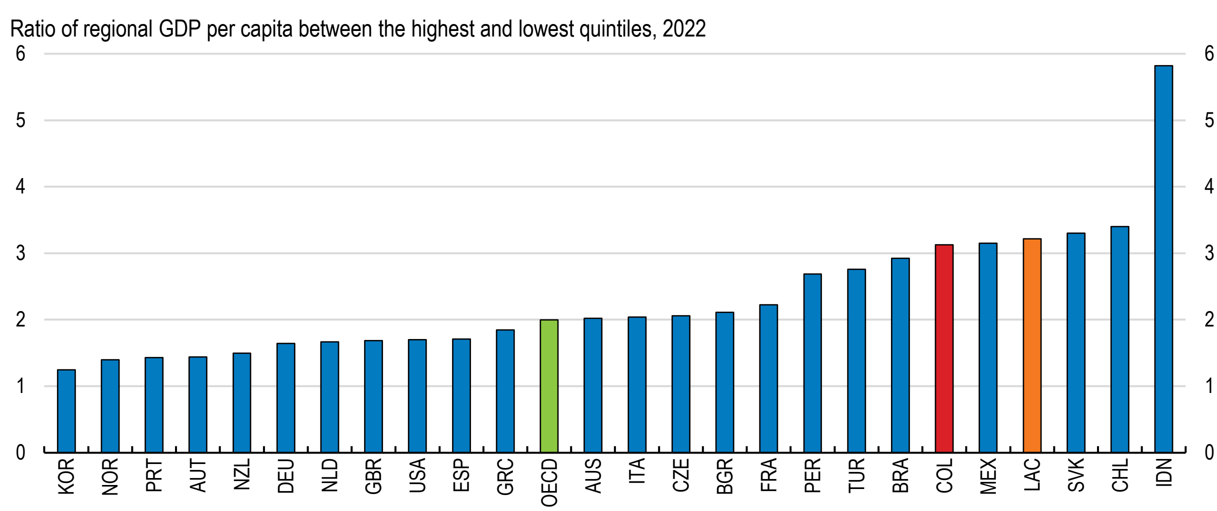
Closing regional gaps in productivity

Colombia faces large and persistent regional disparities in incomes and productivity (Figure 3) alongside stagnant productivity. The global energy transition and shifting global trade patterns provide opportunities for regional development and growth; as does the Peace Agreement, which should receive sufficient resources for implementation.

Figure 3. Regional income gaps are large



Source: *OECD Regional Statistics* (database).

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The quality of transport infrastructure is poor, resulting in high transport costs and limited regional integration. Infrastructure projects should prioritise interconnectivity of ports, river, rail and road transport, and improvements in the rural road network to connect cities to their rural hinterland.

There are large regional differences in the business environment holding back productivity. Expanding one-stop shops that integrate national and subnational procedures and encouraging greater take-up of the simplified tax regime would improve the business environment. Innovation and technology upgrade policies could better target businesses in lagging regions.

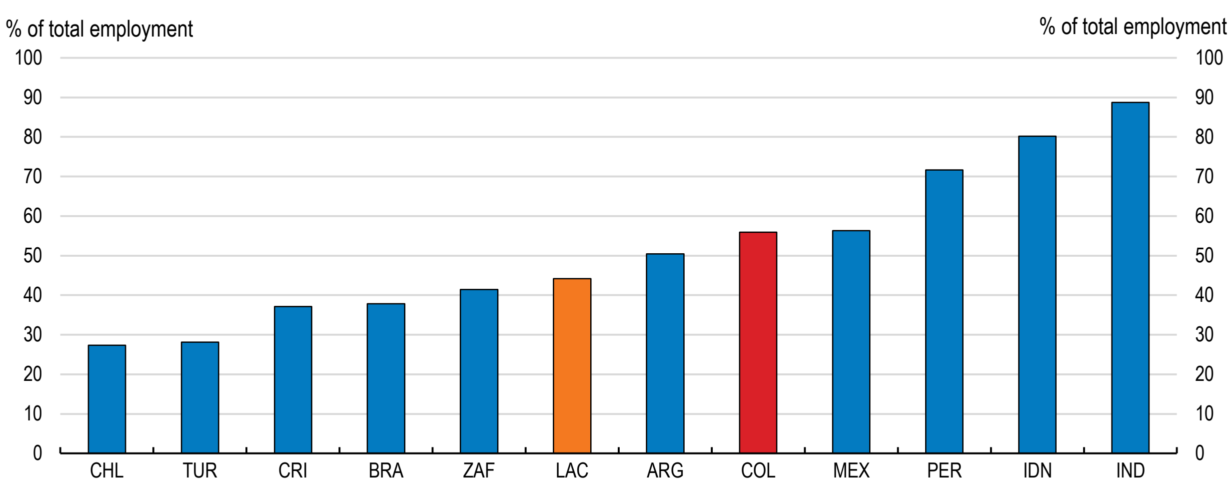
Greater fiscal and administrative capacity of subnational governments could improve infrastructure and services. In line with the findings of Colombia's decentralisation commission, this would require strengthening fiscal equalisation mechanisms and improving direct revenue generation. Building administrative capacity should coincide with delegation of authority, clarifying spending responsibilities, and improving intergovernmental coordination. Continuing the fight against corruption would strengthen the state capacity especially in poor and peripheral area.

Addressing inequalities and poverty

Colombia ranks among the OECD's most unequal countries, facing high poverty, driven by high informality, low access to high-quality education, and gender gaps in the labour market. The government has an ambitious and broad social reform agenda that will help to reduce inequalities and alleviate poverty. Further measures are, however, needed to address entrenched disparities and tackle informality.

Reducing informality in Colombia, where around 56% of workers hold informal jobs without access to employment protection or social security benefits, remains a challenge (Figure 4**).** A comprehensive strategy is needed to tackle informality. This should include reducing social security contributions for lower-income workers that sustain high informality, particularly among the most vulnerable. Enhancing labour law enforcement and tax compliance, lowering costs for formal firm creation, reviewing the minimum wage to achieve a more formal-job-friendly level and skill development would all reduce informality.

Figure 4. Informality is widespread



Note: LAC simple average of ARG, BRA, CHL, CRI, MEX, and PER.
Source: OECD calculations based on *ILOSTAT* (database).

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Female labour participation is low, and many women work informally. Expanding access to early childhood education, especially in rural and vulnerable regions, would boost both children's prospects and their mothers' engagement in the formal labour force. Increasing elderly care services would also boost female labour force participation.

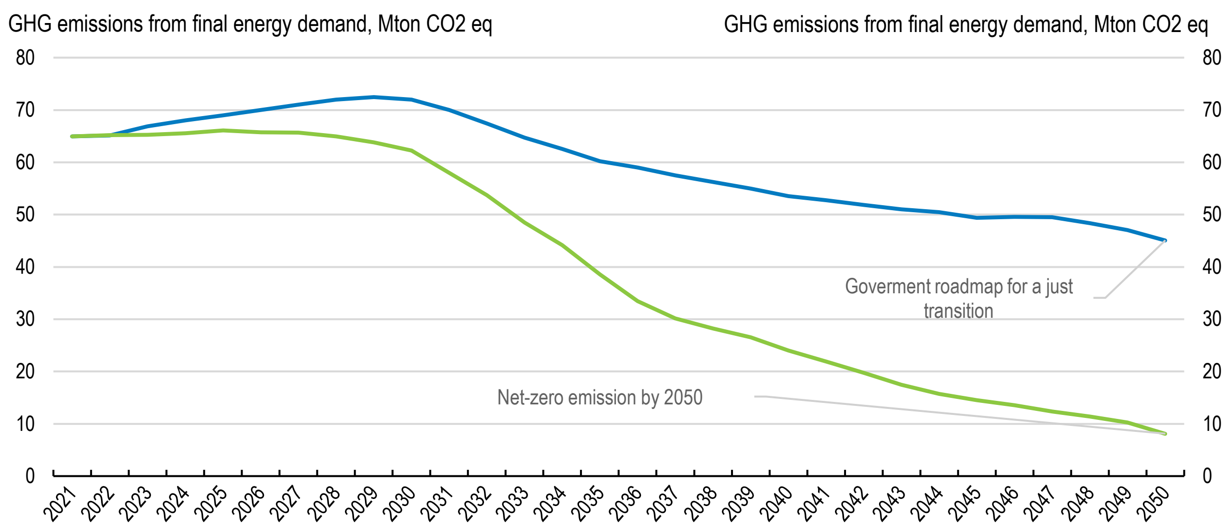
Low levels of learning are at the core of persistent inequalities, and the pandemic has exacerbated this challenge. Many students leave school early with low skills, particularly those from disadvantaged socio-economic backgrounds, requiring tailored support for students at risk of falling behind. Upper-secondary VET programmes can teach locally relevant skills and are often the only educational option at this level in rural areas.

Facilitating the energy transition and seizing new opportunities

Colombia is confronting three critical climate transitions. First, it aims to achieve net-zero greenhouse gas emissions by 2050. Second, it needs to strengthen climate resilience through effective adaptation measures. Third, with the global decline in oil and coal demand, Colombia needs to transform its economy and diversify its production and exports and take advantage of its vast renewable energy potential, mineral resources, and rich biodiversity to drive growth, create jobs, and reduce poverty.

To combat climate change, Colombia has pledged to achieve carbon neutrality by 2050. Meeting emission targets will depend largely on further progress in combating deforestation, a key source of emissions. This will require better enforcement of the law and coordination efforts across administrations to combat illegal deforestation. The government's Just Energy Transition roadmap will reduce emissions, but it may fall short of reaching carbon neutrality by 2050 (Figure 5). Speeding up the generation of renewable energy generation, alongside developing green financial instruments, a stable regulatory framework and more ambitious price signals for abatement are necessary.

Figure 5. Net-zero energy emissions by 2050 require intensified efforts



Source: Colombian Ministry of Mines and Energy (2023), *National Scenarios Just Energy Transition*.

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Increased investments in adaptation are crucial to boost resilience. Higher coordination and monitoring of climate adaptation measures at all government levels, coupled with regular updates of risk assessments to inform subnational planning, are needed to overcome obstacles in adaptation project implementation. Efforts are needed to expand early warning systems and enhance insurance schemes to manage climate risks effectively, particularly in the agricultural sector.

Achieving emission reduction also offers opportunities. To manage risks and capitalise on the transition, Colombia must diversify its exports away from oil and coal and further boost renewable energy. It should also prioritise investment in critical minerals and biodiversity conservation and provide policy support to reintegrate displaced workers into the labour market.

MAIN FINDINGS	KEY RECOMMENDATIONS
Reinforcing macroeconomic stability	
Inflation has declined but remains high at 6.1% in August, above the Central Bank target of 3%. There are several upwards risks to inflation, while the output gap is estimated to be negative.	Continue a gradual, prudent, and data-based easing of monetary policy to facilitate a gradual return of inflation to the target.
Consolidation efforts have decreased gross public debt to 56.7% of GDP from pandemic highs, and planned consolidation is prudent and balances the need to reduce debt, weak growth and high inflation. While government fiscal plans for 2024-25 are on the limits of the fiscal rule, headline deficits and interest payments remain high, and there are risks of revenue shortfalls.	Maintain fiscal consolidation in line with current fiscal plans and ensure compliance with the fiscal rule to achieve convergence of net debt to its anchor.
Public spending efficiency remains low. While the elimination of petrol subsidies is commendable, diesel subsidies still account for 0.7% of GDP. Subsidies for public utilities are poorly targeted, benefitting 80% of non-poor households, and discourage energy saving.	Undertake regular and systematic public spending reviews, and reduce spending inefficiencies, including by gradually reducing eliminating diesel, electricity, and gas subsidies and improving targeting of social spending.
The 2022 tax reform has boosted tax revenues and improved progressivity, yet at 22% of GDP, they fall short of addressing social demands and public investment needs. The tax system inadequately tackles high income inequalities, with personal income taxes having minimal impact and heavy reliance on corporate income taxes. Complexities, such as numerous special regimes and tax expenditures, result in significant revenue losses and impede growth and investment. Weaknesses in tax collection lead to yearly revenue losses exceeding 5% of GDP.	Enhance the tax administration and implement a comprehensive tax reform with a planned gradual implementation to rebalance the tax burden from corporate to personal income taxes and reduce tax expenditures in VAT, personal and corporate taxes.
Boosting productivity of Colombia's regions	
The quality of infrastructure is low and transport costs are high, reducing the integration among regions and with global markets.	Improve the interconnectivity of ports, river, road, and rail transport.
Productivity is low and stagnant and productivity gaps between regions are large. Business informality is high. Regulations on product markets and administrative barriers restrict entry of formal firms. Virtual one-stop shops have been introduced in larger cities.	Reduce the costs of doing business formally, especially for small firms, by expanding one-stop shops that fully integrate national and sub-national procedures.
The share of young adults not in education, employment, or training (NEET) is among the highest in the OECD, with large regional differences. Performance of VET students is relatively good.	Expand upper-secondary VET programmes, starting with the regions where few upper-secondary alternatives exist and where NEET rates are the highest.
Spending decentralisation is substantial, but few subnational governments have strong revenue generating capacity. Different transfer systems are fragmented and uncoordinated.	Strengthen fiscal equalisation mechanisms and boost revenue-raising capacities among subnational governments.
Corruption reduces the attractiveness of the business environment and impinges on the ability of its state to provide high-quality infrastructure and services for all its citizens. Corruption especially affects poorer and more rural regions.	Combat corruption by better enforcing regulations on private funding for political campaigns, strengthening civil society protection, and implementing standards for disclosing final beneficiaries of financial transactions.
The Peace Agreement provides opportunities for advancing rural development, especially in areas affected by the conflict, and lays the basis for a comprehensive rural reform. Only 1% of planned land restitutions have taken place since 2017, largely due to insufficient resources.	Allocate adequate resources to implement the Peace Agreement, including the rural reform.
Reducing inequalities and poverty	
Around 56% of workers are in informal jobs and many are women. This deprives them from access to many social security benefits and employment protection, while reducing productivity and tax revenues.	Pursue a comprehensive strategy to reduce informality, including enhancing skills, strengthening the enforcement of labour and tax laws, reducing corporate tax and regulatory burdens, and lowering social security contributions for lower-income workers.
Colombia faces significant educational disparities, driven by people's socioeconomic status and geographic location. School non-completion rates in secondary education are high. Early childhood education and care enrolment has improved but 20% of 3-5-years-old and 70% of the 0-2-years-old are not enrolled, hindering female labour market participation.	Identify students in need of support, establish a system to support those at risk of leaving the education system and provide them with targeted tutoring. Continue expanding access to early education and care facilities, prioritizing rural areas and vulnerable children.
Facilitating the green transition and seizing opportunities	
Colombia faces increasing climate-related risks. Failure to adapt can result in significant economic losses, damage to infrastructure, increased vulnerability to extreme weather events, and threats to food and water security.	Coordinate and monitor climate adaptation measures across all government levels, while conducting and regularly updating detailed risk assessments to inform subnational planning.
Deforestation, driven by activities such as agriculture, mining, and logging, is a major source of greenhouse gas emissions in Colombia.	Increase enforcement efforts to combat illegal deforestation while ensuring the effective coordination of deforestation control efforts across different levels of government by the new national council.
The Just Energy Transition roadmap is welcome and will help to curb emissions, however it is not enough to meet Colombia's commitment to carbon neutrality by 2050. To achieve it larger investment in renewable energies are needed. Colombia's renewable resources potential are large. Renewable energy and transmission line projects have faced delays, attributed to insufficient local community support and regulatory hurdles. The carbon tax rate at USD 6 per tonne of CO_2 is low, yet climate change targets are ambitious.	Strengthen the regulatory framework to incentivise investment in renewable energy, and schedule regular auctions for long-term power contracts. Increase the carbon tax rate and broaden its base to align it with the desired emission reduction targets, while supporting vulnerable households with targeted and temporary transfers.

1 Investing to unlock Colombia's vast opportunities

Colombia's sound macroeconomic policy framework, including fiscal rules, a robust financial regulatory framework, a successful inflation targeting regime pursued by an independent central bank, and a flexible exchange rate, have ensured economic stability and enabled the country to triple its GDP per capita since the 1990s. Over the same period, poverty rates declined, and a burgeoning middle class emerged, alongside notable enhancements in various social indicators, such as better access to education and healthcare. Moreover, the signing of the peace agreement in 2016 represents a significant stride towards achieving social and economic progress.

Following a robust recovery from the COVID-19 pandemic, which propelled GDP above its potential in 2022, economic activity begun to decelerate in 2023 on the back of tight macroeconomic policies and slowing global growth. The deceleration has been exacerbated by a sharp slowdown in investment. Economic growth will remain moderate at 1.8% in 2024, before picking up to 2.8% in 2025. Private investment is expected to remain subdued. Inflation will continue falling and is projected to converge to the target by the end of 2025.

Despite the economic and social progress in the last decades, significant structural barriers need to be addressed to accelerate income per capita growth and address entrenched regional and social inequalities. Reducing inflation and boosting investment are short-term priorities, but long-term solutions require tackling entrenched issues. GDP per capita ranks lowest among OECD countries (Figure 1.1). Regional disparities persist due to unequal access to infrastructure, financing, education, training, and labour market opportunities, exacerbated by the long history of conflict that particularly affected remote and marginalised regions. Limited subnational state capacity and weak intergovernmental coordination hinder the delivery of quality public services and infrastructure. Disparities in access to quality education contribute to low learning outcomes (Figure 1.2). Gender disparities in the labour market are entrenched, particularly affecting women from ethnic backgrounds and those with lower levels of education. At 56% of the workforce, informality has decreased in the last decade, but remains stubbornly high, leading to low social protection coverage, high poverty, low productivity and low tax collection. Climate change and the global green transition poses significant risks to Colombia due to the country's high exposure to climate-related disasters and its heavy dependence on oil and coal exports. Despite Colombia's relatively low emissions and clean energy matrix (Figure 1.3), significant investments are required to raise the share of renewables, ensure energy security and achieve carbon neutrality. These efforts must align with export diversification to mitigate risks effectively.

Despite these challenges, Colombia holds numerous opportunities for growth and social development. Its strategic geographical location, bridging the Pacific and Atlantic Oceans, coupled with abundant natural resources, offers avenues for investment amidst shifting global trade patterns. A relatively young population capable of driving innovation and economic progress through education and skill development, diverse economic hubs and major cities, and cultural heritage present compelling opportunities for diversification of its economic activities. Additionally, Colombia's rich biodiversity, abundant critical minerals and significant potential for renewables position it favourably for the global green transition. The implementation of the peace agreement presents an opportunity to attract investment and redirect resources from conflict towards development initiatives, allowing for the integration of previously marginalized communities into the formal economy.

The government's ambitious reform agenda aims to raise equity, living standards, and ensure social justice. Its policy priorities include fostering regional convergence, embarking on an ambitious energy transition and promoting a productive transformation of the economy. All these reforms are likely to shape the future of the society and economy for years to come. A reform to improve working conditions, is being discussed in Congress, and the pension reform has been enacted into law. Evidence-based reforms are the only way to overcome long-lasting challenges and should preserve what has worked well in the past, such as the strong and well-functioning macroeconomic institutions. Ensuring fiscal rules compliance and that reforms are financed sustainably and maintain debt sustainability are essential as they have underpinned economic growth and social development in recent decades.

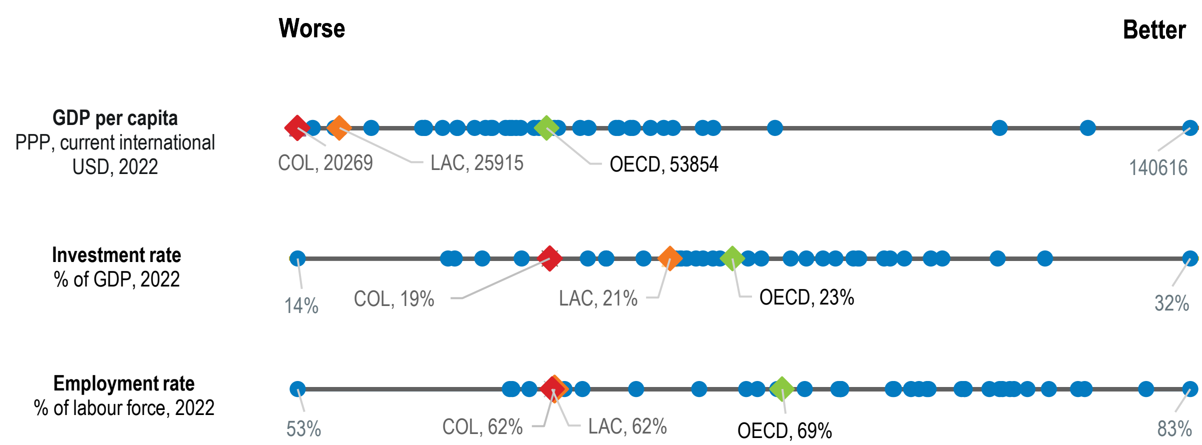
Capitalising on the opportunities and unlocking Colombia's potential for sustainable economic growth and social development requires significant reforms and investment, both public and private. The investment rate has fallen since the end of the commodity boom in 2015 and has become one of the lowest among OECD countries (Figure 1.1) despite pressing needs in education, infrastructure, innovation, the green transition, public services, rural development, and peace-building initiatives. Resolving uncertainty regarding the implementation and funding of reforms and fostering an investment-friendly environment are priorities for robust short-term growth but also to accelerate income converge to more advanced countries and to achieve the energy transition. Boosting productivity across all regions would improve incomes especially of those Colombians that have been left behind and reduce spatial inequalities. Doing so requires reforms to create an attractive business environment, foster innovation, diversify exports, and enhance state capacity and the rule of law across all territories. Narrowing gender gaps in the labour market, improving access to high-quality education, reducing informality and expanding social protection coverage, would raise potential growth, empower all citizens to seize economic opportunities and promote a fairer distribution of income and opportunities. Adapting to and mitigating climate change risks would enhance resilience and would allow Colombia to diversify its productive structure and boost productivity. To meet the increasing demands for public spending and investment, including the ambitious social reform agenda, it is necessary to enhance spending efficiency and boost tax revenues with a comprehensive and gradual tax reform to ensure public debt sustainability.

This Survey contains a comprehensive review of recent macroeconomic developments and policy challenges in Chapter 2, followed by an in-depth assessment of strategies to enhance the productivity of all regions in Chapter 3. Chapter 4 delves into potential avenues for reducing inequalities and poverty, while Chapter 5 examines priorities to facilitate the green transition and achieve decarbonization. The main messages of the Survey are:

- Monetary policy should continue a gradual, prudent, and data-based easing cycle to ensure a gradual return of inflation to the target. In the short term, the government should implement the planned fiscal consolidation and adhere to the fiscal rule to ensure debt convergence to its anchor. Responding to spending needs for advancing social reforms, the green transition, and closing infrastructure gaps while maintaining debt sustainability requires raising tax revenues and spending efficiency.

- Regional gaps in productivity and living standards can be narrowed by lowering the cost of doing business, prioritising the interconnectivity of ports, river, rail, and road transport and strengthening subnational government capacities. Further strengthening governance, transparency and mitigation of uncertainty would boost private investment and potential growth. The fiscal transfer system can be strengthened through better equalisation mechanisms, greater direct revenue generation by subnational governments and better intergovernmental coordination mechanisms.
- Strengthening the quality of education and facilitating female labour market participation would help to continue reducing inequalities while reinforcing Colombia's growth potential. Implementing a comprehensive strategy to reduce informality by enhancing skills, strengthening the enforcement of labour and tax laws, reducing corporate tax and regulatory burdens, and lowering social security contributions for lower-income workers would boost potential growth, improve tax collection, and provide better job opportunities.
- Large investments are needed to adapt to and mitigate the impact of climate change. Stronger efforts to strengthen adaptation policies, fight deforestation, a stable regulatory framework for renewable energy investment, and stronger price signals for abatement are needed to get Colombia on a sure path to net zero emissions by 2050, requiring significant private investment.

Figure 1.1. Living standards and production factors are lower than in most OECD countries



Source: World Bank; *OECD Labour Market Statistics* (database); and OECD calculations.

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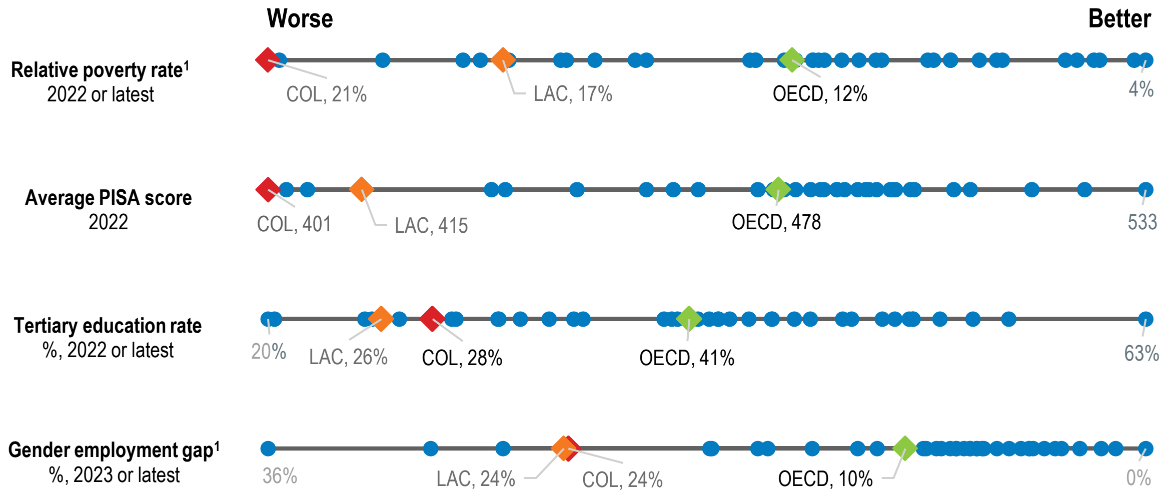
Figure 1.2. High poverty, gender gaps, and low skills hinder social mobility



Note: 1. Indicator reversed so that the right side of the scale corresponds to a better outcome. The relative poverty rate is the proportion of people earning less than 50% of the median income. The average PISA score is the average score of mathematics, science and reading.
Source: *World Bank World Development Indicators* (database); *OECD PISA* (database); *OECD Education at a Glance* (database); *OECD Labour Market Statistics* (database); and OECD calculations.

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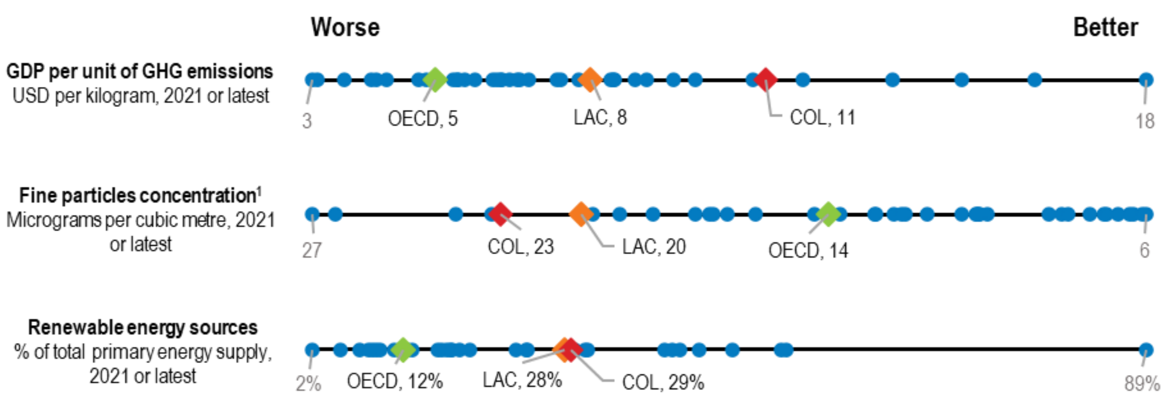
Figure 1.3. There is room to expand clean energy



Note: 1. Indicator reversed so that the right side of the scale corresponds to a better outcome. GDP per unit of GHG emissions is the production-based CO2 productivity. Fine particles concentration is mean population exposure to PM2.5. Primary energy supply is defined as energy production plus energy imports, minus energy exports, minus international bunkers, then plus or minus stock changes.
Source: *OECD Green Growth Indicators* (database); and OECD calculations.

StatLink https://stat.link/5bs32q

2 Macroeconomic developments and policy challenges

Paula Garda, OECD

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After a strong recovery, GDP growth has slowed down on the back of tighter monetary and fiscal policies and weakened investment. Inflation has decelerated but remains high. Immediate macroeconomic priorities include continuing to reduce inflation and fostering an investment-friendly environment. Fiscal prudence is required to address various fiscal risks and ensure compliance with the fiscal rule. To meet growing government spending needs – including the government's ambitious social and productive transformation reform agenda – broad reforms to raise spending efficiency and increase tax revenues will be needed.

2.1. A strong recovery has given way to weak growth

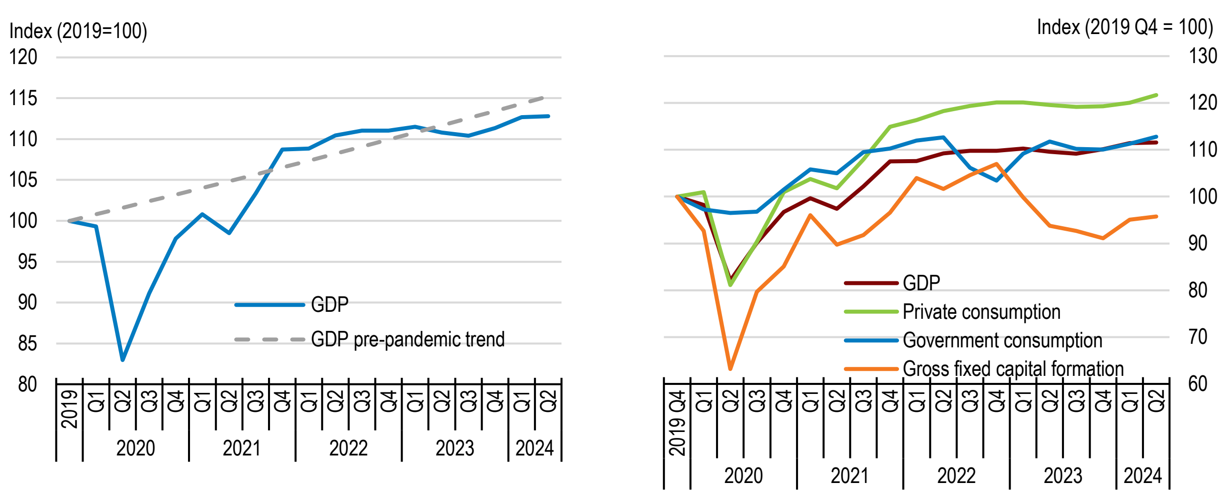
2.1.1. Low investment is dragging down growth

After one of the strongest rebounds among OECD countries from the COVID-19 crisis with GDP growing by 10.8% and 7.3% in 2021 and 2022, respectively (Figure 2.1, Panel A), growth moderated sharply to 0.6% in 2023 on the back of tight macroeconomic policies, slowing global growth, and higher global borrowing costs. The strong recovery above pre-pandemic trends was driven by a boom in consumption especially of durable consumer goods, driven by accumulated savings during the pandemic, a significant increase in consumer credit, a strong labour market and minimum wage hikes. Accommodative fiscal and monetary policies also played a significant role in the recovery. Domestic demand growth started to level off in late 2022 as private consumption moderated, and weak investment added to sluggish growth in 2023. Economic activity started to rebound in 2024, with GDP growing by 1.7% in the first semester of 2024 with respect to the semester before, driven by private consumption growth. Investment started increasing in the second quarter of 2024, particularly in infrastructure. However, GDP grew only 0.1% in the second quarter of 2024 with respect to the quarter before. Headline inflation peaked in March 2023 at 13.3% and declined to 6.1% by August 2024. The disinflationary process was slower than in other countries due to a strong rise in energy prices, driven by the exemplary removal of petrol subsidies by end-2023, stronger domestic demand in 2021-2022, significant increases in the minimum wage, widespread price indexation mechanisms, a sharp depreciation of the Colombian peso in 2021 and 2022, and strong hikes in food prices due to supply constraints.

Figure 2.1. A strong recovery has given way to subdued growth

A. GDP vs. GDP pre-pandemic trend, by quarter

B. GDP components, by quarter



Note: In panel A, 2019 refers to annual data, and the pre-pandemic trend is defined as the 2019 quarterly average growth rate.
Source: OECD calculations based on the *OECD Economic Outlook* (database).

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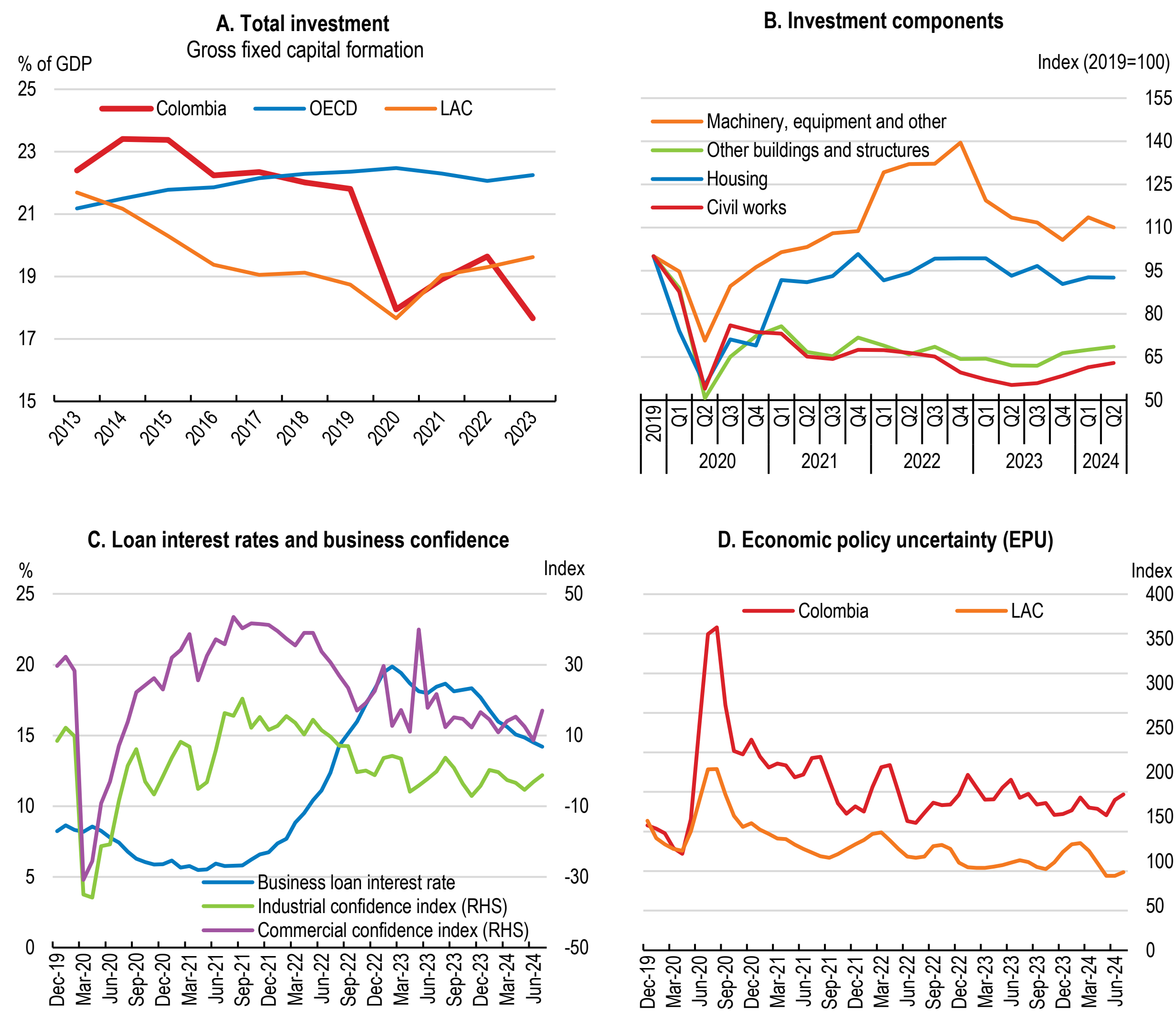
Colombia has experienced a long-lasting decline in total investment since the end of the commodity boom in 2015 (Figure 2.2, Panel A). The low and declining investment-to-GDP ratio since then hinders the already low potential growth and ability to catch up in productivity and living standards with more advanced economies. Several drivers could have contributed to the declining investment rate, including a low savings rate and misallocation of capital. High informality might be another driver contributing to Colombia's low potential growth, low national savings rates, and inefficient capital allocation, as firms and workers in the informal sector often face precarious employment conditions, low wages, and lack of access to formal financial institutions limiting their ability to save and invest in productive activities. Moreover, investment in science, technology, and innovation has remained relatively low, at around 0.5% of GDP, which may hinder economic diversification and higher value-added investments.

Before the pandemic, the investment-to-GDP ratio stood at around 23%, in line with the OECD average (Figure 2.1, Panel B and Figure 2.2, Panel A), but has since plummeted to one of the lowest among OECD countries, 17.8% in 2023. To achieve a potential growth rate of around 3%, an investment rate of at least 20% of GDP is required (Fedesarrollo, 2024[1]). Gross fixed capital formation grew by 3.8% in the first semester of 2024 compared to the previous semester, but investment remains weak, with both public and private investment underperforming. A particular concern is civil works investment (Figure 2.2, Panel B) which has fallen to a little more than half of the pre-pandemic level. The government has launched new initiatives to encourage investment in infrastructure (particularly in railways, airports and roads), but public investment is hindered by the low execution capacity of many local governments.

Figure 2.2. Investment has slowed down



Note: In Panel C, for the confidence index, values higher than 0 represent an optimistic view, whereas values lower than or equal to 0 represent a pessimistic view. In Panel D, the data represents 3-month moving averages and incorporates the domestic press coverage. LAC is a simple average of Argentina, Brazil, Chile, Mexico, and Peru.

Source: *OECD Economic Outlook* (database); OECD calculations based on DANE quarterly National Accounts; Banco de la República; Fedesarrollo; and Banco de España.

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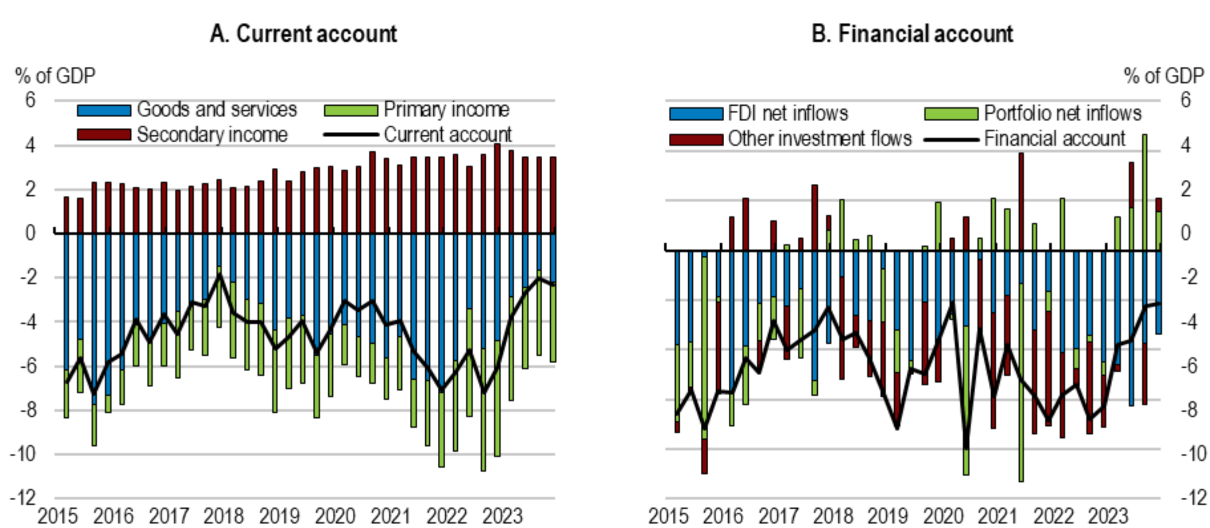
During 2023, private investment slowed down driven by high credit costs, stricter lending criteria on the back of tighter monetary policy and low business confidence, (Figure 2.2, Panel C). Other drivers affecting investment are the rising costs of construction materials, such as steel, cement, asphalt, and concrete, global supply chain disruptions caused by the pandemic and the war in Ukraine that further exacerbated these issues. The 2021 and 2022 corporate tax increases might have also impacted private investment. Uncertainty (Figure 2.2, Panel D) regarding the pace and implementation of reforms might have also hindered private investment. Delays in private infrastructure investments stemmed from a slow adoption of the new generation of the public-private partnerships portfolio (‘5G’), following the near-complete execution of the 4G projects. Lower-than-agreed annual road toll increases could have increased uncertainty, potentially disincentivising private involvement in infrastructure PPPs. The transition to better-targeted housing subsidies, while welcome, may have negatively impacted investment in the construction sector. Difficulties in securing land rights, environmental licenses, and necessary prior consultations with ethnic communities might have also explained delays in investment. On the upside, four ‘5G’ infrastructure projects will soon start to be implemented and record-high Foreign Direct Investment influx of USD 17 billion in 2023 signals foreign investor confidence in Colombia.

The current account deficit has significantly narrowed from high levels in 2022. The strong growth in 2022 driven by durable consumer goods fuelled import growth and widened the current account deficit, amid favourable terms of trade. In 2023, all components of the balance of payments contributed to correcting the external imbalance (Figure 2.3, Panel A), with the trade deficit in goods showing the most significant improvement due to reduced imports amid lower domestic demand. Despite increased interest payments on external loans, net outflows from factor income decreased, from 2022 high levels, mainly because of lower profits from foreign direct investment, driven by lower oil and coal prices. Additionally, higher remittances, equivalent to 2.8% of GDP, mainly from the United States and Spain, helped reduce the current account deficit. Foreign direct investment (FDI) has reached a record high of 5% of GDP and remains the primary source of external financing (Figure 2.3, Panel B), helping to more than compensate for net portfolio outflows, mainly from residents increasing their assets abroad. In 2023, the Colombian peso appreciated by approximately 21% year-over-year against the USD in nominal terms (end-of-period), following a depreciation of 20% in 2022, correcting some of the overshooting of the previous year. This significant appreciation, one of the largest among emerging markets, was in addition driven by improvements in Colombia's fiscal and external positions.

Figure 2.3. The current account deficit has narrowed and is funded by foreign direct investment



Source: Banco de la República; and OECD calculations based on the *OECD Economic Outlook* (database).

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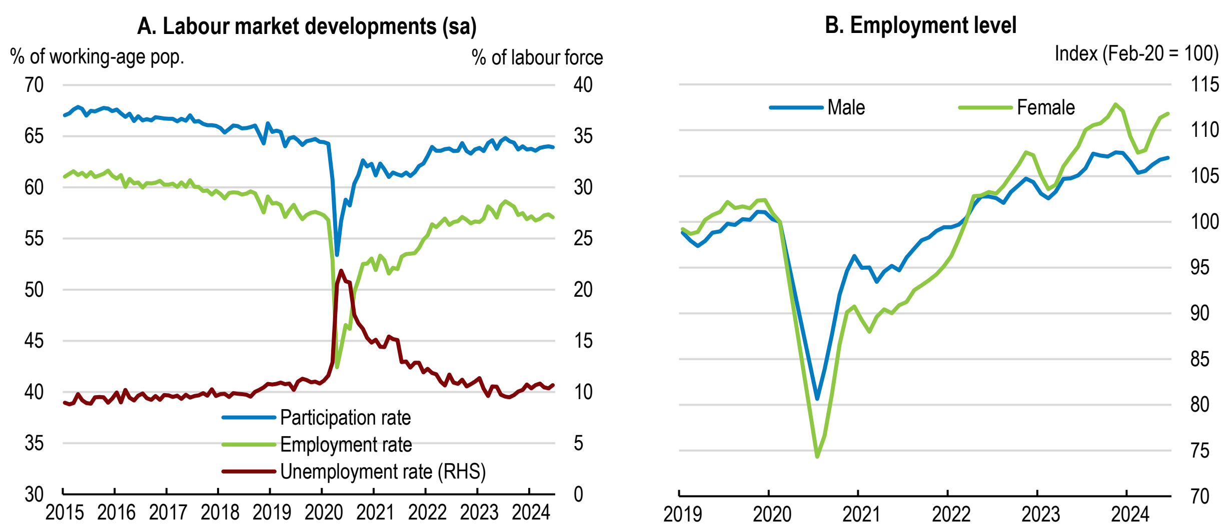
2.1.2. The labour market performed strongly but has shown signs of slowing down

The labour market has been resilient and is nearing full post-pandemic recovery, with robust job creation and reduced informality rates, but recent data suggest a slowdown. Employment growth surged in 2022 in line with strong economic growth, especially among 24-54 years old and small firms, and remained dynamic throughout 2023 but has slowed since September 2023 in line with the slowdown in economic activity. Labour force participation and employment rates are close to pre-pandemic levels (Figure 2.4, panel A), but, among the youngest (up to 24 years) employment remains below pre-pandemic levels. The unemployment gender gap narrowed in 2023 as female employment has grown faster than male employment (Figure 2.4, panel B), mainly due to job creation in artistic activities, the services sector, and public employment, the primary sources of female employment. In 2023, real labour income of salaried workers rose by 5%, primarily due to the nominal minimum wage hike of 16% (Banco de la República, 2024[2]). After bottoming out in August 2023 at 9.5%, the unemployment rate increased to 10.7% in December 2023 and remained around this level until July when reached 10%, similar to the 2015-2019 average, but above the OECD average of 5%. The informality rate was 56% in June, like a year earlier, but it has increased slightly in recent months, which might be driven by the slowdown in economic activity and the impact of large minimum wage hikes.

Figure 2.4. The labour market has shown resilience



Source: OECD calculations based on DANE; and CEIC.

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2.1.3. Economic growth will return to low potential growth

GDP growth will experience another year of relatively modest growth, reaching 1.8% in 2024, before picking up to 2.8% in 2025 (Table 2.1), returning to a low potential growth. Private consumption growth will remain moderate but solid supported by disinflation, monetary policy easing and significant remittances. Exports will grow moderately given the still weak external demand and lower oil prices. Investment will gradually continue its increase in line with the easing of domestic and external financial conditions that will allow for a partial rebound in private investment, and accelerate in 2025, when real interest rates fall back to levels seen in the previous decade. Civil works investment is expected to continue to rebound with the implementation of newly adjudicated public-private partnerships. Inflation will continue falling and converge close to the 3% target by end of 2025. The current account deficit will remain just below 3%, below pre-pandemic levels. Unemployment will stabilise in 2024 and then slightly fall in 2025.

Table 2.1. Economic growth will remain sluggish before accelerating in 2025

	2019	2020	2021	2022	2023	2024	2025
	Percentage changes, volume (2018 prices)						
GDP at market prices	3.2	-7.2	10.8	7.3	0.6	1.8	2.8
Private consumption	4.1	-5.0	14.7	10.7	0.8	1.6	1.5
Government consumption	5.3	-0.8	9.8	0.8	1.6	2.6	3.1
Gross fixed capital formation	2.2	-23.6	16.7	11.5	-9.5	2.3	10.8
Stockbuilding[1]	0.2	0.6	-0.9	0.8	-3.3	-0.3	0.0
Total domestic demand	4.0	-7.5	13.4	10.2	-4.0	1.8	3.5
Exports of goods and services	3.1	-22.5	14.6	12.3	3.4	3.1	3.8
Imports of goods and services	7.3	-20.1	26.7	23.6	-15.0	1.9	6.4
Net exports[1]	-1.0	0.8	-3.5	-3.6	4.9	0.1	-0.7
Memorandum items							
GDP deflator	4.0	1.5	7.8	14.9	6.3	5.5	5.2
Consumer price index (average)	3.5	2.5	3.5	10.2	11.7	6.7	4.4
Consumer price index (Q4-on-Q4)	3.9	1.7	5.2	12.7	10.0	5.7	3.6
Core inflation index[2] (average)	2.8	2.0	1.8	6.4	9.8	6.0	4.2
Core inflation (Q4-on-Q4)	3.0	1.3	2.4	9.0	8.9	5.1	3.6
Potential growth	3.0	2.7	2.7	2.9	2.6	2.5	2.7
Output gap (% of GDP)	0.1	-9.5	-2.4	1.8	-0.2	-0.8	-0.7
Unemployment rate[3] (% of labour force)	10.9	16.5	13.8	11.2	10.2	10.5	10.0
Current account balance (% of GDP)	-4.6	-3.4	-5.7	-6.1	-2.6	-2.7	-2.4
Government fiscal balance[4] (% of GDP)	-4.1	-8.8	-7.8	-5.0	-4.3	-5.6	-5.1

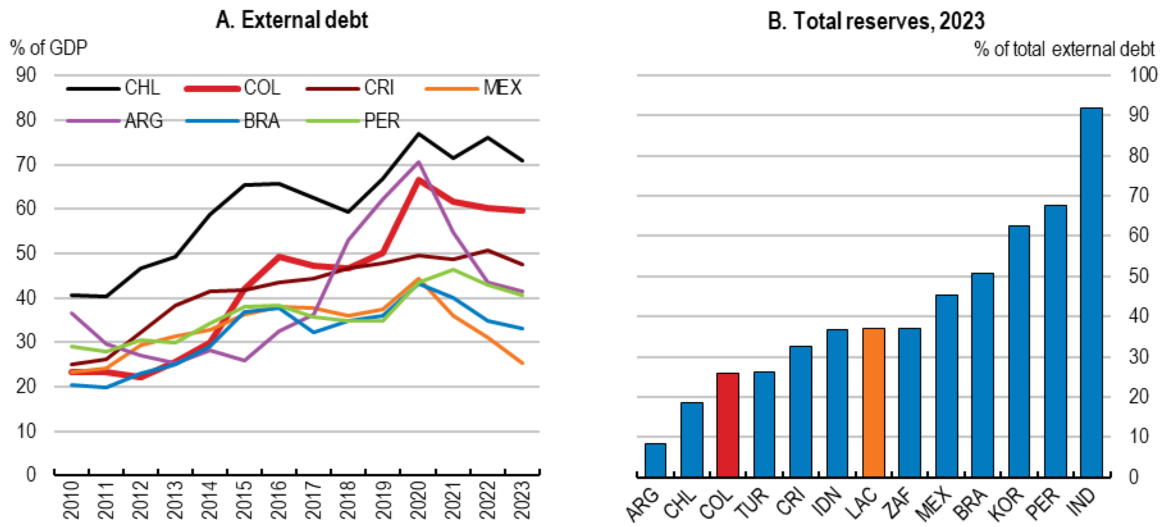
1. Contributions to changes in real GDP, actual amount in the first column. 2. Consumer price index excluding food, regulated utilities, and fuel prices. 3. Based on national employment survey. 4. The fiscal balance shows the central government budget.
Source: OECD STEP 115 database.

2.1.4. Risks around the outlook remain substantial

Risks and uncertainties remain elevated (Table 2.2). Externally, geopolitical tensions could lead to global recession and may trigger greater risk aversion and increase financing costs and foreign exchange market volatility. Lower-than-expected growth in the United States, the main trading partner as highlighted in Chapter 3, could weaken growth, worsen the terms of trade and lower exports, widening the current account deficit. Upside risks to growth include sustained higher commodity prices, faster global growth and a faster than anticipated recovery of the United States economy. The rising trend of nearshoring, which has heightened foreign investors' attraction to Latin America, may also result in increased foreign direct investment and output growth.

External gross debt at 60% of GDP has significantly risen since 2010s (Figure 2.5, Panel A), is higher than other countries in the region and a significant share of Colombian sovereign debt is denominated in foreign currency, mostly USD, increasing vulnerability to global financial conditions and exchange rate fluctuations. Furthermore, a weaker fiscal outcome could lead to a higher external deficit. Twin deficits are a concern because they can lead to increased public debt, vulnerability to external shocks, and potential downgrades in credit ratings. These risks are mitigated by comfortable foreign exchange currency reserves (Figure 2.5, Panel B), a resilient financial sector, a current account deficit that is largely supported by foreign direct investment (see Figure 2.3, panel B above), and a flexible exchange rate. These buffers are complemented by a two-year Flexible Credit Line arrangement with the IMF.

Figure 2.5. External debt has risen, but foreign exchange reserves are comfortable



Source: *IMF International Financial Statistics* (database); and *IMF World Economic Outlook* (database).

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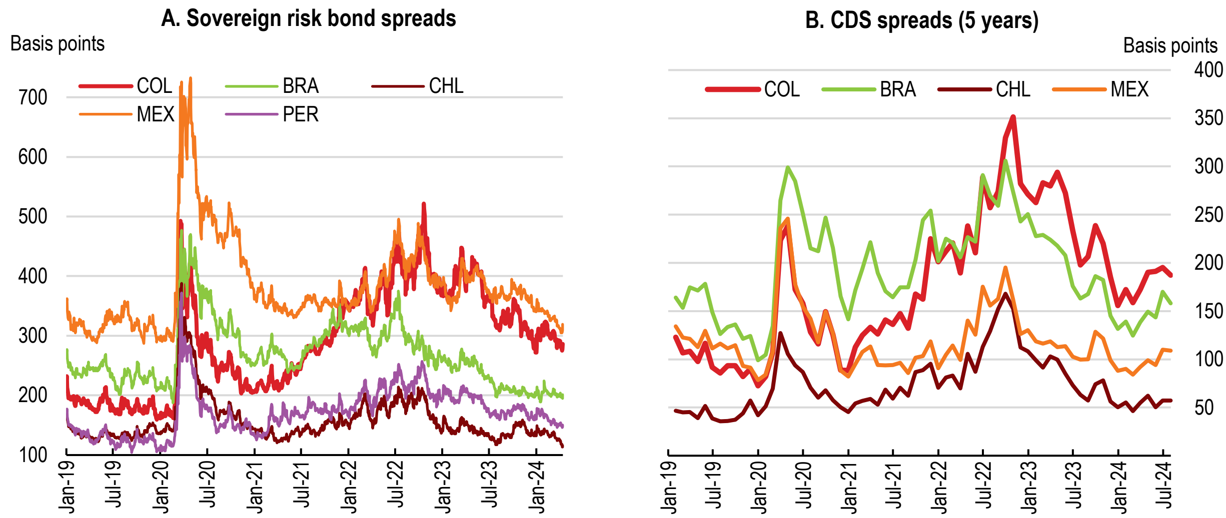
Domestically, more persistent inflation may require keeping high interest rates for an extended period. Weaker than expected private demand resulting from tighter financial conditions, or a weakened labour market also presents potential risks to economic growth. Failure to accelerate public works and PPP infrastructure investments may perpetuate subdued investment levels. The risk of heightened social tensions and increased violence cannot be ruled out and could disrupt economic activity. On the upside, a faster-than-expected implementation of the ongoing reindustrialisation policy could boost investment faster than anticipated.

Risk perceptions have moderated, after peaking in 2022, but remain elevated compared to pre-pandemic levels and those of countries with similar credit ratings (Figure 2.6). Persistent uncertainty can increase borrowing costs and worsen the debt outlook, as evidenced by Colombia losing its investment grade in 2021 and Standard and Poor's recent shift in outlook to negative in January 2024. The latter change highlights concerns about long-term investor confidence, which may hinder private investment (S&P, 2024[3]). Uncertainties regarding the implementation of and funding for reforms, along with implementation and regulatory challenges, may elevate borrowing costs, prompt capital outflows causing currency depreciation and inflationary pressures, and hinder private investment.

Colombia is highly vulnerable to climate change facing risks such as extreme weather events, rising temperatures, changing precipitation patterns, and natural disasters like floods and landslides (see chapter 5). El Niño and La Niña, climate phenomena characterised by the changes in sea surface temperatures that cause draughts or heavy rainfall, are becoming more frequent and intense due to climate change. These natural hazards pose significant threats to ecosystems, water resources, infrastructure, and human health and well-being, exacerbating risks to economic activity and the inflation outlook, particularly in climate-sensitive sectors like agriculture and tourism. As Colombia's energy supply relies heavily on hydropower, natural hazards such as El Niño can lead to disruptions in electricity supply and increases in energy prices. As fossil fuel producer, Colombia is highly exposed to changes in oil prices, as 40% of its exports and 5% of its tax revenues come from oil. A sharper-than expected decline in long-term oil prices due to an accelerated global transition to clean energy poses a risk if the economy fails to diversify at a similar pace. Other risks include social and economic dislocation resulting from the phasing out of traditional energy sources such as oil extraction and coal mining. Job losses in these sectors could lead to increased unemployment and social tensions, while the shift to clean energy infrastructure requires substantial investment and technological upgrades, posing financial and logistical challenges for the government and private sector.

Figure 2.6. Risk perceptions are above pre-pandemic levels



Note: In Panel A, data refer to JP Morgan EMBI spreads.
Source: *OECD Economic Outlook* (database); and LSEG.

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Table 2.2. Potential major medium-term vulnerabilities

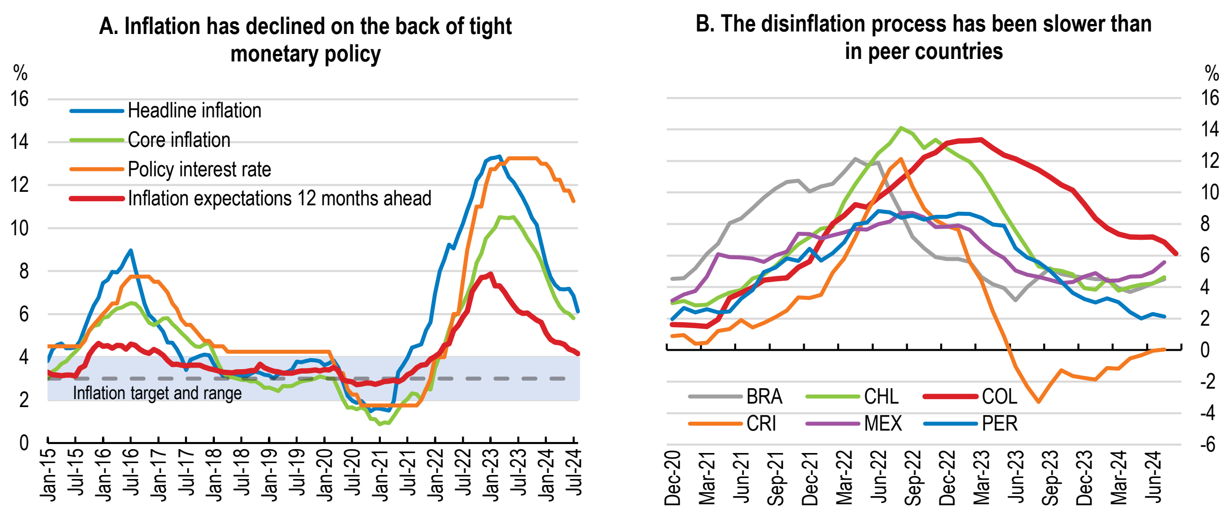
Uncertainty	Possible outcome
Abrupt global slowdown or recession, including in the United States.	Lower export prices, falling terms of trade, and lower exports and growth.
Natural disasters and environmental risks related to climate change, including El Niño and La Niña weather phenomena.	Extreme rainfall, droughts, floodings, transmission of viral infections, food and water insecurity, water rationing, infrastructure damage with negative impact on GDP per capita, inflation outlook and fiscal sustainability.
Lower long-term oil prices or disorderly clean energy transition. With 5% of public revenues coming from fossil fuel extraction, long-term fiscal sustainability challenges may arise.	Deterioration of fiscal outcomes, disruptions in energy supply, increased energy costs, and economic instability. It may exacerbate social tensions due to potential job losses in traditional energy sectors.
Heightened global financial stress.	Capital outflows in a rush towards safety causing further currency depreciation and worsening the outlook for dollar denominated external debt and a sudden increase in risk premia.

2.2. Monetary policy has reacted decisively to high inflation

A tight monetary policy stance, with ex-ante real interest rates at 6.7% in July after peaking in February at 7.6%, has contributed to the decline in inflation from its peak of 13.3% in March 2023 to 6.1% in August 2024 (Figure 2.7, panel A). Disinflation occurred despite significant increases in energy prices, especially petrol, driven by the welcome phase-out of distortive subsidies, and two strong minimum wage increases of 16% in 2023 and 12% in 2024. During 2023 inflation of goods prices decreased substantially due to the peso appreciation, while service price inflation has shown persistence due to the high degree of price indexation. Price indexation – either to past inflation or to minimum wage increases – affects 60% of the consumption basket on which the consumer price index is based (Banco de la República, 2023[4]). Indexation, coupled with high increases of the minimum wage, rising fuel prices, and strong domestic demand, could explain the slower pace of disinflation compared to countries like Brazil or Chile (Figure 2.7, panel B). Other explaining factors are the delayed impact of the significant peso depreciation during 2021 and 2022, and sharp increases in food prices caused by supply constraints from 2021 social protests and climate hazards. The El Niño weather phenomenon, which causes droughts, is nearing conclusion but has led to low reservoir levels and contributed to rising energy prices, but its expected impact on higher food prices has not materialised as expected. Core inflation has also declined to 5.5% in August. One-year ahead inflation expectations have declined since early 2023, but remain above target, at 4.2% in August.

Monetary policy has played a crucial role in reducing inflation with the central bank starting its easing cycle in December 2023, totalling a 250-basis points reduction since then. The easing cycle is midway and given falling expected inflation and a negative output gap, monetary policy can continue pursuing its gradual, prudent, cautious, and data-based easing cycle. Policy rate cuts are projected to continue through 2025 to bring inflation close to the 3% target by end-2025, in line with the Central Bank's objective and announcements made by its Board of Directors at the end of 2023. Neutral real interest rates are estimated at around 2.5% for Colombia (Banco de la República, 2024[5]), higher than pre-pandemic levels due to the higher public debt ratio, an elevated sovereign risk premium, and tighter global financial conditions following the pandemic. However, caution is required as there are several upside inflation risks. The planned phase-out of diesel subsidies, while necessary, could add to inflationary pressures, although the impact on inflation should be lower than that of the 2023 petrol price increases. Other upward risks for inflation include wage and price indexation and persistence of inflation, unanchoring of inflation expectations due to prolonged deviations from the target, inflationary pressures from a possible extreme La Niña, tightening of external financial conditions, and heightened sovereign risk perception leading to exchange rate pressures and/or increases in the neutral real interest rate.

Figure 2.7. Inflation has declined but remains high



Source: Banco de la República, DANE; and *OECD Economic Outlook* (database).

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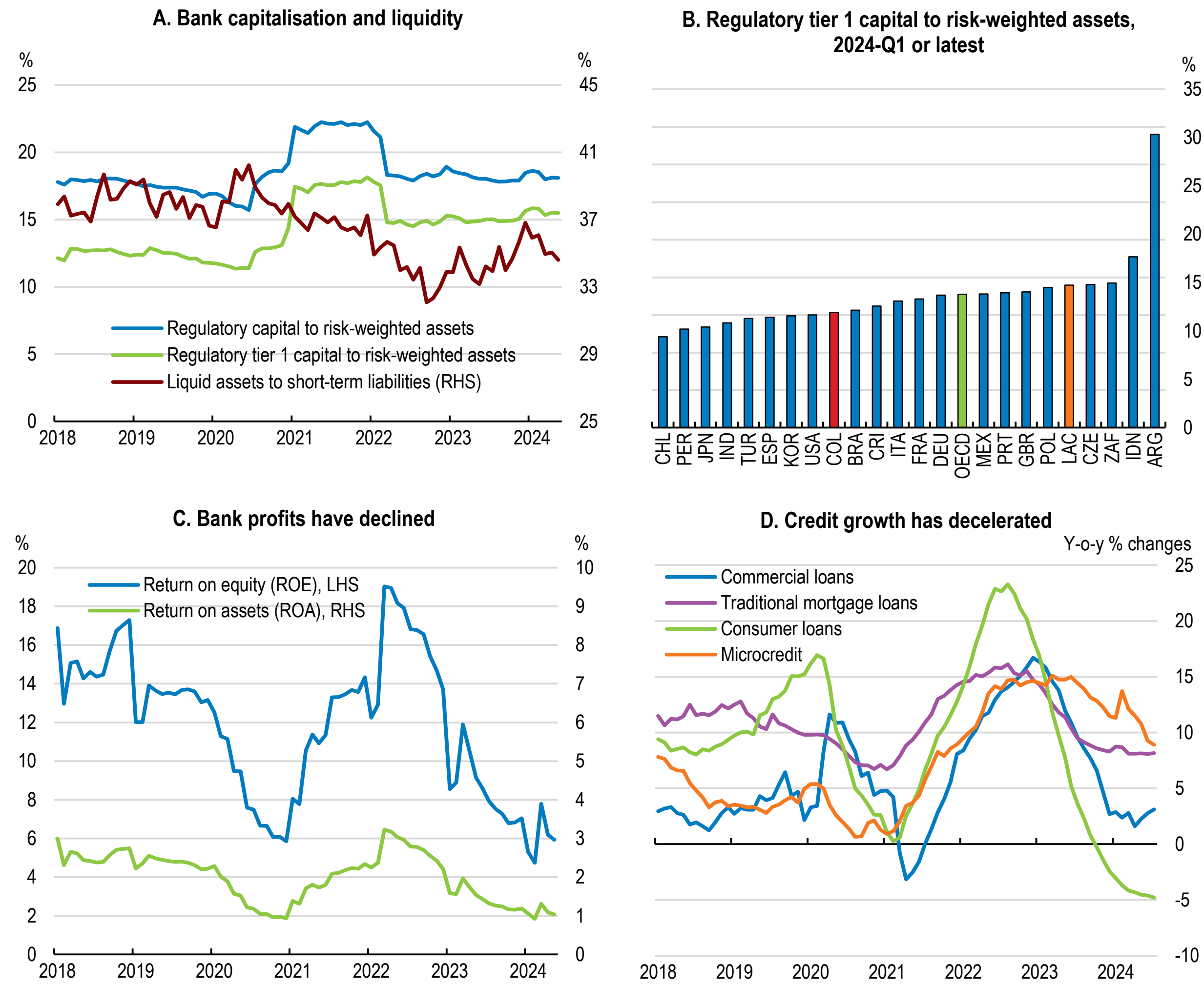
2.3. Financial stability risks seem contained

Financial market regulation, macroprudential oversight, and banking supervision are sound, particularly following the adoption of Basel III standards in 2021. The banking sector remains resilient, with strong capitalisation and liquidity in banks (Figure 2.8, panel A and B). While there have been recent declines in some indicators of credit quality, these are manageable with the existing buffers. Profitability has declined from previous highs, particularly in the consumer portfolio (Panel C). Stress tests by the Central Bank and the Financial Superintendency confirm that even under adverse shocks, aggregate bank capitalisation exceeds regulatory limits (Banco de la Republica, 2023[6]).

Figure 2.8. Banks capital and liquidity ratios are adequate and credit growth has decelerated



Source: CEIC; Superintendencia Financiera de Colombia; BIS; and BRC.

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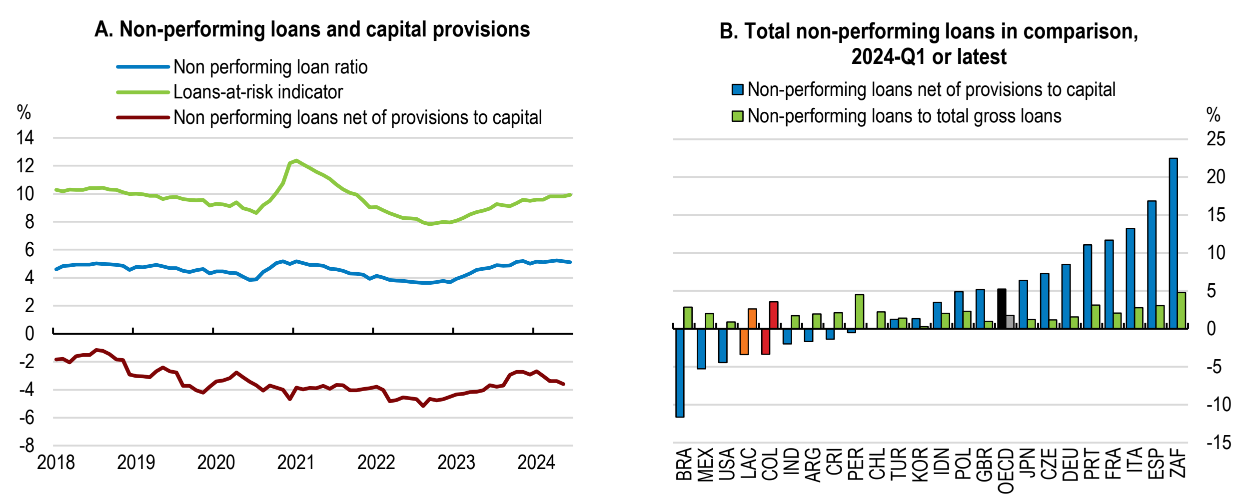
Figure 2.9. Non-performing loans have risen, especially among consumer loans



Source: IMF Financial Soundness Indicators (database).

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After growing at the fastest pace in over a decade, credit growth has decelerated, across all loan types, reflecting the normalisation of the economy and tight monetary policy (Figure 2.8, panel D). The slowdown was particularly pronounced for households' consumer loans. This moderation in consumer credit growth reflects increased broad requirements for granting new loans, monetary policy tightening and higher provisioning requirements for consumer loans. As a result, the household debt-to-income ratio decreased in 2023 to levels well below historical peaks. Corporate indebtedness also declined to 49% of GDP in 2023, given the economic activity deceleration and the peso's appreciation, but remains 3 percentage points above 2019 levels (Banco de la Republica, 2023[6]). Around 73% of corporate foreign currency-denominated private debt has risk mitigation measures.

Non-performing loans have risen in 2023 and the first months of 2024 (Figure 2.9), especially in consumer portfolios, because of the economic slowdown and previous risk-taking by lenders (Banco de la Republica, 2023[6]). The coverage indicator (provisions to non-performing loans ratio) decreased in 2023 due to a disproportionate rise in non-performing loans, although it remains at adequate levels. Counter-cyclical provisions in consumer and commercial sectors, intended to address scenarios of deteriorating credit quality, declined in 2023 (Banco de la Republica, 2024[7]). The microcredit segment requires close monitoring and strong supervision, as non-performing loans have risen rapidly, especially in unsupervised microfinance institutions (Banco de la República, 2023[8]). Given high interest rates and slowing economic activity, this trend may continue and jeopardise portfolio quality. Maintaining the rules-based mechanisms of the countercyclical provisioning framework, with cautious adjustments as needed, remains warranted.

Extreme weather events pose financial stability risks, requiring efforts to assess these risks and integrate climate risks into financial frameworks (see also chapter 5). Colombia was the first Latin American country to carry out a climate stress test of its financial sector. Led by the Financial Superintendence of Colombia, initiatives include incorporating climate-related elements into regulations, developing supervisory tools, and regulating green financial instruments. Adopting a risk-based approach to supervising climate-related risks, enhancing information disclosures, and improving data availability would further reinforce financial stability.

2.4. Fiscal prudence is needed to support public debt sustainability

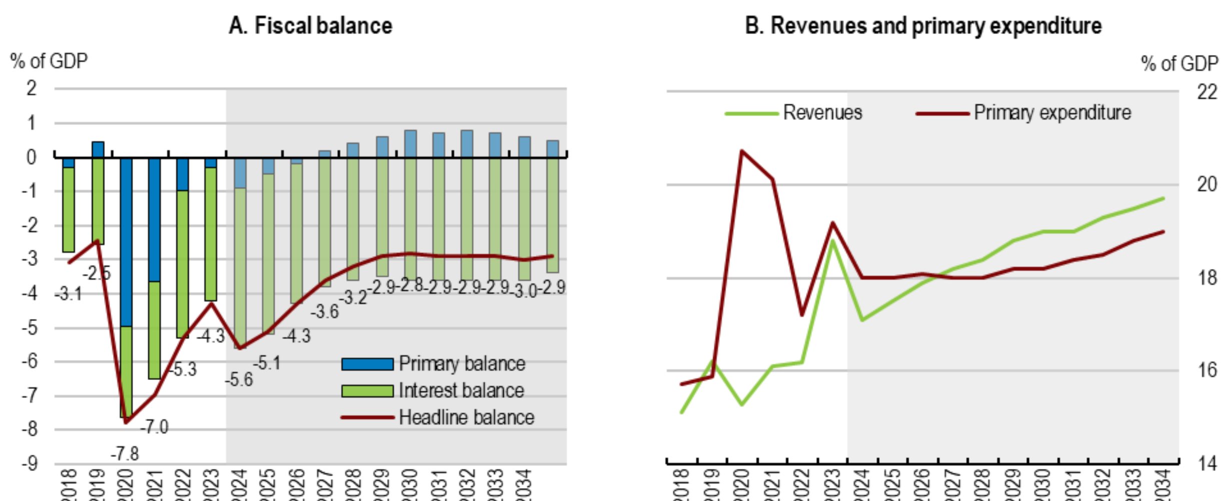
Colombia's strong rule-based fiscal framework (Box 2.1), underpinned by a long-term commitment to fiscal sustainability, has provided macroeconomic stability and fiscal discipline since its implementation. Following the substantial fiscal response during the COVID-19 pandemic Colombia managed appropriately to narrow the fiscal deficit in 2022 aided by the strong economic recovery (Figure 2.10, Panel A). Deficits were further reduced in 2023, despite the growth deceleration and higher spending mainly for social transfers, over complying with the fiscal targets. The deficit decline benefited from the gradual elimination of petrol subsidies and gains from the 2021 and 2022 tax reforms (Box 2.2), even if the reforms fell short of the expected yield of 2.3% of GDP in 2023 due to the economic deceleration (CARF, 2023[9]), requiring some ad-hoc spending cuts. The increase in primary spending following the pandemic has been permanent, rising from 15.8% of GDP in 2019 to 20% of GDP in 2020 and 19% in 2023 (Figure 2.10, Panel B). This increase has only been partially financed through the 2021 and 2022 tax reforms.

Box 2.1. Colombia's fiscal framework

Colombia implemented a fiscal rule in 2011 targeting the structural balance to enhance fiscal sustainability and to regain investment grade after losing it in 1999. Between 2011 and 2019, although fiscal rule targets were met, the government faced increasing fiscal pressure due to rapid debt accumulation (Arbelaez et al., 2021[10]). After appropriately suspending the fiscal rule in 2020 and 2021 to address the COVID pandemic, in 2021, a reform introduced a new fiscal rule to establish a link between structural net primary balance targets and observed net debt. The new rule includes an explicit debt anchor and sets a floor for the structural primary balance net of the economic and oil prices cycle and one-off transactions, as a direct function of the distance of net public debt to the anchor of 55% that will enter into force in 2026. Until 2026, a transition period is envisaged where the structural primary balance cannot be lower than -0.2% of GDP in 2024, and 0.5% of GDP in 2025. Due to the faster-than-expected decrease in net debt since 2021, which has now aligned with the anchor, the government is planning to bring forward the implementation of the parametric formula of the fiscal rule to 2025, pending congress approval. The rule also requires primary structural surpluses of at least 1.8% of GDP for net debt levels exceeding the limit of 71% of GDP.

Colombia's Medium-Term Fiscal and Expenditure Frameworks are also robust tools to align fiscal policy with fiscal rules, aligning budgetary decisions with long-term fiscal objectives. In addition, the 2021 reform created the Autonomous Fiscal Rule Committee that serves as an independent fiscal council, which has positively influenced fiscal policy decisions by providing constructive recommendations to the Ministry of Finance and shaping the public debate.

Figure 2.10. The government plans to continue the gradual fiscal consolidation



Note: The shaded area is a forecast from the Government Updated Financial Plan 2024 and the Medium-Term Fiscal Plan 2023-2027.
Source: Colombia Ministry of Finance, 2024 Updated Financial Plan and 2023-2027 Medium-term Fiscal Plan.

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Box 2.2. The 2022 tax reform

After the 2021 tax reform, in 2022 right after the current administration took office, a tax reform was passed to raise revenues by 1.0%-1.3% of GDP in 2023 and 2024, and then by about 1.3% from 2025. The 2022 reform aimed to limit the excessive use of tax expenditures that reduce the tax burden of higher-income taxpayers and create distortions between economic activities, internalise negative environmental and public health externalities, and reduce tax evasion and avoidance. This reform is a step in the right direction and has made the system less regressive.

The main measures of the reform include:

- Individual Income Tax: Consolidation of labour and capital income. Lower nominal cap on tax-exempt income and deductions (790 UVT= USD 8 325).
- Capital Gains Tax: Increased to 15%, with exemptions for certain transactions. Increase in the exempt amount for certain occasional gains.
- Dividend Tax: Increased marginal rates for those not taxed at the corporate level as a withholding tax set at 15% for residents and 20% for foreigners.
- Wealth Tax: Tax on fortunes made permanent and rates changed. Over COP 3.4 billion (USD 860 thousand; UVT 72 000) tax rates range from 0.5% to 1.5%. The highest tariff of 1.5% applies until 2027, when it reduced to 1%.
- Corporate Taxes: Standard rate maintained at 35%. Reduction of tax rates for the small and medium enterprises in the Simple tax regime. Certain deductions capped at 3% of net income. Changing the 50% discount on the Industry and Commerce Tax (ICA) to a 100% deduction of the amount paid for this tax.
- Surcharge for Specific Sectors: Additional income taxes for oil and coal if international prices exceed historical levels, in line with windfall taxes. The surcharge for financial sector is fixed at 5% until 2027.
- VAT Exemptions: Removal of the three VAT-free days.
- Carbon Tax: Gradual expansion to cover sales, imports, and extraction of coal from 2025.
- National Tax on Single-Use Plastics: New tax on single-use plastic products.
- Taxes on Ultra-Processed Goods: New levies on sugary drinks and highly processed foods high in sugar, sodium, or saturated fats.
- Strengthening Tax Procedures: Penalties increased for asset omission and tax fraud.

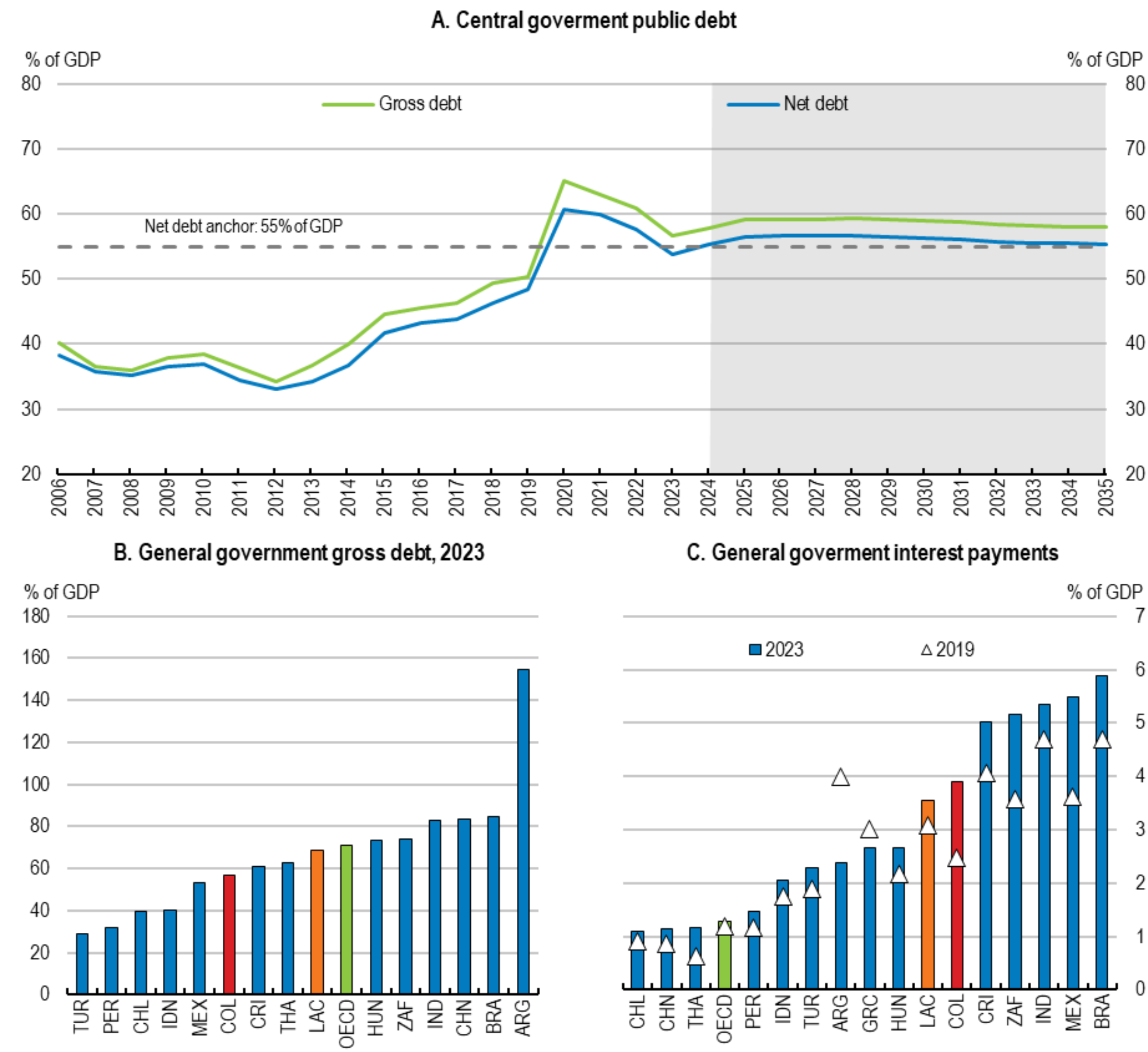
The reform includes provisions to enhance enforcement capabilities and combat tax evasion, including taxation based on significant economic presence and institutional strengthening of the tax authority. These efforts are expected to reduce tax evasion and generate an additional 0.8% of GDP in revenue.

The expected increase in tax revenues from the 2022 reform will be lower, 0.4% of GDP in 2024 and 0.2% of GDP in the following years, as in 2023 the Constitutional Court struck down part of a law that prohibited extractive companies from deducting royalties paid to the government from their taxable income from the exploitation of non-renewable natural resources.

Central government gross public debt surged to 65% of GDP in 2020 but has since declined, driven by the phasing out of pandemic measures and robust economic recovery, to 56.5% in 2023 (Figure 2.11, Panel A). Net debt as a % of GDP has also decreased and converged to the fiscal rule net debt anchor in 2023. General government gross public debt is comparable to the average in other emerging markets of 60% of GDP, but borrowing costs have increased substantially since Colombia lost its investment grade in 2021, accounting for 4% of GDP in interest payments and 17% of total government expenditure in 2023 (Figure 2.11, Panels B and C). This increase is influenced by high global interest rates and a higher sovereign risk premium.

The 2024 Medium-Term Fiscal Plan targets an appropriate improvement in the structural primary balance of 1.2 percentage points in 2024 (MinHacienda, 2024[11]). This prudent tightening of fiscal policy balances debt sustainability, a negative output gap and still high inflation. However, the headline fiscal deficit increases to 5.6% of GDP (Figure 2.10), due to a shortfall in non-oil tax revenues and higher interest payments. The lower-than initially expected tax collection is due to challenges in reducing tax evasion, the absence of revenues from improved litigation processes following the withdrawal of the related bill from Congress, and the Constitutional Court's ruling against the 2022 tax reform's royalty deductibility prohibition. Consequently, the government is reducing its primary spending by 1.6% of GDP in 2024, relative to the previous plan, underscoring the administration's commitment to fiscal sustainability and compliance with the fiscal rule. However, public investment spending will be reduced by 0.5% of GDP relative to initial plans.

Figure 2.11. Public debt and borrowing costs have increased



Note: In Panel A, forecast for 2024 refer to the Updated Financial Plan 2024, and for 2025 onwards to the Medium-Term Fiscal Plan 2023.
Source: Colombia’s Ministry of Finance, 2024 Updated Financial Plan and 2023-2027 Medium-Term Fiscal Plan; and IMF WEO (databases).

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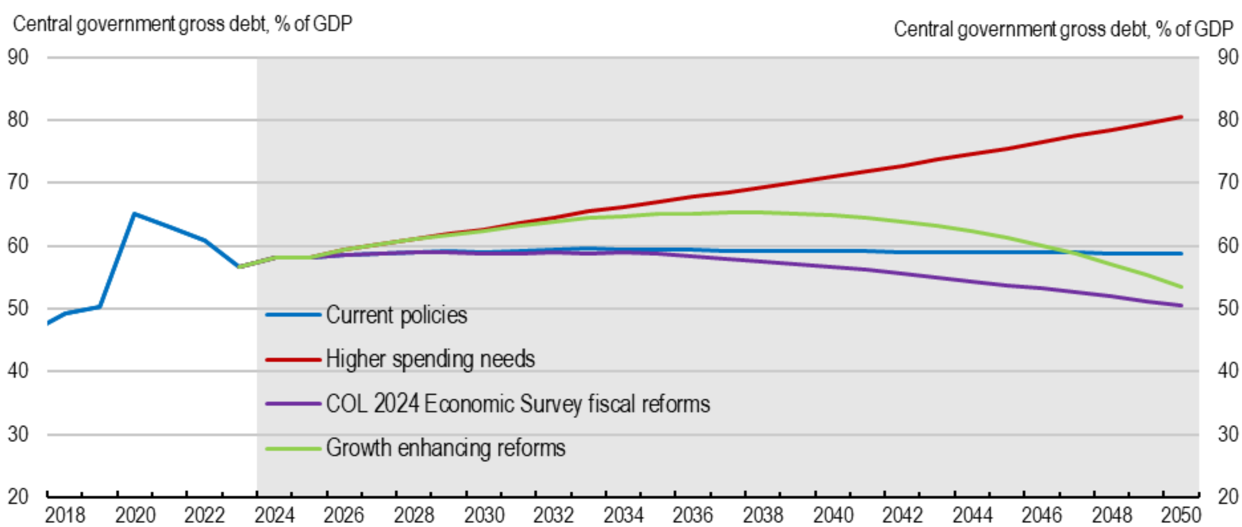
Government fiscal plans in the 2024 Medium-Term Fiscal Plan for 2025 foresee an improvement in the structural primary balance of 0.4 percentage points in 2025 in the limit of the fiscal rule. This assumes approval in congress of the earlier-than-planned implementation of the fiscal rule instead of the transition period target for 2025 (Box 2.1). However, the headline fiscal deficit will remain above 5% of GDP in 2025, reversing the post-pandemic decline for two consecutive years. Such high deficit leaves no margin for tax collection shortfalls, and interest payments remain high at around 5% of GDP in 2025 according to the medium-term fiscal plan and at 6% of GDP according the 2025 budget plan submitted to congress in late July. Such high interest payments leave little margin for important public spending and investment. Furthermore, if fiscal revenues fall short, ad-hoc spending cuts will again be necessary to comply with the fiscal rule, harming further public investment as budget inflexibilities further limit the scope for public spending cuts. In the short-term, maintaining the planned fiscal consolidation is key to prevent increases of public debt and investors' concerns about fiscal sustainability and avoid higher borrowing costs. Doing so while avoiding cuts in public investment could be achieved by gradually eliminating distortive and ill-targeted diesel and public utilities subsidies and improving the targeting of social spending, as discussed below. The gradual elimination of diesel subsidies could create up to 0.7% of GDP in fiscal space.

Considering the government medium-term fiscal adjustment plan to maintain primary surpluses from 2027 onwards (see Figure 2.10) and unchanged tax and spending policies, OECD projections suggest that gross public debt will stabilise at 59% of GDP by 2050 (Figure 2.12, blue line). Concerns remain about the government plans to raise 2.2% of GDP in additional fiscal revenue without further comprehensive tax reform. In the medium term, the government should focus on achieving higher tax revenues and raising spending efficiency, as discussed below, while building fiscal buffers to accommodate future shocks.

Figure 2.12. Scenarios for central government gross debt



Note: The "current policies" scenario assumes existing tax and spending and the implementation of government consolidation plans in compliance with the fiscal rule. It assumes real GDP growth and inflation to follow OECD projections over 2024-25 as in Table 2.1, after that real GDP growth gradually converges to a potential output growth of 3%; the inflation rate is assumed at the target of 3%; and the exchange rate between the Colombian peso and the US dollar is assumed constant over the simulation period. The government primary balance is assumed to follow authorities' medium term fiscal plan over 2024-2035, in compliance with the fiscal rule, and constant primary surpluses are maintained until 2050. The "higher spending needs" scenario assumes a higher 0.7% of GDP annually in primary expenditure than in the "current policies" scenario, as an illustration of the costs of passing the pension reform and other spending needs related to health reforms and the green transition. The "growth enhancing reforms" scenario assumes on top of the higher spending scenario, the implementation of an ambitious package of selected structural reforms as the one recommended in Table 2.3 from 2026. The "Economic Survey fiscal reforms" scenario assumes on top of the higher spending scenario, the implementation of a tax reform and spending efficiency reforms as recommended in Table 2.3. All scenarios account for ageing-related costs, which are estimated to total 2.5% of GDP over the entire period from 2025 to 2050 (Pessino and Ter-Minassian, 2021[12]).
Source: OECD calculations.

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In the medium term, financing higher post-pandemic spending, social reforms, the green transition, and infrastructure gaps will require additional spending leading the public debt-to-GDP ratio to increase significantly (Figure 2.12, red line). For example, the pension reform bill, not yet factored into the medium-term fiscal plan, could require an additional 0.5% of GDP annually in the short term to finance the non-contributory and semi-contributory pillars of the system (CARF, 2024[13]), increasing to 0.6% of GDP in 2040 and 1.1% beyond 2065. The contributory system will require more resources in the long term due to the greater needs of the pay-as-you-go system, needing about 2.5% of GDP from 2065 onwards. Although Congress shelved a recent health reform proposal, the government plans to present a new one with the same core elements. The Ministry of Finance estimated the previous reform would have cost an additional 0.4% of GDP per year in the short term, peaking at 0.6% in 2027, and falling to 0.2% by 2042. However, the fiscal council (2023[14]) notes this estimation overlooks potential cost overruns, including higher primary care costs and inadequate regional management capacity. Colombia also needs to increase public spending to support ambitious climate and energy transition plans (see chapter 5). Meeting climate goals requires between 1% to 2% of GDP annually over the next 20 years (MinHacienda, 2024[11]). While most of this investment must come from private sources, public expenditure must also increase from the current 0.16% of GDP. Furthermore, by 2050, Colombia could lose up to 6% of its government revenues due to the energy transition away from fossil fuels. While government reindustrialisation plans aim to boost economic growth and diversify the economy, the transition could bring pressures on the revenue side.

To put debt on a declining path while addressing spendings needs will require measures to raise tax revenues and improve spending efficiency (Figure 2.12, purple line and Table 2.4), as discussed in the next sections. An ambitious package of structural reforms to enhance growth, including the transition to a higher diversified and more competitive economy, would also help to put debt on a declining path (Figure 2.12, green line, and Table 2.4). The government reindustrialisation policy (see Chapter 3) which aims to diversify the economy, by developing value chains, deepening internationalisation and closing local productivity gaps, could lead to an annual 0.3 percentage point rise in economic growth by 2034 (MinHacienda, 2024[11]).

Table 2.3. Long-term illustrative fiscal impact of the Survey recommendations

Recommendation	Estimated impact on fiscal balance, % of GDP
Revenue side	
Eliminating corporate tax exemptions and reducing the corporate statutory rate from 35% to 30%	+0.0
Broaden the personal income tax base by reducing the basic deduction and eliminating exemptions, while reducing social contributions for low-income workers	+0.8
Strengthen recurrent taxes on immovable property	+0.3
Eliminating VAT expenditures and compensating the poor	+1.5
Increasing the carbon tax to USD 67/tCO2e by 2030	+0.7
Improving tax administration and reducing tax evasion	+1.5
Improving spending efficiency (including better targeting and elimination of distortive subsidies)	+1.0
Revenue losses from oil and coal industries amid the global energy transition	-1.5
Total revenue side	*4.3*
Government's planned pension reform	1.0
Government's planned health reform	0.2
Additional public investment, including meeting climate targets, and other needs	1.4
Expand early childhood education to achieve universal coverage and enhancing education and training systems	0.9
Compensation for the poor for higher carbon prices and elimination of public utilities subsidies	0.3
Total spending side	*3.8*

Note: The estimated fiscal impact of the health and pension reforms by 2040 is assessed by CARF (2023[14]; 2023[15]; CARF, 2024[13]). The need to increase the carbon tax is assessed in Chapter 5 of this Economic Survey.
Source: OECD estimates.

Table 2.4. Ambitious structural reforms would lift long-term growth significantly

Illustrative estimated impact of selected reforms on potential GDP after 15 years relative to the baseline

Reform	Impact on real GDP
Higher female employment and improved education outcomes	7.0%
Improvement of rule of law and reduced corruption	6.0%
Improvement in product market regulations and higher government R&D expenditure	3.6%
Ambitious reform package: all the above reforms together	17.9%
Implied average annual growth increase of implementing the ambitious reform package:	1.2 percentage points

Note: Simulations based on the OECD long-term growth model (Guillemette and Château, 2023). Potential output estimation is based on a Cobb-Douglas production function with constant returns to scale based on the OECD long-term growth model. Scenario A assumes that female employment rates reach the OECD average by 2050, a 1.5 increase in years of schooling relative to today and that average PISA scores in reading, math and science converge to Chile's PISA scores by 2050. Scenario B assumes that the rule of law indicator converges to the first decile of the OECD rule of law by 2050. Scenario C assumes that Colombia's product market regulation score and government R&D expenditure converge to the OECD median by 2050. The individual reform effects do not sum up to the effect of the ambitious reform scenario due to non-linear effects in the model.
Source: Simulations using the OECD long-term model (Guillemette and Château, 2023).

2.5. Identifying savings and reallocating spending to meet short-term fiscal consolidation plans

2.5.1. Implementing spending reviews

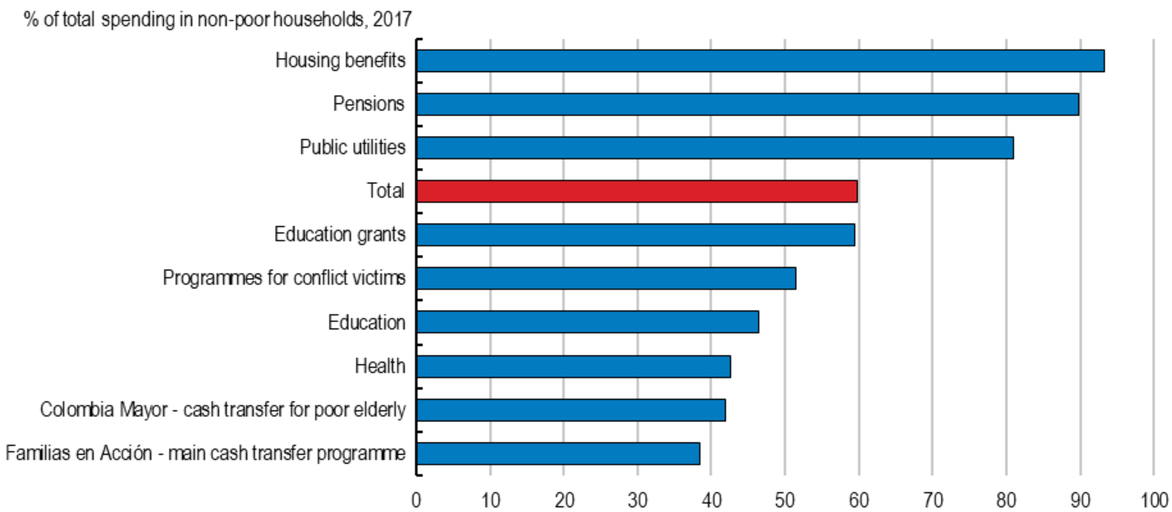
The need to meet the fiscal rule, together with enhancing Colombia's growth potential and support the energy transition makes improving the efficiency of public spending a fundamental priority. Colombia's general government spending, at 34% GDP in 2022, is lower than that of most OECD countries with an average of 46% of GDP, and there is a need to increase investment in pensions, health, education, and infrastructure as discussed elsewhere in this Survey. however, there is also a need to enhance the quality of this expenditure. In the short term, identifying savings or reallocation measures and improving effectiveness within programmes and policies can help Colombia meet the fiscal targets in the short term. Public spending inefficiencies abound in Colombia and are estimated at around 4.8% of GDP annually in 2017 (Izquierdo, Pessino and Vuletin, 2018[16]).

To weed out wasteful spending and effectively allocate resources among priorities a more systematic use of spending reviews could help (DNP & Fedesarrollo, 2018[17]), building on the experiences of other OECD countries. To successfully pursue spending reviews OECD experience suggests that Colombia will need to improve its governance, set up clear objectives for the reviews, foster cooperation between line ministries and carve out high level political support. Establishing a steering committee of senior officials and a working group comprising relevant officials from the Ministry of Finance and line ministries will also help. Moreover, Colombia needs to integrate spending assessments into the government budget planning, particularly within its medium-term framework, to promote spending transparency and help reduce wasteful spending, aligning with OECD best practices (Tryggvadottir, 2022[18]). Setting clear targets for spending cuts or reallocation measures has proven to be a key success factor in OECD countries, as it facilitates monitoring when implementing the results of the spending review.

2.5.2. Improving the targeting of social spending and eliminating distortive subsidies

The targeting of public spending is poor, with a significant share of social spending benefiting the relatively rich (Figure 2.13). This is especially true in the case of pensions, housing, and subsidies for public utilities, such as electricity or telecommunications. For example, 73% of pension implicit subsidies, go to high-income households, while only 5% reach the poorest households (Fedesarollo, 2021[19]), an issue the government is address with the recent pension reform as discussed in Chapter 4. Following the COVID-19 pandemic, the targeting of social assistance programmes was significantly improved, given that before the pandemic the main poverty alleviation programme, *Familias en Acción*, allocated almost 40% of its spending to non-poor families, as discussed in the 2022 Economic Survey (OECD, 2022[20]). Progress has continued with recent efforts to establish a household social registry and an universal income registry, integrating tax records and allowing for self-declaration of income to better identify beneficiaries in 2023. These are welcome steps and should continue to enhance the efficiency and effectiveness of social assistance programmes.

Figure 2.13. Social benefits can be better targeted



Note: Poor refers to the national poverty line. Pensions reflect only the implicit subsidy in the public contributory scheme. Education covers all public education institutions, while education grants refer to educational subsidies and scholarships. Public utilities include subsidies for energy, water, sewerage, and communications. Colombia Mayor is a cash transfer for elderly people in extreme poverty and without a pension.
Source: (Fedesarrollo, 2021[21]).

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Subsidies for public utilities are one of the most ill-targeted items, with 80% of spending going to non-poor households. These subsidies accounted for around 0.8% of GDP in 2022. Moreover, the subsidies reduce incentives for lower energy use and distort price signals, going counter the government's ambitions to reduce greenhouse gas emissions (see Chapter 5). For example, 90% of households receive subsidies for electricity and 60% for gas (Eslava, Revolo and Ortiz, 2020[22]). Rather than using subsidies, it would be best to support vulnerable households through targeted cash transfers. If utility subsidies cannot be eliminated, its targeting needs to improve. Rather than using the current system that does not consider income vulnerability and lacks updated strata, it would be better to use the recently improved household social registry (*Sisbén*), as was done for housing subsidies in 2023.

Continuing the welcome path of gradual elimination of fuel subsidies would save scarce public resources and support Colombia's goal of reducing reliance on fossil fuels. In 2023, the government commendably eliminated petrol subsidies, improving spending efficiency. Since October 2022, monthly adjustments in liquid fuel prices have closed the gap between international and local petrol prices. The government announced that petrol prices will be linked to international prices to prevent future subsidies. Implementing the announcement of the gradual elimination of diesel subsidies is warranted, although the political economy of this measure is proving difficult. Recently, the government announced the elimination of diesel subsidies for large consumers, and a slight reduction for truck drivers. Further efforts to close the gap between the diesel price and its international price could yield savings of 0.6%-0.7% of GDP in public expenditure by 2025 (MinHacienda, 2024[11]), allowing for reallocation of government spending towards more productive and sustainable areas, and encourage investment in cleaner technologies and renewable energy.

2.5.3. Reducing budget rigidities

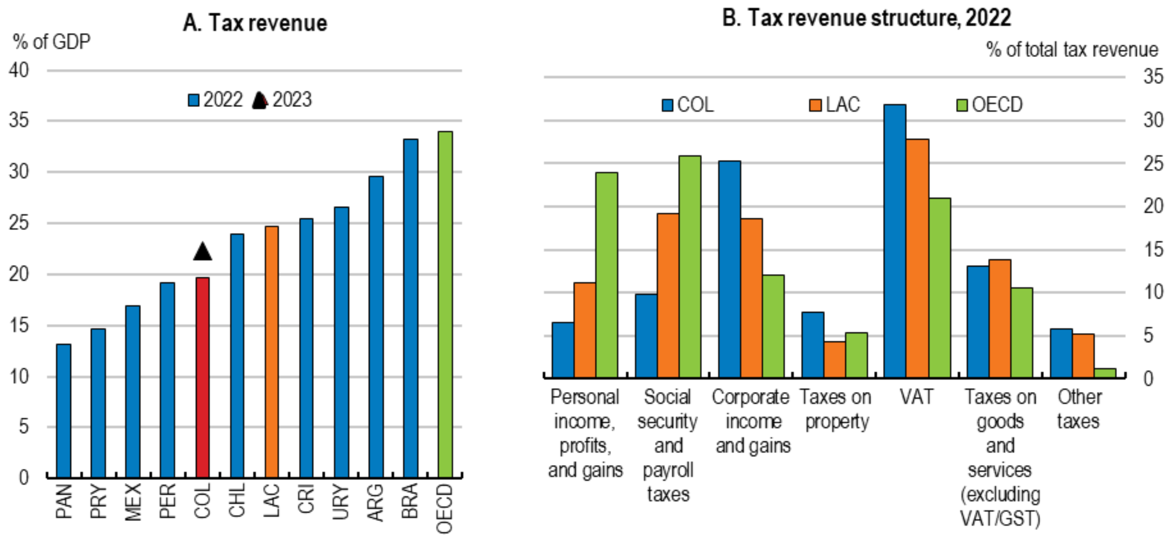
Colombia's excessive budget inflexibility undermines the government's ability to allocate spending to evolving needs and priorities and poses challenges when revenues fall short, leading to higher debt or public investment cuts. Historically, also due to spending rigidities, public investment has fluctuated with revenues in a highly procyclical pattern (Arbelaez et al., 2021[10]). Around 90% of Colombia's central government primary budget is pre-mandated, because of operational expenditures, transfers mandated by law, earmarking, transfers to sub-national entities, and social programmes (CARF, 2023[23]). Colombia implemented budget flexibilisation measures in the 2000s, including constitutional and legal reforms to reduce inherited budget inflexibility, but some measures have been reversed since then (Herrera and Olaberria, 2020[24]). One notable concern is the high level of spending rigidity derived from constitutional provisions that allocate fixed shares of revenues to subnational entities trough the General Participation System. These transfers are linked to the growth of the central government's current revenues over the last four years, irrespective of actual needs. For example, 40% of the revenues gain from the last two tax reforms, in 2021 and 2022, must be allocated to this transfer system (CARF, 2023[23]). Mandated spending and revenue earmarking should be reevaluated to reduce budget rigidities as recommended in the (2019[25]) Economic Survey of Colombia. For example, implementing a more needs-based approach, rather than tying transfers to revenue growth, would ensure resources are allocated where they are most needed. Moreover, municipalities and regional departments heavily depend on central government transfers, highlighting the need for reforms to encourage quality public service delivery and bolster subnational capacities, as discussed in Chapter 3 and in line with the decentralisation mission suggestions.

2.6. Gradually implementing a comprehensive tax reform can increase revenue and stimulate economic growth

Raising more tax revenue will also be needed to address key spending needs and maintain Colombia's commitment with fiscal prudence and debt sustainability. Colombia has undergone 21 tax reforms between the 1990s and 2022 (Figure 2.14, panel A), one every year and half, as described in the last six OECD Economic Surveys (OECD, 2022[20]; OECD, 2019[25]; OECD, 2017[26]; OECD, 2015[27]; OECD, 2013[28]), which have gradually increased tax revenues. However, rather than simplifying the system and improving the tax mix, these frequent and fragmented tax reforms have led to more complexity and inequities often taken the form of tax expenditures, placing a particular burden on businesses within the tax system (Figure 2.14, Panel B). The 2022 tax reform is a step in the right direction to reduce some of these tax expenditures and increase collection from PIT revenues. Frequent reforms have also led to uncertainty and legal insecurity for private investment.

A comprehensive tax reform, properly sequenced and gradually implemented, could not only increase revenues to fund necessary social, infrastructure and climate change needs but also enhance productivity and reduce inequalities. The reform should rebalance the tax burden from corporate to personal income tax, simplify the tax system, reduce tax expenditures and address tax evasion, as outlined in the past OECD Economic Surveys of Colombia and the 2021 Tax Expenditure Report (OECD, Dian and Ministerio de Hacienda, 2021[29]; OECD, 2022[30]). Implementing such reform could yield substantial additional revenues of up to 4.3% of GDP (Table 2.3).

Figure 2.14. After several tax reforms, tax revenues continue to be low



Note: LAC is a simple average of ARG, BRA, CHL, CRI, MEX, and PER. In Panel A, the 2023 estimate for Colombia is based on calculations by the Colombian Ministry of Finance. In Panel B, OECD refers to 2022 or the latest available year.
Source: OECD Revenue Statistics in Latin America (database); OECD Revenue Statistics (database); and Colombian Ministry of Finance.

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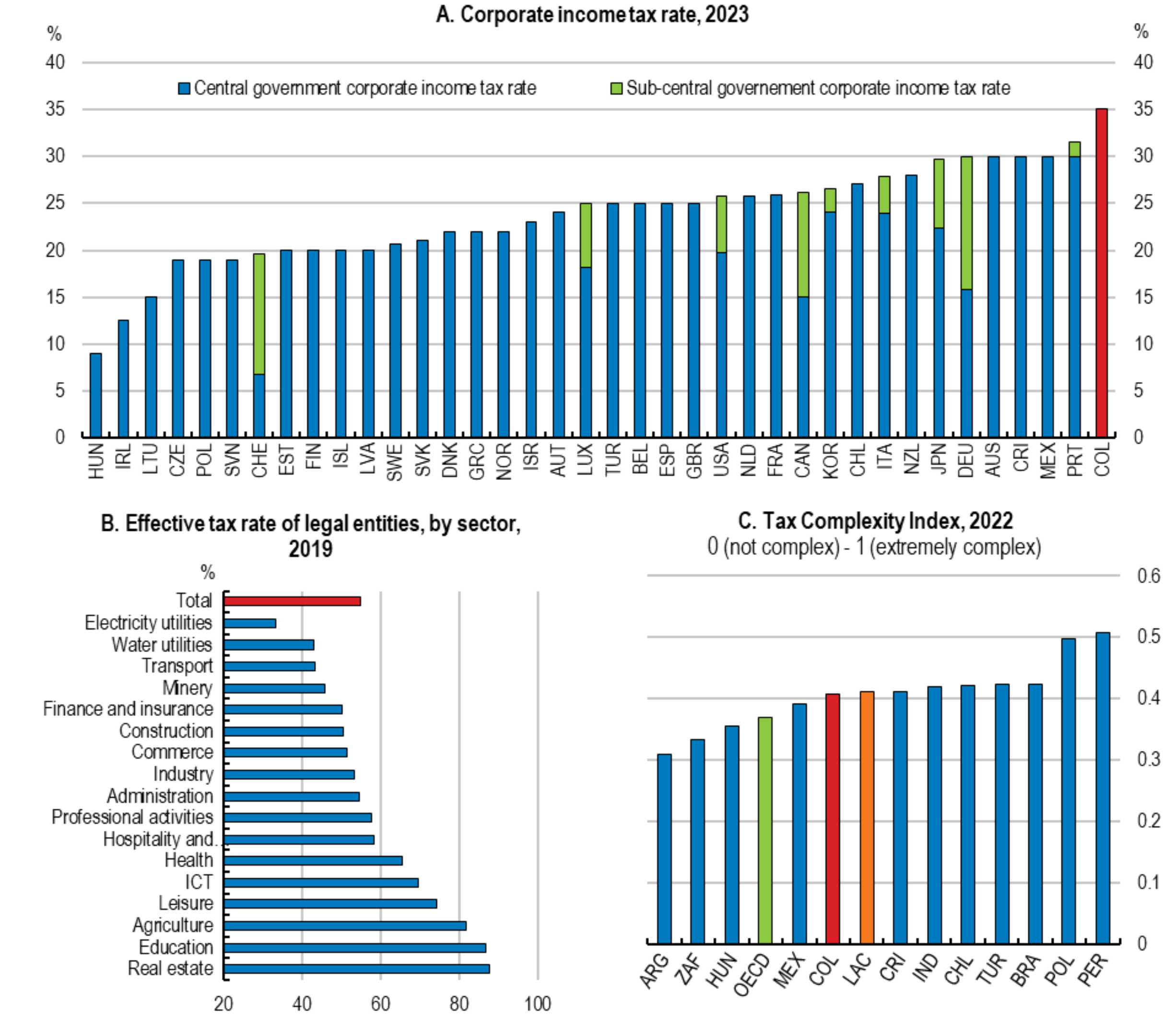
2.6.1. Reducing the tax burden on businesses and streamlining corporate income tax

The statutory corporate tax rate, at 35% in 2023, is very high relative to the OECD average of 23% (Figure 2.15, Panel A). Gradual rate reductions were legislated in 2018, while a 2021 tax reform increased the rate again to 35%. Other distortive business taxes increase the tax burden way above the statutory corporate income tax burden, like the local business turnover tax ICA, all of which weaken investment incentives and are likely to have negative growth effects (OECD, 2022[20]).Effective corporate tax rates in Colombia are also high, with the average effective tax rate at 29.2% in 2021, surpassing both the Latin American average of 24% and the OECD average of 22% (Hanappi et al., 2023[31]). Moreover, significant dispersion of effective tax rates in different sectors, ranging from 33% to 90% in 2019 (Figure 2.15, Panel B), together with special treatment clauses, discounts and differential rates make the tax system complex (Figure 2.15, Panel C), fostering informality, especially among small businesses.

Colombia should consider gradually eliminating exemptions, discounts, or differential rates, while decreasing the statutory corporate tax rate and phasing out other distortive taxes that businesses need to pay. Broadening the corporate income tax base should go hand in hand with abolishing other distortive business taxes. Such reduction of the tax burden on businesses can promote fairness among entrepreneurs, encourage investment and business formalisation, and enhance tax collection (Comité de Expertos, 2016[32]). The tax collection impact of reducing tax expenditures is uncertain and difficult to measure due to the lack of a clear benchmark tax system and inadequate data collection by tax authorities (OECD, Dian and Ministerio de Hacienda, 2021[29]; OECD, 2022[20]). The tax authority is working on a new independent report providing a clear benchmark following the recommendations of the OECD's 2021 Tax Incentives Commission. Highly conservative estimates suggest a reform that eliminates tax expenditures and reduces the statutory corporate rate to 30% could have a neutral impact on tax revenue or a slightly positive one (Fergusson and Hofstetter, 2022[33]). However, revenue forgone from tax expenditures is probably underestimated given data limitations (OECD, 2022[30]).

Figure 2.15. Corporations face high tax burden, horizontal inequities, and a complex tax code



Note: In Panel A, LAC is a simple average of Argentina, Brazil, Chile, Costa Rica, Mexico, and Peru. In Panel B, data refer to both national and local taxes, incorporating all taxes remitted by businesses, inclusive of social security contributions and other corporate levies.
Source: *OECD Tax Database* (database); TRR 266 Accounting for Transparency (2022), *"2022 Tax Complexity I*ndex"; Fedesarrollo (2021), *"Reformas para una Colombia post-covid-19: Hacia un nuevo contrato social".*

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The 2022 tax reform appropriately eliminated some of the 146 special treatments identified in Colombia (MinHacienda, 2022[34]) by reducing nominal caps on tax-exempt income and deductions, eliminating approximately 60 tax expenditures, and imposing limits on 20 more. It's crucial to assess its impact on revenue collection and horizontal equity of the reform to inform future reforms. For instance, the availability of a tax credit for businesses to offset VAT paid on investment in assets, although uncommon, addresses a deficiency in the VAT system. Typically, businesses should be entitled to reclaim input VAT paid on assets; however, this functionality is lacking in Colombia.

Many of the current exemptions or tax expenditures could be reconsidered, and a new rigorous process put in place to introduce new tax expenditures. Tax expenditure for corporate income was estimated at 1.4% of GDP in 2022, with a reduction of around 0.18% GDP thanks to the 2022 tax reform. Before introducing new tax expenditures, the effectiveness of those in place needs to be evaluated, those with positive and cost-effective impacts toward well-defined policy objectives could be retained and the rest eliminated. The gains from this reform could be redirected to targeted transfers for vulnerable populations affected by the change (OECD et al., 2023[35]).

Measures to reduce business informality are needed to boost tax revenues, requiring a comprehensive strategy across various policy areas, such as simplifying administrative procedures and improving access to finance, as discussed in Chapter 3, as well as a comprehensive business tax reform and stricter tax enforcement aligned with more detailed tax data collection by the tax administration. Since 2019, a simplified tax regime (*Régimen Simple*) for self-employed and micro and SMEs aims to facilitate formalisation. In 2022, the regime was modified to include reduced tariffs and expand eligibility. Ensuring integration of the popular economy, which encompasses a wide range of grassroots economic entities, including both individual and communal efforts, often informal and supported by kinship and local networks (see chapter 3) into the simplified regime would be key for formalisation. Furthermore, enhancing its design to facilitate micro and SMEs' tax compliance is key to reduce informality and support business growth. Facilitating a seamless transition between the simplified and the general regime, by helping and guiding firms, would incentivise firms to grow and shift to the general regime. The simplification of the general regime, as discussed above, would be key for this seamless transition. For example, the Simples Nacional regime in Brazil provides a unified tax regime (covering a wide range of taxes) for micro and small businesses, simplifying compliance and allowing firms to transition to the general regime as they grow. A gradual increase in tax obligations and administrative requirements prepares businesses for the complexities of the general tax regime. Outreach campaigns to educate micro and small firms about the opportunities and benefits of the simplified tax regime are essential to promoting voluntary compliance. Continuous evaluation of the simplified regime is also needed to prevent any unintended disincentives to business growth driven by the discontinuities in the tax schedule. Moreover, to improve formalisation incentives, corporate tax rates could be based on net income to generate incentives to taxpayers to declare their costs and expenses, (Mas-Montserrat et al., 2023[36]).

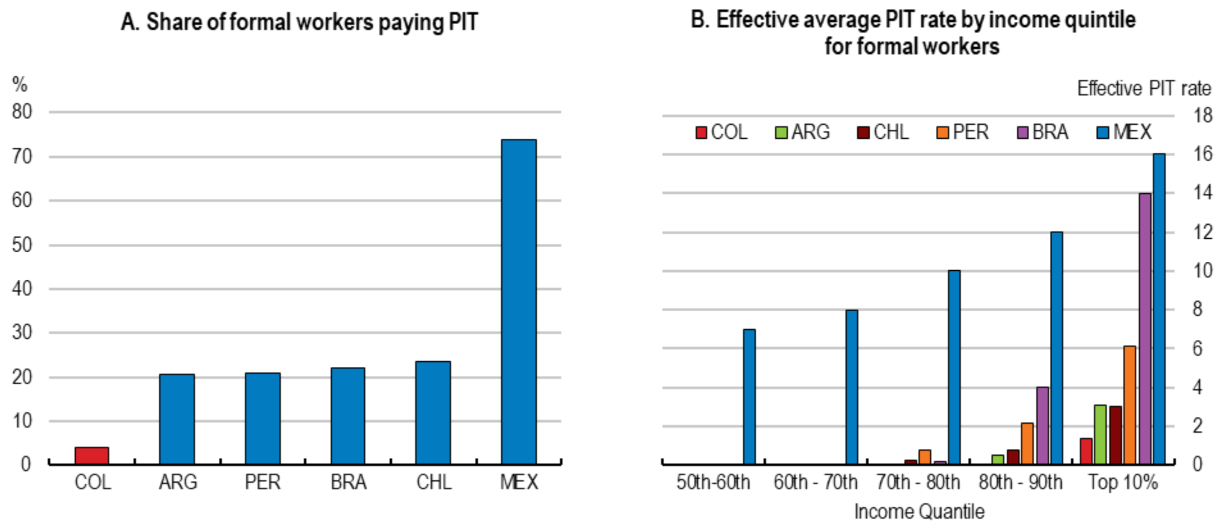
2.6.2. Moving to a more progressive taxation of personal income

The personal income tax yields a low share of tax revenue, both in comparison with other countries in the region and with other OECD countries (Figure 2.14, Panel B) due to high labour informality and few Colombians paying personal income taxes. The 2022 tax reform has marginally improved the redistributive nature of personal income taxes and made permanent a wealth tax introduced during the pandemic, contributing to a reduction in inequality (Baquero, Dávalos and Monroy, 2023[37]), but more can be done.

The personal income tax base could be expanded significantly without impacting the bottom half of the income distribution. Only 5% of formal workers pay personal income tax due to a high labour income threshold below which no personal income tax needs to be paid (Figure 2.16, Panel A), as discussed in the 2022 Economic Survey of Colombia. A complementary two step reform would increase the tax base and make the system more progressive. The first step would involve gradually lowering the basic personal income tax threshold while simultaneously reducing the entry tax rate. In a second step, to reduce informality, social security contribution rates for low-income workers should be reduced, as evidence suggests that reducing the tax wedge, as demonstrated by the 2012 tax reform, would contribute to reducing informality, although is not the only driver of informality (as discussed in Chapter 4). The combined effect of these changes would be progressive because those newly subject to the personal income tax would have higher incomes than those benefiting from reduced social security contributions, ensuring the overall progressivity of the reform. By reducing informality, this reform would also boost productivity and growth. Introducing an earned income tax credit would enhance progressivity further and promote stronger formal labour market participation among low-skilled workers (Pessino et al., 2021[38]).

The gap between statutory and effective tax rates remains significant, particularly for high-income deciles (Figure 2.16, panel B) (Fergusson and Hofstetter, 2022[33]; CPC, 2022[39]; Fedesarollo, 2021[19]). Further streamlining and reducing exemptions and deductions that widen this gap and complicate the tax code could help (Baquero, Dávalos and Monroy, 2023[37]). Examples are the pension income exemption, the exemption of voluntary pension contributions and the mortgage interest deduction. Tax deductions and exemptions of certain incomes cause revenue losses of around 0.7% of GDP and significantly diminish tax progressivity (MinHacienda, 2024[11]). This estimate is likely underestimated due to similar data collection issues as those relevant to the corporate income tax (OECD, 2022[30]).

Figure 2.16. Few Colombians pay personal income taxes, and those who do, pay little



Source: (Acosta Ormaechea, Pienknagura and Pizzinelli, 2022[40])

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2.6.3. Continuing to reduce tax evasion and avoidance

Colombia's strides against tax evasion and avoidance, spurred by recent reforms, must persist. On-going efforts include measures to bolster the tax administration through increased resources and capacity building and digitalisation efforts. The challenge lies now in effectively leveraging these resources to improve enforcement. While the 2021 and 2022 tax reforms have introduced significant measures to reduce tax evasion, there is still significant scope to reduce tax evasion. Estimates suggest that tax evasion leads to revenue losses exceeding 5% of GDP (Benítez et al., 2021[41]).

The tax authorities need to apply more data driven processes to avoid abuse including through risk-based auditing and cross-checking different data streams. Colombia has modernised its tax filling process by including suggested values in PIT returns from third-party data, helping to encourage proper filing and reducing evasion. There is still significant scope to improve tax returns fills to improve granularity of data, as currently corporate and personal income tax returns are not sufficiently detailed to appropriately identify revenue foregone of tax expenditures (OECD, 2022[20]), making the audit of tax evasion harder. As the income tax base becomes broader, a mandatory universal income declaration would foster a positive tax culture, fostering transparency and compliance, reducing tax evasion, particularly if this is accompanied by measures to make the income declaration process more straightforward and efficient. In Colombia, only 10% of the population declared any income in 2020, while countries like Austria and Finland achieved rates as high as 98% (CPC, 2023[42]). Some countries like Canada, the United States, the United Kingdom, and Australia have tax systems requiring individuals, including those with low or no income, to file tax returns for various reasons such as accessing tax expenditures, social assistance programmes, or to keep tax information updated. In the United States, for example, even if a person has no income, they may still need to file a tax return to access certain tax credits or the child tax credit.

Once data collection abilities have improved, Colombia could leverage technologies like Artificial Intelligence and Blockchain to streamline processes and enhance tax compliance (Box 2.3), following Estonia's example. Using technologies like Artificial Intelligence, Estonia enhances cross-data verification, automates data flows, recognises tax patterns and anomalies and simplifies tax declarations (e-estonia, 2023[43]). Blockchain technology prevents information duplication across government authorities and automates tax payments, such as social security deductions through smart contracts. Moreover, real-time information systems can mitigate fraud risks by calculating value-added taxes along the supply chain. Other recommendations to reduce tax evasion are limiting the use of cash, which accounts for 90% of all private transactions, and continue making progress on electronic invoicing, as recommended in past OECD Economic Surveys (OECD, 2022[20]; OECD, 2019[25]).

Box 2.3. Estonia's innovative and digitalised tax system

- E-Tax System: Estonia's e-tax system allows both individuals and businesses to file taxes online easily. This system has simplified tax compliance, reduced paperwork, and minimised administrative burdens.
- X-Road Platform: Estonia's X-Road platform serves as a secure data exchange system, facilitating seamless communication between different government agencies and entities. This interoperability has streamlined tax administration and enhanced efficiency.
- Digital Identity: Estonian citizens have digital identity cards, enabling secure access to various e-services, including tax-related transactions. This authentication system has improved security and reduced the risk of identity fraud.
- Automation and Artificial Intelligence: Estonia has leveraged automation and artificial intelligence (AI) to streamline tax processes, such as data verification and tax calculations. This has increased accuracy, reduced errors, and enhanced overall tax administration efficiency.
- Transparency and Accountability: Estonia prioritises transparency and accountability in its tax system, with clear regulations and reporting requirements. This fosters trust among taxpayers and helps combat tax evasion and avoidance.
- International Cooperation: Estonia actively participates in international efforts to combat tax evasion and avoidance, including information exchange agreements and collaboration.

Each year, around 99% of all tax declarations in Estonia are filed electronically (e-Estonia, 2023), 99% of taxes are filed online and the average time to fill a tax in the country is three minutes.

Source: E-Estonia. (2023). Interoperability services. https://e-estonia.com/solutions/interoperability-services/

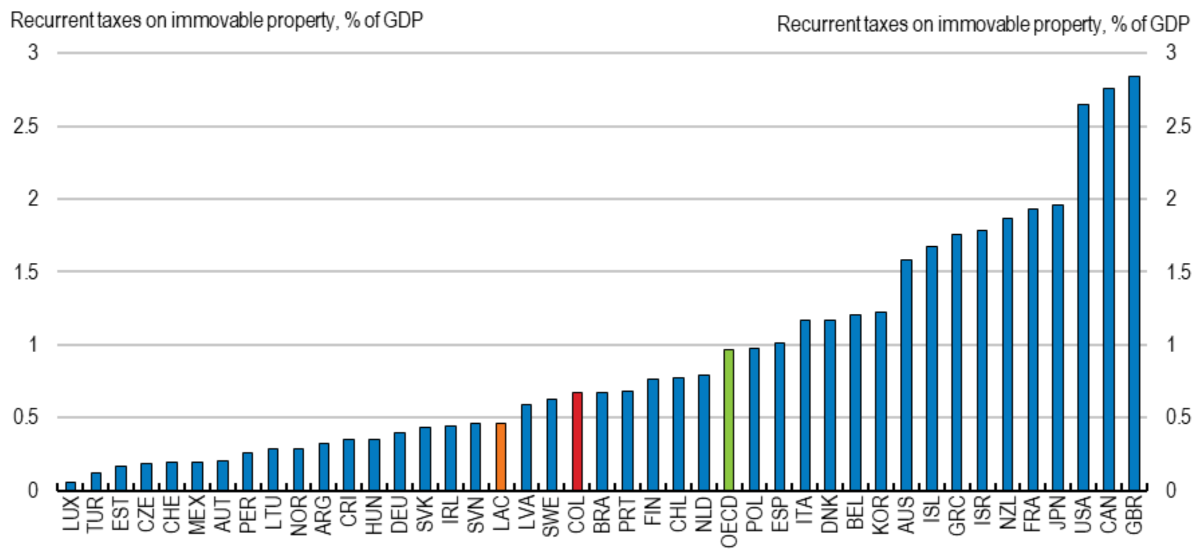
2.6.4. Broadening the value added tax base

VAT revenues could significantly increase by limiting exemptions and reduced VAT rates, along with improving compliance, as discussed in the 2022 OECD Colombia Economic Survey. Exemptions and reduced rates impact various goods and services, including health, education, and food, which disproportionately benefit higher-income households. The VAT rate in Colombia is 19%, but zero and reduced rates and exemptions affect not only basic consumption items, but a wide range of goods and services across health, education, food, medicines and transportation, in addition to computers, tablets and mobile phones up to a price cap. The related revenue loss amounts to 5.3% of GDP in 2023 (MinHacienda, 2024[11]). To mitigate the impact on the poorest households of these reforms, compensation mechanisms such as means-tested benefits, like the existing VAT Compensation programme (*Compensación del IVA*), a cash transfer for poor households, could be enhanced and integrated with other assistance programmes.

2.6.5. Raising more revenues from immovable property by updating and completing the land registry

Recurrent taxes on immovable property (*predial*) are crucial for municipalities, constituting their main source of income, generating revenues of about 0.7% of GDP in 2022, one of the highest proportions in Latin America but behind some other OECD countries (Figure 2.17). The government is updating the multipurpose land registry to address land management issues, ensure property legal security, and enhance municipalities' territorial and financial management, marking significant progress in advancing cadastre coverage, as discussed in Chapter 3. This is welcome; municipalities with updated cadastres reported revenue increases ranging from 11% to 30%. In the long run, conservative estimates suggest that tax collection for immovable property could be increased by 0.3% of GDP.

Figure 2.17. There is room boost taxes on immovable property



Note: Year 2022, except for Australia (2021). LAC is a simple average of Argentina, Brazil, Chile, Costa Rica, Mexico, and Peru.
Source: *OECD Revenue Statistics in Latin America and the Caribbean* (database); and *OECD Revenue Statistics* (database).

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Finally, as highlighted in Chapter 5, there is substantial room to adjust the carbon tax by increasing its rate and broadening its base to better align with mitigation objectives. The additional revenues generated can support sustainable investments and assist vulnerable populations. Furthermore, integrating climate and environmental forecasts and risks into the medium-term fiscal framework would ensure alignment with targets and effective mitigation and adaptation to climate-related economic risks.

Table 2.5. Past OECD recommendations on tax system reform

Recommendations in previous Survey	Actions taken since previous Survey (Feb 2022)
Raise more revenues from personal income taxes by lowering the income threshold where taxpayers start paying income taxes, eliminating exemptions and strengthening rate progressivity.	The 2022 tax reform reduced some exemptions for the richest. See Box 2.1.
Reduce corporate tax expenditures while reducing the tax burden and tax distortions for businesses.	The 2022 tax reform reduced some corporate tax expenditures. See Box 2.1.
Reduce the scope of VAT tax expenditures while compensating low-income households through social benefits.	No actions taken.
Enhance the budget and the financial independence of the newly created autonomous fiscal council.	The Social Investment Law, passed in September 2021, introduced a medium-term debt anchor and revised the structural net primary balance ceiling, which varies based on the debt level. In the short term, the government outlines a transition path of deficits from 2022 to 2025. Concurrently, the fiscal council (Autonomous Fiscal Rule Committee) was granted increased operational independence to oversee fiscal rules, aligning with OECD principles for IFIs.

Table 2.6. Policy recommendations to further buttress macroeconomic policies

MAIN FINDINGS	CHAPTER 2 RECOMMENDATIONS (Key recommendations in bold)
Inflation has declined but remains high at 6.1% in August, above the Central Bank target of 3%. There are several upwards risks to inflation, while the output gap is estimated to be negative.	**Continue a gradual, prudent, and data-based easing cycle to facilitate a gradual return of inflation to the target.**
The financial sector remains robust, although non-performing loans (NPLs) have risen, especially among consumers and microcredit providers.	Continue monitoring developments and reinforce supervision of microfinance institutions.
Consolidation efforts have decreased gross public debt to 56.7% of GDP from pandemic highs, and planned consolidation is prudent and balances the need to reduce debt, weak growth and high inflation. While government fiscal plans for 2024-25 are on the limits of the fiscal rule, headline deficits and interest payments remain high, and there are risks of revenue shortfalls.	**Maintain fiscal consolidation in line with current fiscal plans and ensure compliance with the fiscal rule to achieve convergence of net debt to its anchor.**
Public spending efficiency remains low. While the elimination of petrol subsidies is commendable, diesel subsidies still account for 0.7% of GDP. Subsidies for public utilities are poorly targeted, benefitting 80% of non-poor households, and discourage energy saving.	**Undertake regular and systematic public spending reviews and reduce spending inefficiencies, including by gradually reducing and eventually eliminating fuel, electricity, and gas subsidies, and improving targeting of social spending.** Ensure spending reviews are fully integrated in the budget process. Reorient some spending to infrastructure and climate-related projects while ensuring social spending targets low-income households.
Budget inflexibility, with 90% of public expenditure pre-mandated, severely limits the government's ability to adjust the budget in response to shocks, largely due to central government transfers to subnational governments.	Reduce budget rigidities by reducing the share of mandated spending and earmarked revenue.
The 2022 tax reform has boosted tax revenues and improved progressivity, yet at 22% of GDP in 2023, revenues are low given social demands and public investment needs. The tax system inadequately tackles high income inequalities, with personal income taxes having minimal impact and heavy reliance on corporate income taxes. Complexities, such as numerous special regimes and tax expenditures, result in significant revenue losses and hurt growth and investment. Weaknesses in tax collection lead to yearly revenue losses exceeding 5% of GDP.	**Enhance the tax administration and implement a comprehensive tax reform with a planned gradual implementation to rebalance the tax burden from corporate to personal income and reduce tax expenditures in VAT, personal and corporate taxes.** Reduce social security contributions for low-income workers. Limit VAT exemptions and reduced rates while compensating low-income households through targeted social benefits. Combat tax evasion by leveraging innovative digital solutions. Universalise income tax declarations.

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3 Bridging the gap: Boosting the productivity of Colombia's regions

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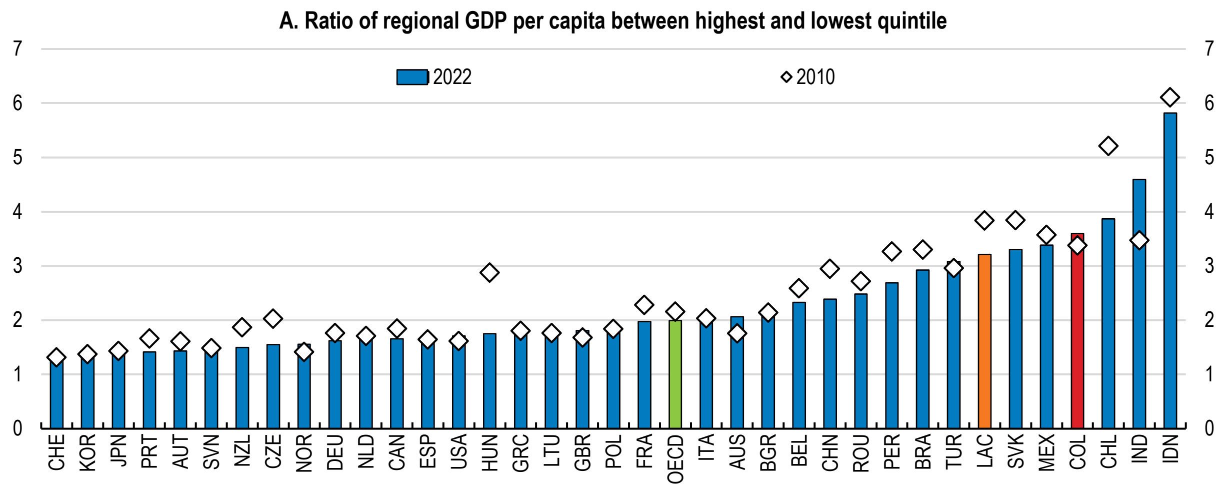
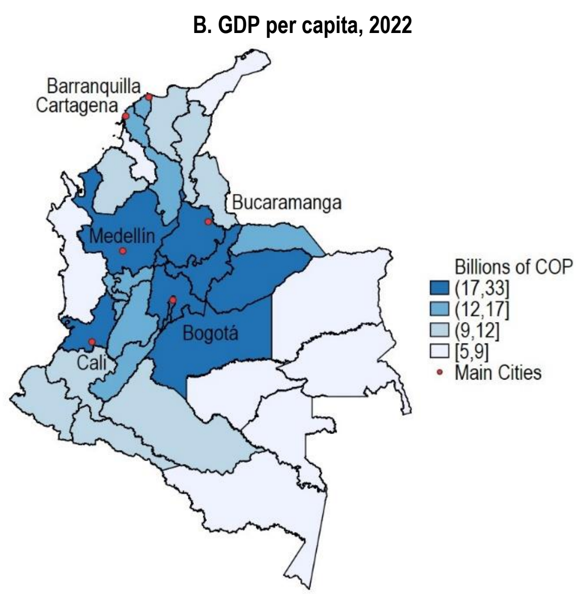
Stagnant productivity has been a long-standing challenge for inclusive growth in Colombia. Productivity differences across regions are large and persistent. The Peace Agreement, urbanisation, the global green transition, and shifting global trade patterns all provide opportunities for development of Colombia's regions. Converting these opportunities into a lasting and sustainable productive transformation requires reforms to improve the competitiveness of every region. These reforms include improving general framework conditions such as lowering the cost of doing business formally and fighting corruption, and policies that explicitly promote regional convergence and development such as better transport interconnectivity and a comprehensive reform of fiscal decentralisation.

3.1. Introduction

Differences in productivity and living standards across Colombian regions are among the highest in the OECD (Figure 3.1). The gaps in per capita income across regions have persisted for centuries (Fergusson et al., 2017[1]). Decades of conflict have further exacerbated regional income gaps by disrupting economic activities, displacing populations, and throttling development in affected areas. The Peace Agreement implemented since 2017 has opened new opportunities for development and to enhance the productive and employment capacities of lagging regions. The main challenge now lies in ensuring that those opportunities benefit all territories in the country (OECD/UN/UNIDO, 2019[2]).

Figure 3.1. Income gaps among Colombian regions are large





Note: Panel A shows TL2 regions (departments in Colombia) for 2022 or the latest available year. Panel B shows categories defined by quartiles of GDP in billions (real 2015 COP).
Source: OECD calculations based on the *OECD Regional Statistics* and DANE.

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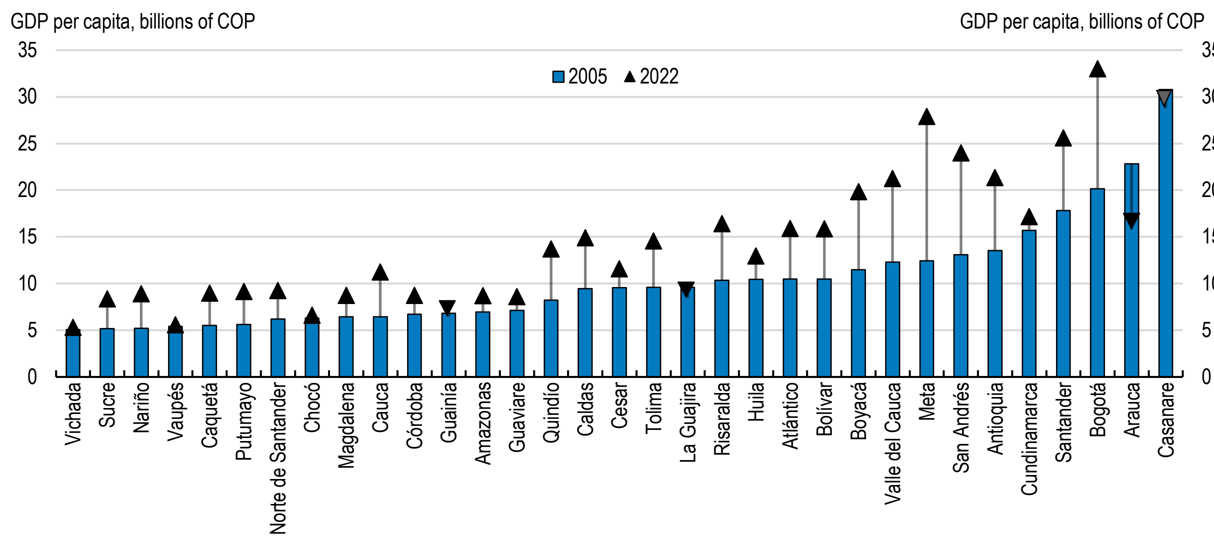
Strong economic growth in the past two decades, averaging close to 4% per year, has mainly benefitted regions with already better initial conditions (Figure 3.2). For example, between 2005 and 2022, real per-capita income in Bogotá, the capital, almost doubled. Strong growth mainly benefited the regions that contain the largest cities – such as Bogotá, Antioquia (with Medellín), or Valle del Cauca (with Cali) – and a cluster of regions in the centre of the country including Risaralda, Quindío, Caldas and Cauca. Overall, regional inequality as measured by the Gini coefficient of per capita income has stayed flat over the last two decades.

Figure 3.2. The fastest-growing regions are among the richest



Source: OECD calculations based on DANE.

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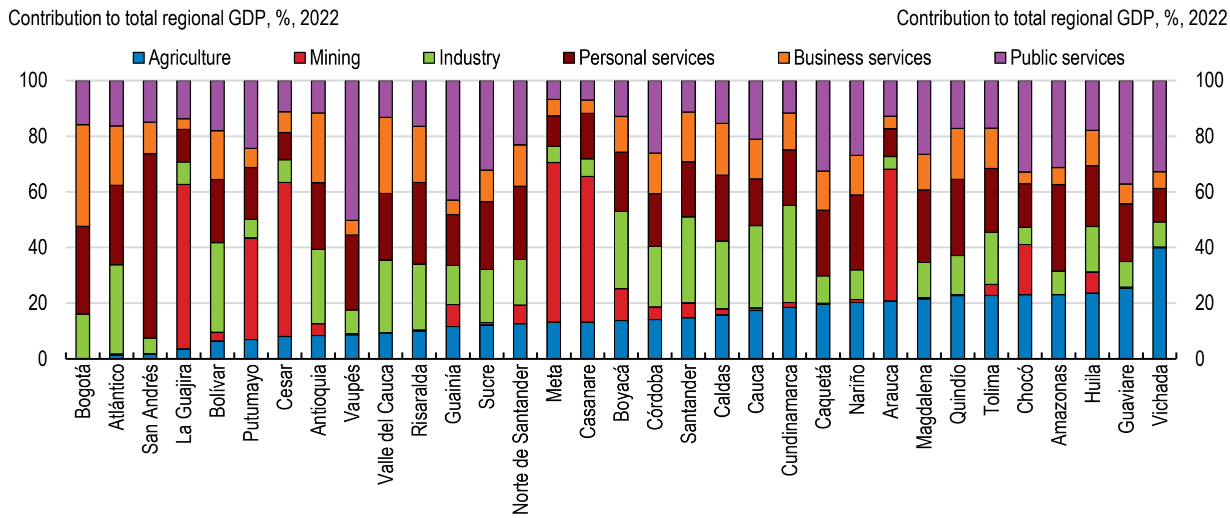
Productivity is the main driver of differences in average income across regions. The average worker in Bogotá is more than four times as productive as the average worker in Nariño, a predominantly rural department on the Pacific Coast. Colombia's regions have very different productive structures (Figure 3.3). The regions with the country's largest cities generate most of their output from industry and advanced services such as professional, ICT, financial and other business services. Other regions in the centre of the country such as Caldas, Cauca, or Risaralda have undergone a similar degree of structural transformation, which might be a driver behind their strong growth (see Figure 3.2). By contrast, predominantly rural departments such as Vichada, Vaupés, or Chocó – which are among the poorest regions and have seen zero improvement in living standards – specialise in agriculture, with a low presence of industry and business services and a large share of activity falling on the public sector. Finally, several regions including Casanare, Cesar, La Guajira, Meta and Putumayo generate more than half of their output from natural resource extraction, creating little value added or formal employment.

The regions in the Andes and on the Caribbean coast are home to most of the country's urban centres, which concentrate economic activity (see Figure 3.1, Panel B). By contrast, the peripheral Pacific coast and the Amazon and Eastern lowlands are sparsely populated and mostly lack the highly productive, large, and formal firms and industries that would generate high-quality jobs for its populations (Box 3.1). While Colombia's economic geography features a relatively large number of metropolitan areas, a challenging geography and a lack of adequate transport infrastructure prevent a better integration among the different economic centres as well as between urban and nearby rural areas. Moreover, the peripheral rural areas are home to most of the country's minority ethnic groups, including Indigenous people who dominate in the Amazon and Afro-Colombians, the majority of which live in regions on the Pacific coast.

Boosting productivity across all regions is crucial to addressing Colombia's persistently low aggregate productivity. During the three decades since 1990, labour productivity has been mostly stagnant, growing only by 1% per year, on average (Figure 3.5, Panel A). This is about half the rate of average productivity growth among OECD countries and Latin American peers. Some countries in the region, such as Brazil, Chile, and Peru, have seen their productivity double over the same period. As a result, Colombia is still the OECD country with the lowest GDP per hour worked, even after considering differences in purchasing power (Figure 3.5, Panel B).

Figure 3.3. Sectoral composition of Colombia's regions



Note: Regional GDP excludes taxes. Industry includes manufacturing, utilities, and construction. Personal services include retail and wholesale trade, transport, food and accommodation, and other services. Business services include ICT, finance, real estate and professional and scientific services. Public services include health, education, public administration, and defence.
Source: OECD calculations based on DANE.

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Low productivity – at the national and the regional level – results from gaps in a number of enabling factors, including the business environment, infrastructure, skills, and institutions (WEF, 2019[3]). At the country level, Colombia ranks the worst among OECD countries in such enabling factors (Figure 3.6, Panel A) and there are large gaps among regions (Figure 3.6, Panel B, C). As in many other countries, cities are ahead of most rural municipalities (Figure 3.6, Panel D) due to economies of scale and agglomeration, closeness to markets and facilities, and stronger governance capacity (Government of Antioquia, 2021[4]). Improving the competitiveness of Colombia's regions further requires reversing the long-term decline in investment (see Chapter 2). Attracting investment, in infrastructure and in sectors that contribute towards diversification of the productive structure and of exports, would help attain the higher growth potential necessary for a sustainable economic convergence of Colombia and its regions.

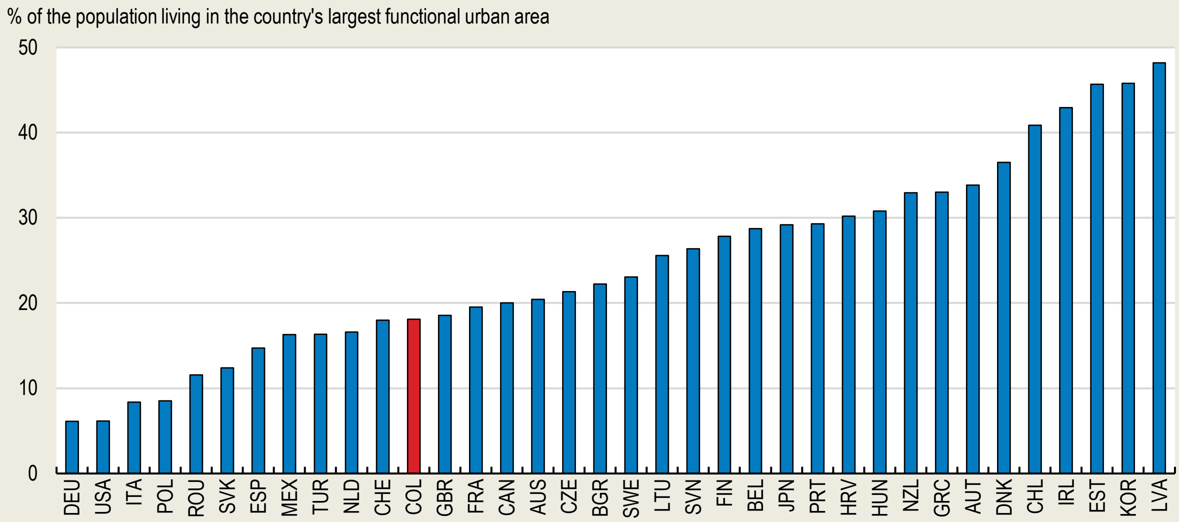
Box 3.1. A territorial view of Colombia

Colombia is the 9th biggest OECD country by population (with about 52 million inhabitants) and 5th largest by area (with about 1 million square km). Administratively, Colombia is a unitary republic divided into 33 regions (called departments) including the Bogotá Capital District and 1,103 municipalities, 18 non-municipalised areas and the San Andrés Island. Geographically, the country is divided into the central Andean area, the Caribbean coast, the Pacific coast, the Amazon lowlands (*Amazonía*), Eastern lowlands (*Orinoquía*), and Caribbean islands. Several major rivers cut across the Andes, adding to Colombia's challenging geography and contributing to high transport costs. For example, while the air distance between

Bogotá and Medellin is only about 250km, it takes more than 8 hours to travel between the cities by road due to large elevation changes.

Colombia's population structure is similarly concentrated as other large OECD countries, and less concentrated than Latin American economies such as Argentina, Chile, Costa Rica, or Peru. Colombia is a highly urbanised country, with 76% of its population living in cities (OECD, 2022[5]). The population is concentrated in several major cities, six of which have more than 1 million inhabitants: Bogotá, Medellín, Cali, Barranquilla, Cartagena, and Bucaramanga (see Figure 3.1, Panel B). About 19% of the population live in the functional urban area of Bogotá (Figure 3.4).

Figure 3.4. Colombia's population structure is less dominated by its largest city than other countries



Note: Data refer to 2022 or the latest available year. Functional urban areas (FUAs) are defined as in (Dijkstra, Poelman and Veneri, 2019[6])
Source: *OECD City Statistics*.

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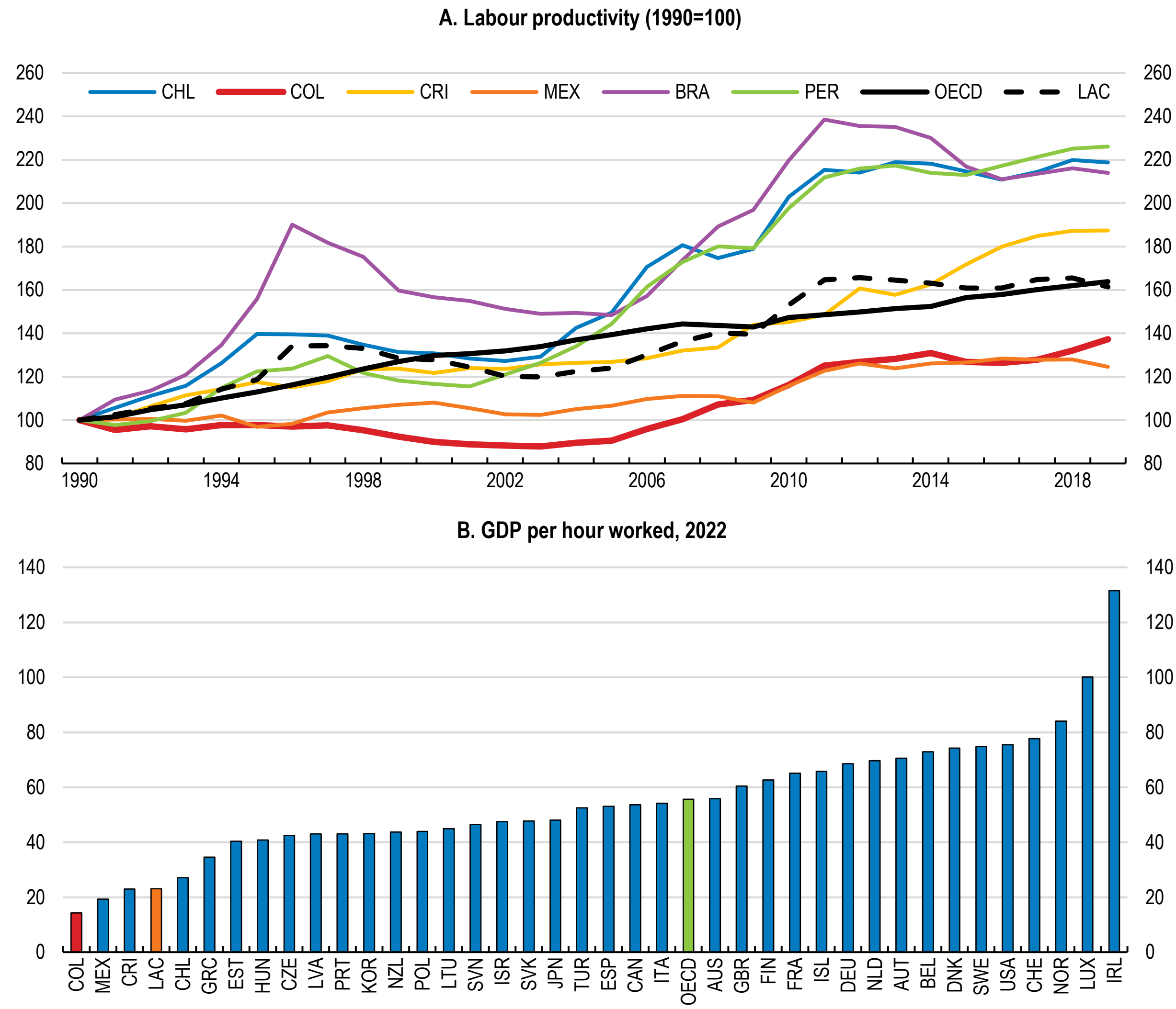
Colombia's regional disparities are often described along a centre-periphery model. Most metropolitan areas are situated in the Andes and along the Caribbean coast. By the same token, there are large urban-rural divides, and the rural hinterlands are often poorly connected to regional administrative and economic centres (OECD, 2014[7]). However, high inequalities also occur within cities and metropolitan areas, in the periphery of which many Colombians internally displaced by the conflict settled, often in poor housing conditions and surrounded by inadequate infrastructure (World Bank Group, 2021[8]).

Improving the performance and productivity of regions and catalysing a regional convergence process has been on the agenda of successive governments. The government's National Development Plan 2022-2026 aims at regional convergence, among other priorities. Similarly, one of the five pillars of the government's Reindustrialisation Strategy – which aims at closing regional productivity gaps, developing value chains, deepening internationalisation, promoting diversification, and strengthening the institutional framework – is designed to identify and support locally defined priorities and needs for productive development to better integrate regions into global value chains (see Box 3.2). The government envisages a close connection between policies to encourage the development, sophistication, and diversification of the economy's productive base and the energy transition, which for Colombia as an oil-exporting nation requires not only a transformation of the domestic energy matrix but also a diversification of its exports. Authorities view the global green transition as a chance for Colombia to build on its specialisation in clean energy and position itself within global value chains as a source of sustainably produced goods and services.

Boosting the productivity of Colombia's regions requires a broad policy strategy resting on two pillars. The first pillar consists of policies that aim at improving general framework conditions to lift productivity overall, regardless of location, including measures to improve the business climate, foster innovation, diversification, investment and trade, improve access to finance, level up education, and fight corruption across the country. The second pillar is comprised by genuinely regional and place-based policies that differ according to specific regional needs and explicitly aim at improving the productivity of the most lagging regions. It includes reducing infrastructure gaps, especially in rural areas, fostering rural development and improving the capacity of the fiscal decentralisation framework to narrow gaps in living conditions across the country.

Figure 3.5. Aggregate productivity is low and has been stagnant



Note: In Panel A, data refer to USD 2017 PPPs, and labour productivity is defined as GDP per worker. LAC and OECD are GDP-weighted averages for countries with available data. In Panel B, data refer to USD constant prices 2015 PPPs, and LAC is a simple average of Chile, Costa Rica, and Mexico.
Source: Feenstra, Robert C., Robert Inklaar and Marcel P. Timmer (2015), "The Next Generation of the Penn World Table", *American Economic Review*, 105(10), 3150-3182, available for download at www.ggdc.net/pwt; and *OECD Productivity*.

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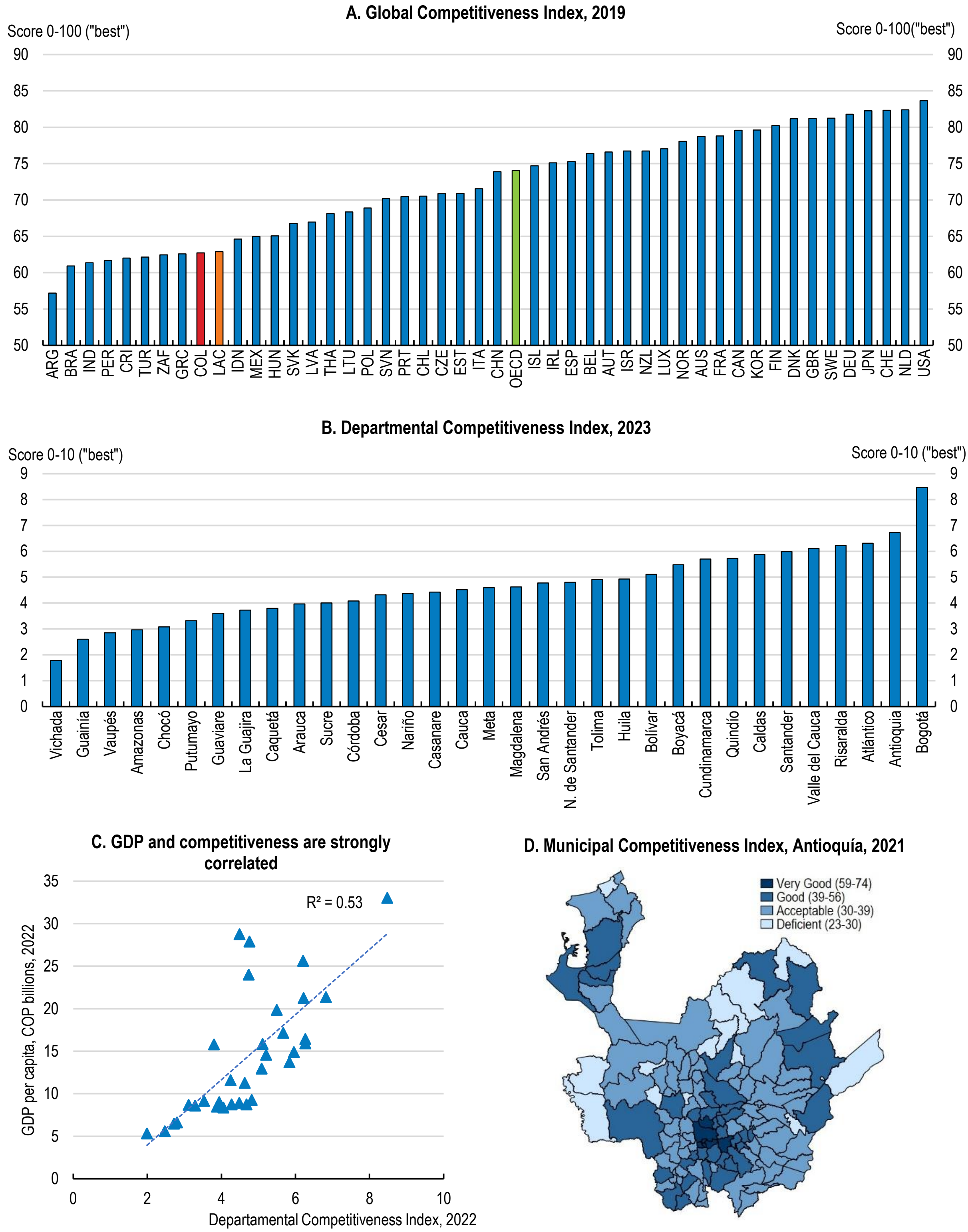
Figure 3.6. There are large gaps in enabling factors across Colombia's territories



Note: The competitiveness indicators in this chart are based on the framework by WEF (2019[3]), Consejo Privado de Competitividad, Universidad del Rosario SCORE, and the University of Antioquia. They are composed of variables representing business dynamism, access to finance, human capital, digitalisation, infrastructure, innovation, functioning of the labour market, trade openness, and institutions.

Source: World Economic Forum (WEF), *the Global Competitiveness Index 4.0 2019 dataset*; Consejo Privado de Competitividad, *Departmental Competitiveness Index 2023*; DANE; and Government of Antioquia, *Municipal Competitiveness Index 2021*.

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Box 3.2. Colombia's Reindustrialisation Strategy

The Reindustrialisation Strategy (*Política Nacional de Reindustrialización*) is a broad-based policy to support the transformation of the productive sector to meet the challenges of climate change, accelerated technological change, and the changing geopolitical environment. Notwithstanding its name, the strategy includes both goods and services sectors and is targeted not at protecting specific industries but at supporting the development of value chains chosen for their forward and backward linkages as well as their importance to the national interest.

The strategy rests on five pillars, four of which target broad economic sectors: (1) the just energy transition, including renewable energy and electromobility; (2) agroindustry and food sovereignty, (3) health, pharma, and biotech, (4) defense-related industries, including shipbuilding and civil defense engineering. A fifth, horizontal pillar is meant to strengthen regional and local economies according to their respective comparative advantages and economic structures.

Over the 10-year horizon until 2034, the Strategy is supposed to accomplish the following objectives: (a) close productivity gaps, (b) increase diversification and sophistication of the economic structure, (c) strengthen value chains, (d) deepen and balance regional and global trade integration and attract FDI inflows, and (e) improve the institutional framework and incentives to raise value added and with it productivity, competitiveness, and innovation.

The Reindustrialisation Strategy is flanked by other economic strategies in the 2022-2026 National Development Plan, including a rural development strategy built around the Peace Agreement (see below) and a strengthening of the grassroots economy and its integration with formal economic activity (see Box 3.3).

Source: *Documento CONPES No. 4129, Política Nacional de Reindustrialización, December 2023*

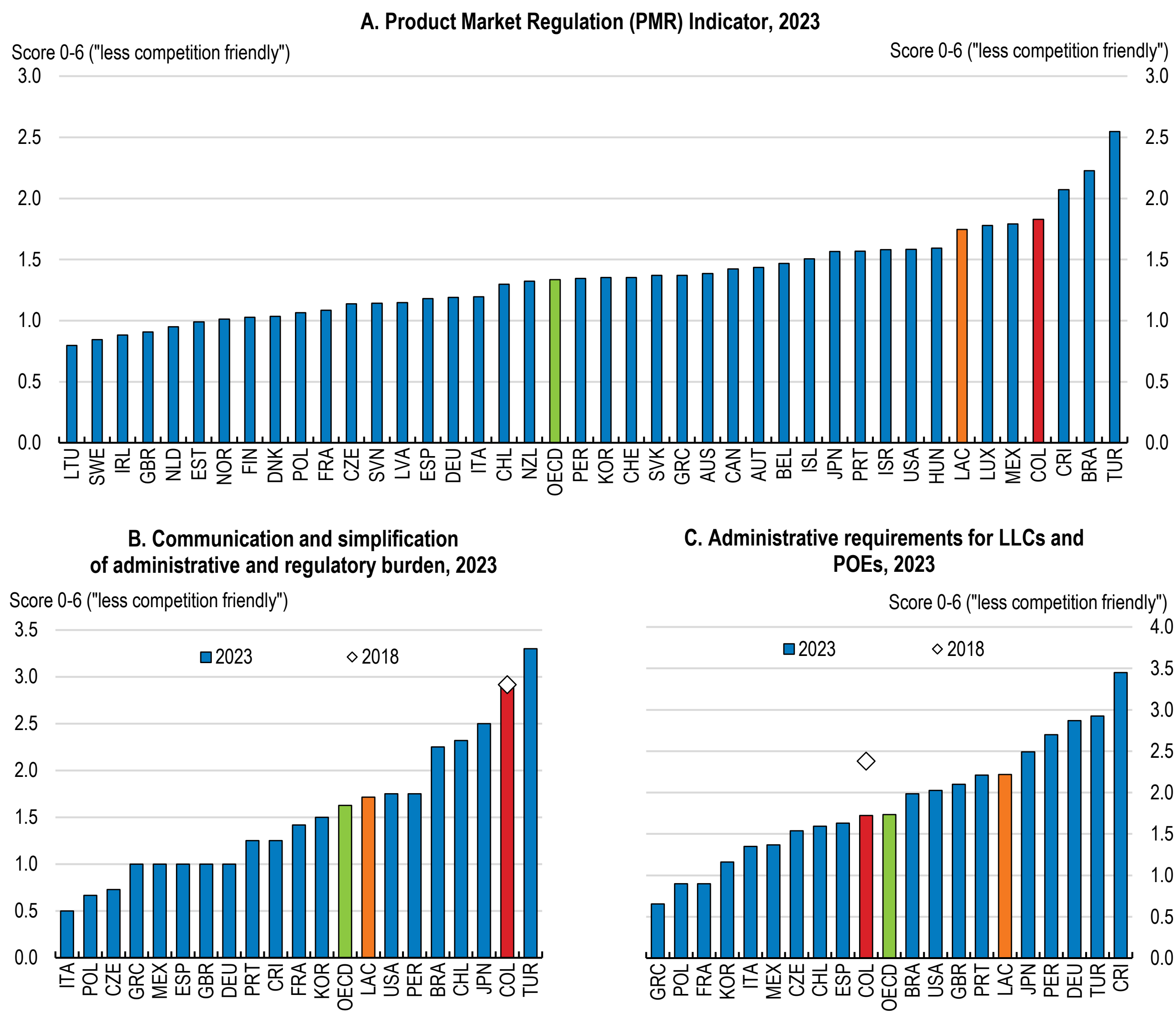
3.2. Improving general framework conditions to lift productivity

3.2.1. Creating an attractive business environment in all regions

One factor that contributes to low and highly dispersed productivity are burdensome regulations (Figure 3.7), which are especially stringent for licenses and permits and other administrative requirements on businesses (Panel B). The 2020 Entrepreneurship Law reduced registration costs and simplified some administrative requirements, but many of its provisions have not yet been elaborated and implemented (Global Entrepreneurship Monitor, 2023[9]). Accelerating the implementation of already legislated measures to ease entrepreneurship by regulatory simplification would further improve the business environment and support the government's aim to create a diversified, broad-based, and entrepreneurial business economy, as for example envisaged in the Reindustrialisation Strategy and the strategy to boost the grassroots economy (see below). Pilot schemes to create regulatory sandboxes as envisaged in the Entrepreneurship Law and the Reindustrialisation Strategy are a welcome step and should be monitored and evaluated with a view of permanently implementing what has worked well.

The establishment of online one-stop shops is an important step in reducing the regional differences in the burden on start-ups. Colombia introduced a virtual one-stop shop after 2018, resulting in a significant improvement in the burden of administrative requirements on new start-ups (Figure 3.7, Panel C). One of the administrative requirements for starting a business is registering with the local chamber of commerce, which used to require an in-person visit to the chamber's offices. Since 2022, all 57 chambers of commerce have integrated these procedures in the virtual Single Entrepreneurship Window, which now offers a true one-stop shop for starting a business available in 84 municipalities. While this is a welcome progress, it still means 92% of municipalities do not offer yet fully integrated one-stop shops to start a business. The authorities should continue to expand the geographic coverage as well as the number of procedures available through the Single Entrepreneurship Window, and gradually include digital payment options. Similarly, one-stop shops can be leveraged as a single point of information for entrepreneurs, beyond just complying with formalities. For example, in Sweden the one-stop shop is run by a consortium which includes the agency for economic and regional growth, and it helps entrepreneurs navigate public support available locally, both on business operations such as finance and accounting and on personal matters such as pensions. A step in this direction in Colombia could be to link the single window to other information portals for entrepreneurs, such as *Portal Innovamos* for innovation policy.

Figure 3.7. The business environment is hampered by cumbersome regulations



Note: In Panels A and B, LAC is a simple average of Brazil, Chile, Costa Rica, Mexico, and Peru. In Panel B, LLCs = Limited liability companies and POEs = Personally-owned enterprises.
Source: *OECD Product Market Regulation Indicators 2023.*

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High informality harms the business environment and competition in Colombia, as in other countries in Latin America (Eslava, Meléndez and Urdaneta, 2021[10]). By not complying with costly regulations and taxes, informal firms create unfair competition for formal firms, lowering the number of formal firms that operate in each market. At the same time, informality is often a response to a complex business environment where regulations are burdensome and enforcement is imperfect (Ulyssea, 2018[11]). The 2019 National Strategy for Business Formalisation envisaged lowering the cost of regulatory compliance, increasing the benefits of formalisation, stepping up monitoring and control, and improving evidence for public policy-making with better statistics and impact evaluation. The roll-out of one-stop shops discussed above as well as a reduction in the annual renewal fees for business registration are among the implemented measures of this strategy. Incentivising greater formalisation is also a component of the current authorities' focus on the grasroots economy (Box 3.3) through a lens which views formality as a multi-dimensional phenomenon, with different types of informality alongside administrative, social security, regulatory and tax dimensions (Box 3.4).

A long-standing challenge to assess the success of formalisation policies is the lack of reliable and up-to-date information on the informal economy (CONPES, 2019[12]). The economic census planned for 2024, the first in three decades, is a welcome step to better understand the scope and size of the informal and grassroots economy. Mexico, for example, has been conducting an economic census of all fixed business establishments (formal and informal) every five years since the early 1990s. The microdata are linkable over time as well as with other business statistics, allowing to gain a detailed and comprehensive picture of informal firms and their dynamics, including at geographically very disaggregate levels. Mexico's statistical institute makes these data available to researchers in a secure environment that ensures data confidentiality and protection.

Box 3.3. A strategy to boost the grassroots economy

The "economía popular", as it is known in Colombia, encompasses a diverse array of grassroot economic organisations, both individual and communal, often informal and relying on kinship and neighbourhood networks. Authorities recognise the persistence and significance of these economic structures, which have often developed over decades of violent conflict with limited state presence. A detailed national strategy on the popular economy is expected for late 2024.

According to the National Development Plan, the main elements of the strategy to boost the grassroots economy include:

- Recognition for and visibility of the grassroots economy, including in national statistics, and promotion through a new consultative and advisory body, the National Council of the Popular Economy.
- Vocational training and mapping of skills for the occupations in the grassroots economy, such as through the National Qualifications Framework.
- Gradual inclusion of informal workers in social protection and occupational health schemes.
- Simplification of administrative procedures for starting and running a business.
- Provision of direct and indirect support for economic units, such as through public procurement, training and technology extension services, access to credit, and a better digital and financial infrastructure to serve the specific needs of participants in the grassroots economy.
- Promotion of access to formal jobs through training, certification, and public employment services.

Source: Government of Colombia (2022) "Colombia, Potentica Mundial de la Vida. Bases del Plan Nacional de Desarrollo, 2022-2026."

One way of increasing the participation of firms in the formal economy is by offering simplified tax and regulatory regimes to small businesses, or at least offering simplified administrative proceedings to comply with the general regimes (Mas-Montserrat et al., 2023[13]). The National Development Plan envisages raising awareness and promoting the use of the simplified tax regime for small businesses and creating a simplified insolvency regime.

Colombia's insolvency framework is more favourable to productivity growth and reallocation than those of other Latin American or emerging market economies, but there is still room for improvement vis-à-vis best practices in OECD countries (André and Demmou, 2022[14]; Adalet McGowan and Andrews, 2016[15]). Insolvencies and corporate restructuring tend to be slow and cumbersome and yet result in a low recovery rate (CONPES, 2020[16]). The introduction of a simplified insolvency framework for small businesses during the pandemic was a step in the right direction, but the regime was discontinued after a court ruling. The experiences with the regime should be evaluated and its useful features integrated into permanent legislation.

The simplified tax regime was introduced in 2019 for some sectors of activities and broadened to more sectors in 2022. This regime is open to micro and small enterprises and to auto-entrepreneurs and covers up to seven different categories of taxes, including corporate income tax, personal income tax (for auto-entrepreneurs) and some sub-national taxes through a single, simplified tax declaration. By mid-2023, about 118,000 taxpayers had opted for the new regime, split roughly equally between individuals and firms, and half of those contributors did not previously have a tax identification number. There is also suggestive evidence that the simplified regime is helping subnational governments to expand their tax base, since businesses no longer need to register separately with the different tax authorities, but only sign up once to the simplified regime. Extending the regime to all economic activities, and to gradually include those in the grassroots economy would be helpful to reduce informality and support business growth (Chapter 2). Enhancing its design to facilitate micro and SMEs' tax compliance, for example by defining the tax base as net income, would also help. A net income tax base would incentivise firms to report their costs that are at the same time revenues of other firms, facilitating cross-reporting which can be used to improve tax enforcement. Facilitating a seamless transition between the simplified and general regimes will be essential to incentivise high-growth firms to shift to the general regime. More generally, broadening the corporate income tax base and lowering the very high statutory corporate income tax rate as well as abolishing other distortive business taxes would foster formality and productivity growth (Chapter 2).

Box 3.4. The different dimensions of business formality

The National Strategy for Business Formalisation (CONPES, 2019[12]) recognises four dimensions of business formality: registration upon starting a business, compliance with social security charges for workers, formality in production processes, and tax formality.

Data from the National Survey of Microenterprises reveals significant differences in the degree of compliance along these different dimensions (Table 3.1). Whereas about a quarter of small businesses register, less than 10% and 5% make health and pension contributions on behalf of their workers, respectively. Around 20% comply with local business taxes. Most microenterprises fall below the mandatory thresholds for making corporate income (CIT) and value added (VAT) tax declarations.

Table 3.1. Business informality is a multidimensional phenomenon

Share of informal firms by indicator, 2022

Starting a business		Non-compliance with social security charges		Informality in production		Tax informality			
Tax ID	Business registration	Health contributions	Pensions contributions	Register renewal	License fees	Written accounts	CIT declaration	VAT declaration	Local tax declaration
77.5%	71.5%	90.9%	95.2%	74.3%	91.9%	94.4%	9.1%	1.9%	79.0%

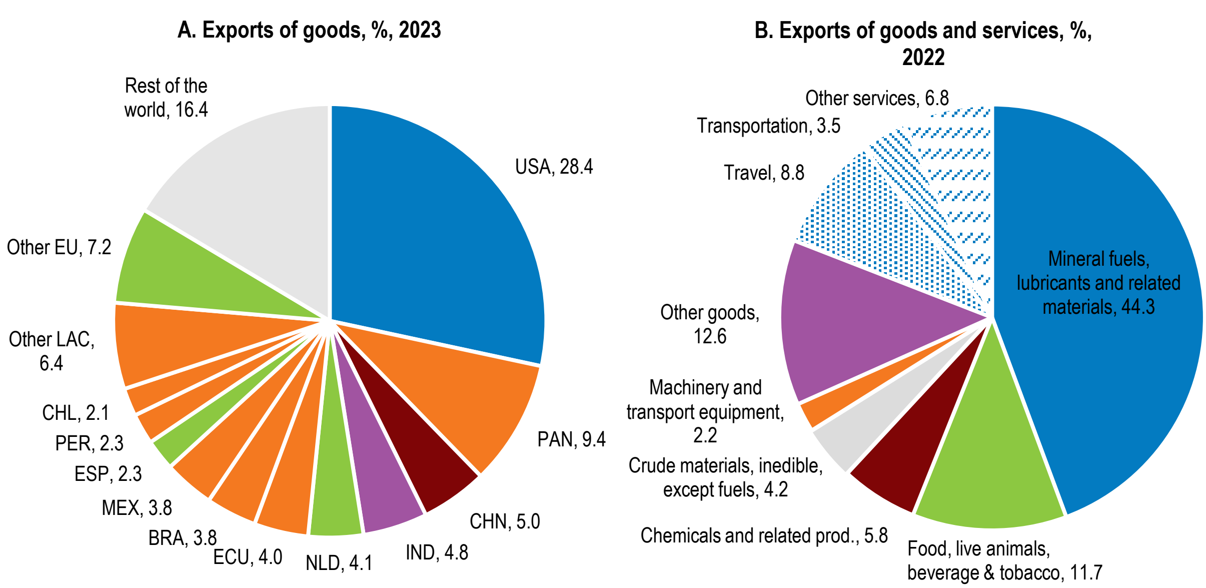
Source: DANE, *Índice multidimensional de informalidad empresarial (IMIE)*

3.2.2. Continuing to remove barriers to trade

Strong engagement in international trade and investment flows plays a key role boosting productivity, for several reasons. First, trade promotes the adoption of internationally competitive production techniques through competitive pressures and the advanced technology, managerial and organisational practices that foreign affiliates tend to bring with them (Javorcik, 2004[17]; Arnold and Javorcik, 2009[18]). Second, the size of the global export market provides opportunities for exploiting economies of scale, especially when domestic markets are relatively thin, thus increasing the incentives to innovate (Aghion et al., 2022[19]). Third, imports of sophisticated intermediate goods and modern machinery can facilitate technology adoption (Amiti and Konings, 2007[20]; Caunedo and Kala, 2021[21]).

Colombia and its regions are not making the most out of international trade and foreign direct investment. Goods exports are concentrated in a few natural resource commodities and destinations (Figure 3.8, Panel B), with oil and other minerals accounting for close to half the export basket (44%), and a total share of primary exports (including oil, coal, and raw agricultural exports) accounting for 60%. The United States is the main export destination. Other countries in the region are also important markets (Figure 3.8, Panel A). Exposure to trade is one of the lowest in the OECD and lower than in other medium-sized and large countries such as Peru, Chile, Mexico, France, or Spain (Figure 3.9, Panel A), and has not improved much over time (OECD, 2019[22]). Regional trade disparities are significant: Antioquia, Cesar, and Bogota accounted for over 50% of Colombia's non-natural resource exports in 2023. Micro, small and medium-sized enterprises collectively contribute only 18% to the country's total exports. Advancing on export diversification is a long-standing recommendation by the OECD to Colombia (OECD, 2013[23]; OECD, 2019[22]; OECD/UN/UNIDO, 2019[2]). It is also essential in the country's twin strategy of ushering in the green transition away from fossil fuels, which requires developing alternative drivers of export and growth, and the productive transformation embodied by the Reindustrialisation Strategy, which foresees the development of a broader industrial and export structure.

Figure 3.8. Exports are still dominated by commodities



Source : *UN Comtrade.*

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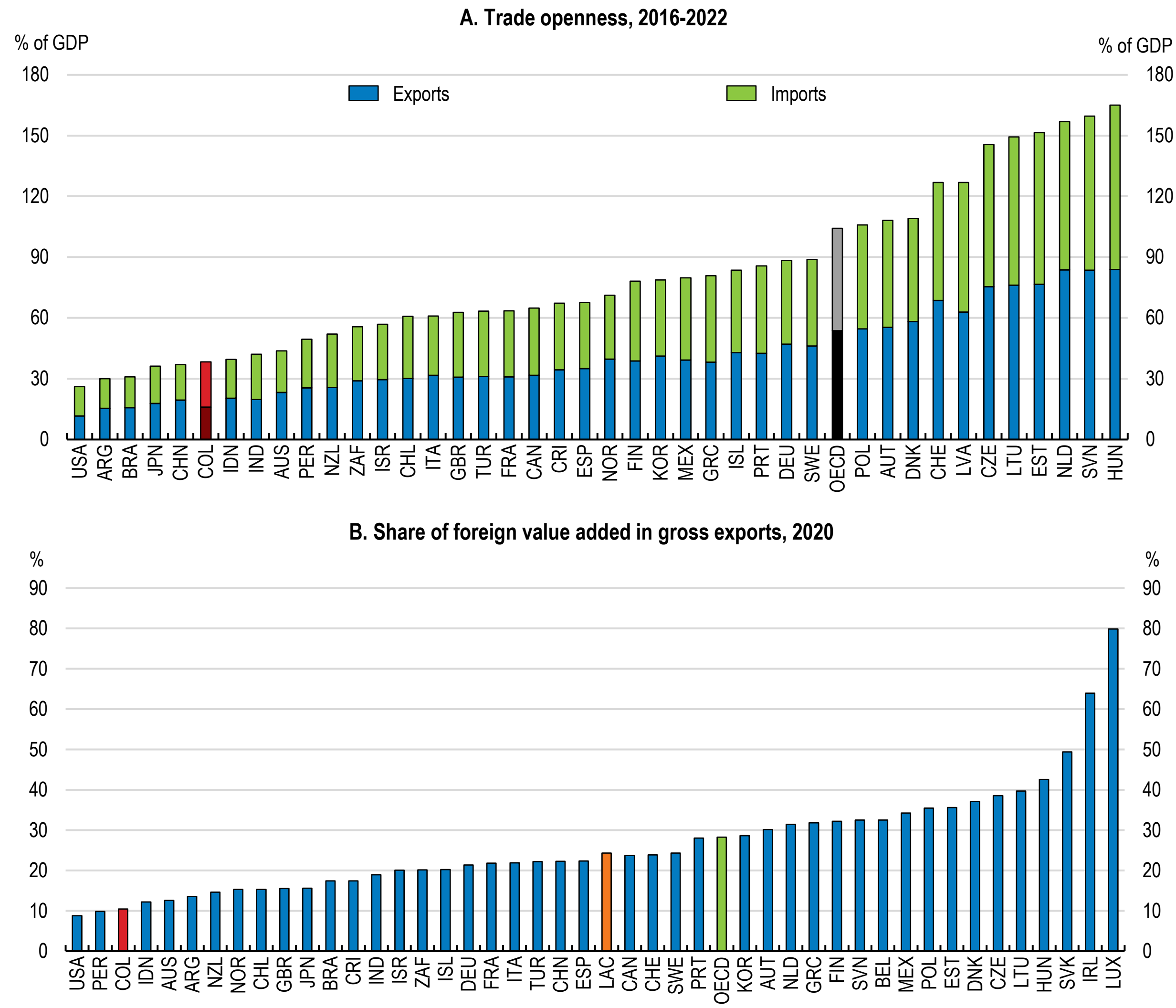
Colombia benefits relatively little from the embedded technology, better quality, and lower prices that come with advanced intermediate inputs. Only about 10% of value added in Colombian exports is of foreign origin, the second lowest in the OECD, only behind the United States with its enormous domestic market (Figure 3.9, Panel B). Such low backward participation in global value chains also reflects the fact that exports are still dominated by natural resource commodities, especially oil. More generally, there is room for the country to make better use of the market access facilitated by its existing free trade agreements to achieve greater export diversification in terms of products and markets. A new foreign trade policy was put in place in 2023 with the objectives of supporting the internationalisation of Colombia's regions, integration with the LAC region and the Global South, and the energy transition.

Significant trade barriers are one explanation behind Colombia's tepid embrace of internationalisation, as analysed in detail in a previous *OECD Economic Survey* (OECD, 2019[22]). Tariffs are higher than in other countries of the region such as Chile or Peru. Although average tariffs have decreased and the number of tariff-free products has increased, tariff dispersion has risen (Rivera Perez et al., 2021[24]; Garcia Guzmán, Rivera and Robledo, 2021[25]). This means that remaining tariffs are concentrated in specific sectors, where they are often applied only to narrow tariff lines relevant for specific domestic producers (Echevarria, Giraldo and Jaramillo, 2019[26]; Garcia Guzmán, Rivera and Robledo, 2021[25]). This limits exposure to global competition and access to inputs for these sectors, especially within value chains (i.e. if an upstream sector is highly protected). In addition, non-tariff trade barriers are high, especially in the food, agriculture, and textile sectors, and their prevalence has been increasing while tariffs went down (Echevarria, Giraldo and Jaramillo, 2019[26]).

As recommended by the OECD previously (OECD, 2022[27]; OECD, 2019[22]), Colombia could start reducing its high tariff and non-tariff barriers. Starting with those items where current protections are the highest would most significantly reduce tariff dispersion. A review of trade barriers on selective items, especially intermediate goods that are essential to specific value chains, such as materials for shipbuilding and maintenance and temporary imports of vessels to be repaired in docks, should be undertaken as they might be important bottlenecks to the Reindustrialisation Strategy and more broadly to an increased participation by Colombia in global value chains and in high value-added sectors.

Many import goods must be shipped via a small number of authorised ports of entry, creating non-tariff barriers that are especially onerous for regions far away from the respective authorised port. The designation of those ports does not always correspond strictly to technical criteria, such as logistical capacity or the capacity to prevent smuggling. Colombia uses port of entry restrictions more widely than any other country in the LAC region, affecting more than 1,700 different products (Kee and Forero, 2021[28]). For example, sugar can only be imported via one pacific port (OECD, 2022[27]). Such restrictions together with high domestic transport costs result in inefficient logistics and price dispersions across regions. Authorised port of entry restrictions should be reviewed according to technical criteria and reduced. In parallel, expanding the capacity at ports, including technical installations and customs procedures to handle a greater variety of products, should also be a priority.

Figure 3.9. Colombia could benefit from greater trade openness and global value chain integration



Note: Panel A is the average from 2016-2022. Panel B shows 2020 or latest, and LAC is an average of ARG, BRA, CHL, CRI, MEX and PER.
Source: *OECD Trade in Value Added (TiVA)*.

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One notable source of export diversification are services, which make up almost 20% of total exports (see Figure 3.8). Tourism, 60% of total services exports, is a major and fast-growing source of foreign exchange earnings and promoting it is a priority for the government. Currently tourism benefits mainly urban areas such as Medellín and the Caribbean coast. By contrast, there is still a largely untapped potential of attracting tourism to rural areas, which the government is trying to foster (Box 3.5). The continued implementation of the Peace Agreement, a reduction in violence, as well as the development of rural infrastructure are important enablers of attracting foreign tourists to rural areas, taking advantage of the many natural assets of Colombia’s regions including in areas such as eco-tourism and community tourism, which could become important sources of mid-skilled jobs for peripheral regions. At the same time, there is room to increase exports of knowledge-intensive services, mostly based in urban areas, as discussed in a previous *OECD Economic Survey* (OECD, 2019[22]). A useful example could be the case of Costa Rica, which over two decades moved from a services industry structure largely based on tourism to one sustained by knowledge-intensive services through the strategic attraction of foreign direct investment.

Box 3.5. Fostering productive development and peace in vulnerable areas through tourism

The government plans to harness tourism to promote peace and foster territorial development and to create opportunities for growth and reconciliation in communities affected by conflict by highlighting local cultures and natural landscapes.

According to the Tourism Sector Plan 2022-2026, there are three main programs to boost local economic development with tourism and to improve the capacity of tourism services providers:

- "Tourism for a peace culture" targets groups such as conflict victims, peace agreement signatories, former combatants, those involved in illicit crop substitution, and other peace-building actors and prioritises 90 territories historically affected by conflict.
- National Programme for Stimulus, Incentives, and Promotion for the Tourism Sector (EMPRETUR) is a programme to foster capacities, innovation, quality standards and productivity in the tourism sector, with participation awarded on a competitive basis. Regions on the Pacific coast, which have been historically affected by armed conflict and where tourism is underdeveloped relative to the Caribbean coast, are prioritised by the programme.
- Tourism-Friendly Schools is a programme to develop skills and capacities, strengthen the tourism culture, and promote peacebuilding, implemented in currently 302 secondary schools.

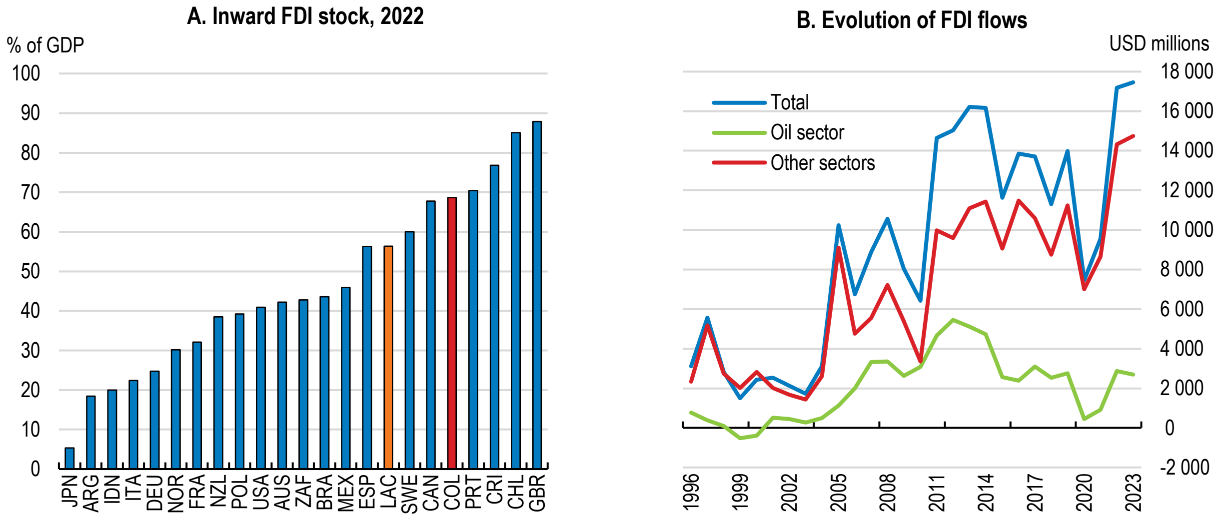
Source: Government of Colombia (2022) "Tourism in harmony with life. Tourism Sector Plan 2022-2026."

3.2.3. Taking advantage of nearshoring opportunities to move up the global value chain

Foreign direct investment (FDI) flows have recovered to their historical average of around 5% of GDP, after a decline since 2015 and a further fall during the pandemic. At the same time, FDI has continued to become more diversified, as already noted in the 2019 *OECD Economic Survey of Colombia* (OECD, 2019[22]). While the oil sector attracted a third of all inward FDI between 2006 and 2015, its contribution has reduced to around 16% in the last two years (Figure 3.10). Financial and business services and manufacturing are now among the largest destination sectors for FDI. Foreign-owned firms in these sectors outperform similar Colombian firms and generate positive spillovers (Li and Aranda Larrey, 2021[29]). Yet there is still room for making better use of FDI to improve Colombia's participation and position in global value chains (CONPES, 2023[30]). Like exporting, FDI is highly concentrated in the more developed regions, with six regions making up 85% of the total FDI stock in the country (Li and Aranda Larrey, 2021[29]).

Colombia is geographically well-placed to take advantage of nearshoring opportunities. Its Caribbean ports are within less than a week's shipping time from the United States, and only a few days from Mexico. Moreover, Colombia has free trade agreements with most other countries in the Americas. There are specific opportunities in offshoring of service activities, given that Colombia is in a similar time zone as other major economies on the Latin American continent, including the United States, Mexico, and Canada. However, with the exception of call centers, few such opportunities have materialised, despite a large potential (Baldwin, Cárdenas and Fernández, 2021[31]) boosted by the global rise of remote work (Adrjan et al., 2024[32]). Countries such as Costa Rica have successfully managed to become a hub for IT and business service offshoring activities. Some cities in Colombia, in particular Medellín, have since the pandemic become important destinations for "digital nomads", i.e. fully remote expatriate workers, employed by or contracting for firms in their country of origin, typically the United States. This trend has not transformed yet into meaningful opportunities for Colombians residing in Colombia, despite large wage differences even in specialised and highly skilled professions.

Figure 3.10. Foreign direct investment has become diversified



Note: In Panel A, LAC is the simple average of Argentina, Brazil, Chile, Costa Rica, and Mexico.
Source: *UNCTAD STAT Data Centre*; and Banco de la República.

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Policies to increase the attractiveness of Colombia as an FDI and nearshoring destination consist first and foremost in improvements in the investment and business climate. This would include increasing regulatory and policy certainty for investors, safeguarding macroeconomic stability and the strong macroeconomic policy framework, improving regulations, and better infrastructure and logistics performance. In other words, the same policies that would foster investment and productivity in general would also help increase Colombia's attractiveness for nearshoring. Moreover, there is evidence at the regional level that better institutional efficiency, regulations, and infrastructure are associated with more entrance of multinational enterprises (Li and Aranda Larrey, 2021[29]). There is large heterogeneity in nearshoring opportunities across the country, such as services in cities and sustainable manufacturing in regions with a high renewable energy potential. Continuing to improve coordination between the central investment promotion agency ProColombia, regional agencies (such as Invest in Bogotá), departmental competitiveness councils, and other actors such as local governments, could bring FDI to more regions. The Reindustrialisation Strategy offers another anchor point for strategic attraction of FDI to improve productivity and positioning in global value chains. Finally, approaches to improve regional attractiveness more broadly, including on social indicators which are as dispersed as economic ones (IADB, 2024[33]), would improve their image vis-à-vis investors (OECD, 2023[34]).

The impact of FDI on invest-receiving regions is amplified if it results in productivity spillovers, either through supply chains or via worker movements in the local labour market (Greenstone, Hornbeck and Moretti, 2010[35]; Abebe, McMillan and Serafinelli, 2022[36]). There is robust empirical evidence of positive spillovers of FDI in Costa Rica (Alfaro-Ureña, Manelici and Vasquez, 2022[37]) where explicit policies to promote linkages between foreign and local firms have long been put into place. These policies include screening potential local suppliers, facilitating exchanges and matchmaking with foreign affiliates. Colombia could learn from Costa Rica's experience, for example by evaluating and expanding the supplier development project introduced by *Colombia Productiva* in 2023 and by continuing to strengthen FDI facilitation services and the single window of investment.

One source of untapped potential for better international integration is Colombia's diaspora (CONPES, 2022[38]). About 10% of the population – about five million Colombians – reside abroad, with the largest group in the United States and sizeable populations in Canada, Chile, Mexico, and Spain (Nedelkoska et al., 2021[39]). Many retain close ties to their region or city of origin and frequently visit Colombia. While currently the main economic role of the diaspora are remittances – about 2.7% of GDP in 2022 – there is a large potential for diaspora Colombians to be facilitator of trade and foreign direct investment. Colombia could follow the example of other countries with a strong diaspora – for example, Ireland with its Global Irish, Scotland with its GlobalScot programmes, and programmes of the Spanish regions of Cantabria and Valencia – and actively promote networking, investment opportunities, and opportunities for engagement with Colombian entrepreneurs and firms. Such initiatives could also be led by regions or cities to foster regional ties of their specific diasporas.

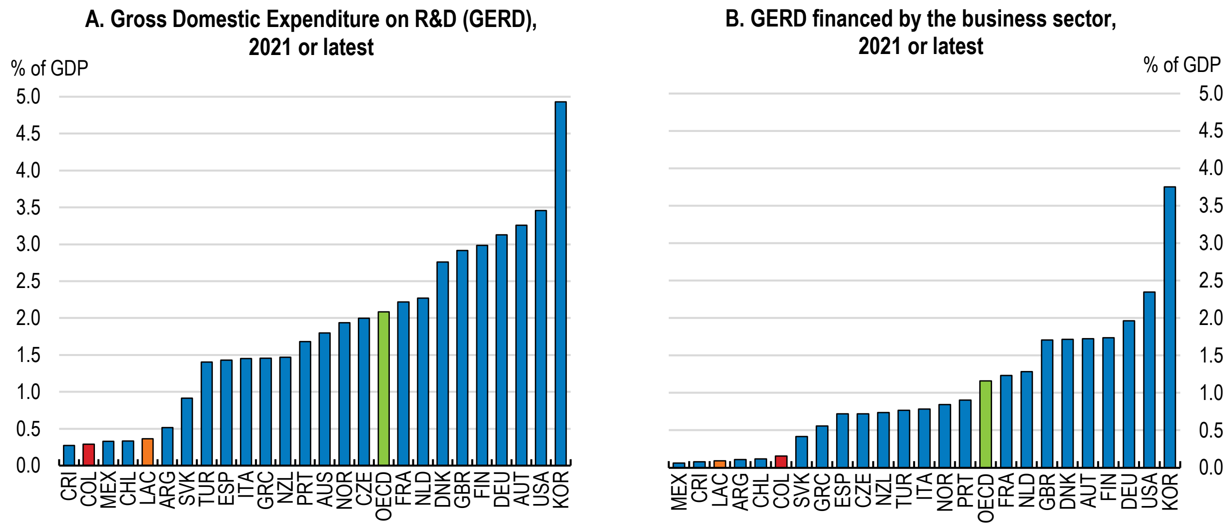
3.2.4. Fostering innovation and diversification

Innovation and the adoption of new technologies are key to improving productivity within sectors and firms, as well as the usher in structural transformations and take advantages of the opportunities offered by nearshoring and the global energy transition. Innovation is also required to advance the green transition of Colombia's domestic economy (Chapter 5). Public and private expenditure on research and development (R&D) is low (Figure 3.11). In 2020, Colombia only spent 0.3% of GDP on R&D, less than most other countries in the region and an order of magnitude less than the average OECD country. R&D spending needs to increase rapidly to reach the target of 0.5% the government has set for 2026. R&D and innovation is low in the private sector: more than 80% of firms never invest into any R&D (DANE, 2023[40]).

There are large regional inequalities in innovation (Figure 3.12). The leaders are Bogotá and its surrounding region and Antioquia, which host the country's main universities, research centres and innovative firms. By contrast, very little innovation takes place in many peripheral regions including for example La Guajira, which has Colombia's highest solar and wind energy potential and thus large potential for being a leader in the energy transition. Innovation is particularly low in the agricultural sector, where only 2% of large farms make use of advanced technologies such as drones, sensors, or automated systems (CONPES, 2023[30]). One of the results of such inequalities in innovation is that highly productive and competitive activities are concentrated in a small number of superstar firms (Figure 3.13).

Innovation programmes such as R&D tax credits can support business R&D spending and stimulate innovation with positive results (OECD, 2023[41]; Millot and Rawdanowicz, 2024[42]). The eligibility of firms to qualify for R&D tax credits was broadened a few years ago (OECD, 2019[22]) and now attracts firms in a broad cross-section of sectors. There are no eligibility criteria according to sector and firm size; however, most tax credits tend to be awarded to large firms, even though small firms benefit from higher deduction rates. R&D tax credits make up most (about 90%) of government support for business R&D, with direct grants only playing a minor role. The maximum grant size has been recently lowered, and eligible projects can now include knowledge transfer from large to small firms. Other instruments of R&D policy are capacity development for regional governments (who are envisaged to take more responsibilities in targeting R&D support in their region), the promotion of alliances between national and regional innovation support programmes, and an earmarked portion from the royalty transfer system that is reserved for R&D (see below). More generally, the government tries to foster strong complementarities of innovation policy with the Reindustrialisation Strategy and the energy transition.

Figure 3.11. R&D spending is low



Note: LAC is the unweighted average of Argentina, Chile, Costa Rica, and Mexico.
Source: *OECD Main Science and Technology Indicators (MSTI)*.

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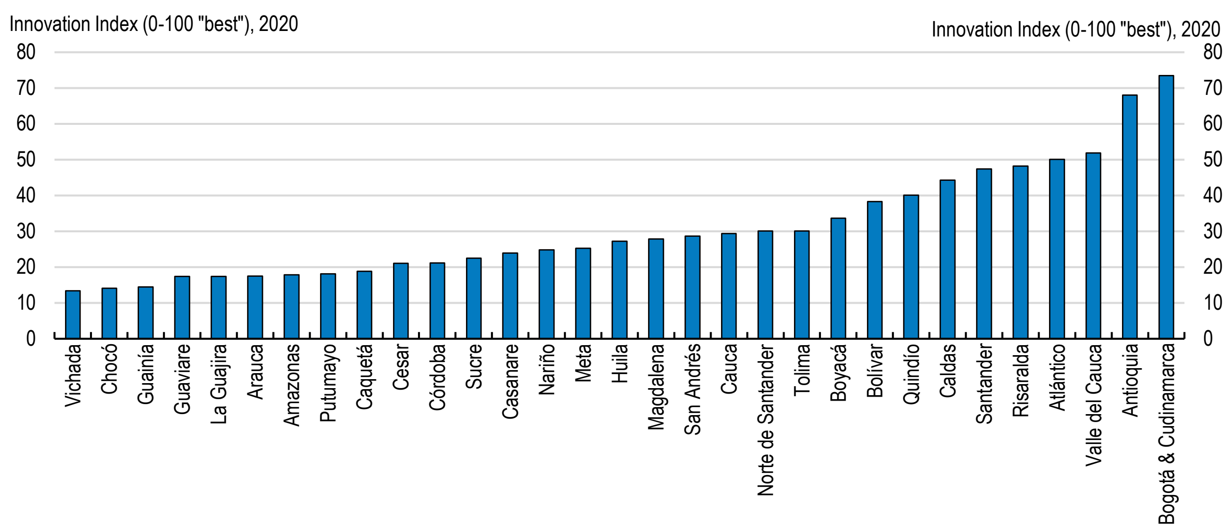
Figure 3.12. There are large regional disparities in innovation



Note: The Innovation Index measures performance in innovation by region via seven pillars: (1) Institutions; (2) Human capital and research; (3) Innovation infrastructure; (4 & 5) Market and business sophistication, (6) Knowledge production and technology; and (7) Creative output.
Source: *Observatorio Colombiano de Ciencia y Tecnología*.

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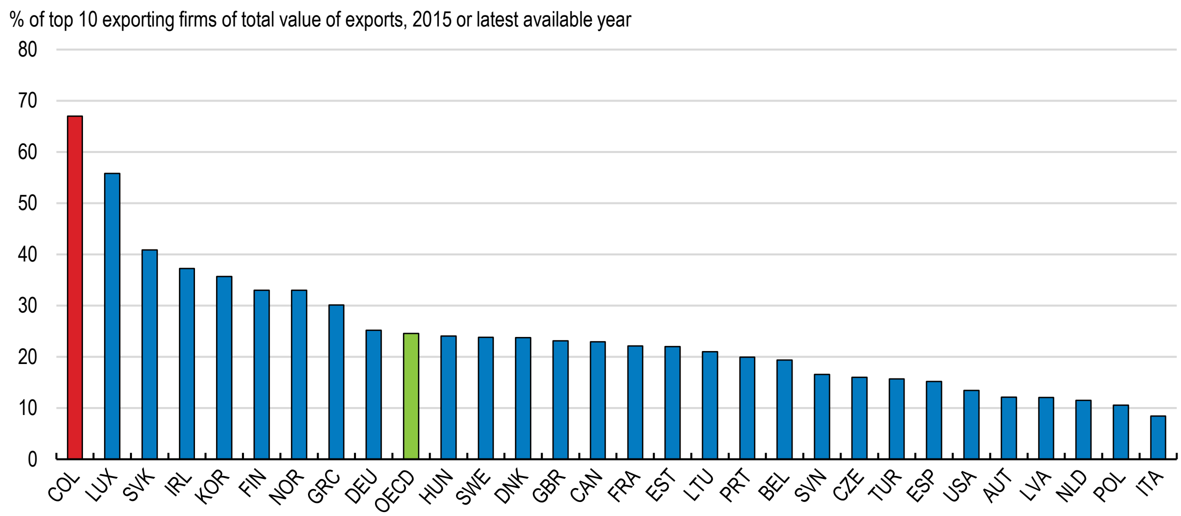
The prioritisation process for providing industrial and productive development policies including R&D subsidies, investment promotion, export promotion, and technological extension services could be improved. One direction could be to follow best practices and formulate priorities in terms of national challenges – such as the energy transition or internationalisation – rather than specific products or industries (OECD/UN/UNIDO, 2019[2]). Another would be placed-based approaches, which target certain areas. Such place-based approaches could also help coordinate interventions in different policy areas, by focalising complementary interventions in the same geographical areas. Geographic targeting should focus on functional areas rather than administrative boundaries to account for spatial economies; new methodological guidelines have been developed for this purpose. Targeting could involve cross-regional and cross-departmental cooperation models, such as Administrative Planning Regions and Territorial Association Schemes (see below). One tool to implement place-based approaches are "industrial corridors", such as those in Mexico, where the government concentrates infrastructure investment, the creation of industrial parks, and investment promotion in one location with the goal of creating new regional value chains. However, there are trade-offs to be considered between targeted policies and more general ones. For example, evidence from the United States suggests that financial incentives to individual firms can be more costly and less effective compared than more general policies such as infrastructure, manufacturing extension services, or customised job training (Bartik, 2020[43]).

Figure 3.13. Exports are particularly dependent on a few highly competitive firms



Source: OECD/UN/UNIDO (2019), *Production Transformation Policy Review of Colombia*.

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Colombia has a wide array of programmes of technology and knowledge transfer services. *Fábricas de Productividad*, a programme that offers consulting services to firms, was found to be associated with large increases in productivity of participating firms (Fedesarrollo, 2021[44]). An evaluation of an earlier pilot showed significant improvements in management practices, productivity, sales, and profits (Iacovone, Maloney and McKenzie, 2021[45]). Other programmes managed by the export promotion agency ProColombia, the Ministry of Science, Technology and Innovation, the National Planning Department, and other agencies provide support and consulting services to develop new products for export markets and to transform knowledge and patents into practical innovation. *Zasca* training centres offer integrated training, consulting, technology extension and matchmaking services to microentrepreneurs as part of the government's reindustrialisation and grassroots economy strategies. However, productive and business development programmes are still quite concentrated, with 65% of resources destined to SENA. It would be worthwhile to re-evaluate from time to time the programme mix and the funding allocated and to continue programmes that proved successful in evaluations, discontinue those that did not, and experiment with adding new programmes to the mix.

Industrial, innovation, and trade policies could be better coordinated (OECD/UN/UNIDO, 2019[2]). There are important synergies between these policy areas. For example, production development policies might identify mechanisms to increase productivity such as learning from exporting. This would in turn call for coordination with export and investment promotion and R&D support policies. Vocational and technical training programmes work better when they are conceived in partnership with the private sector and take into account local skills demand (see below). Another area for better coordination are business support programmes, which could become a tool to implement the regional component of the

Reindustrialisation Strategy. The regional competitiveness councils could play an enhanced coordination role for business and productive development initiatives between regional and local governments, the private sector, chambers of commerce, and universities and other research centres (OECD, 2023[34]). Coordination could also be improved by through better linkages between regional and national productivity agendas, for example building on recent initiatives by the National Planning Department. A key challenge here lies in striking a balance between top-down approaches, ensuring implementation of the national government's strategies throughout the territory, and bottom-up initiatives, empowering locally identified priorities and policies advocated by elected regional and local authorities, a challenge common to many OECD countries. Türkiye, for example, formulated a ten-year national strategy of regional development which provided a unified framework for the numerous regional development initiatives, and helped to coordinate the work of the independent regional development agencies (OECD, 2018[46]).

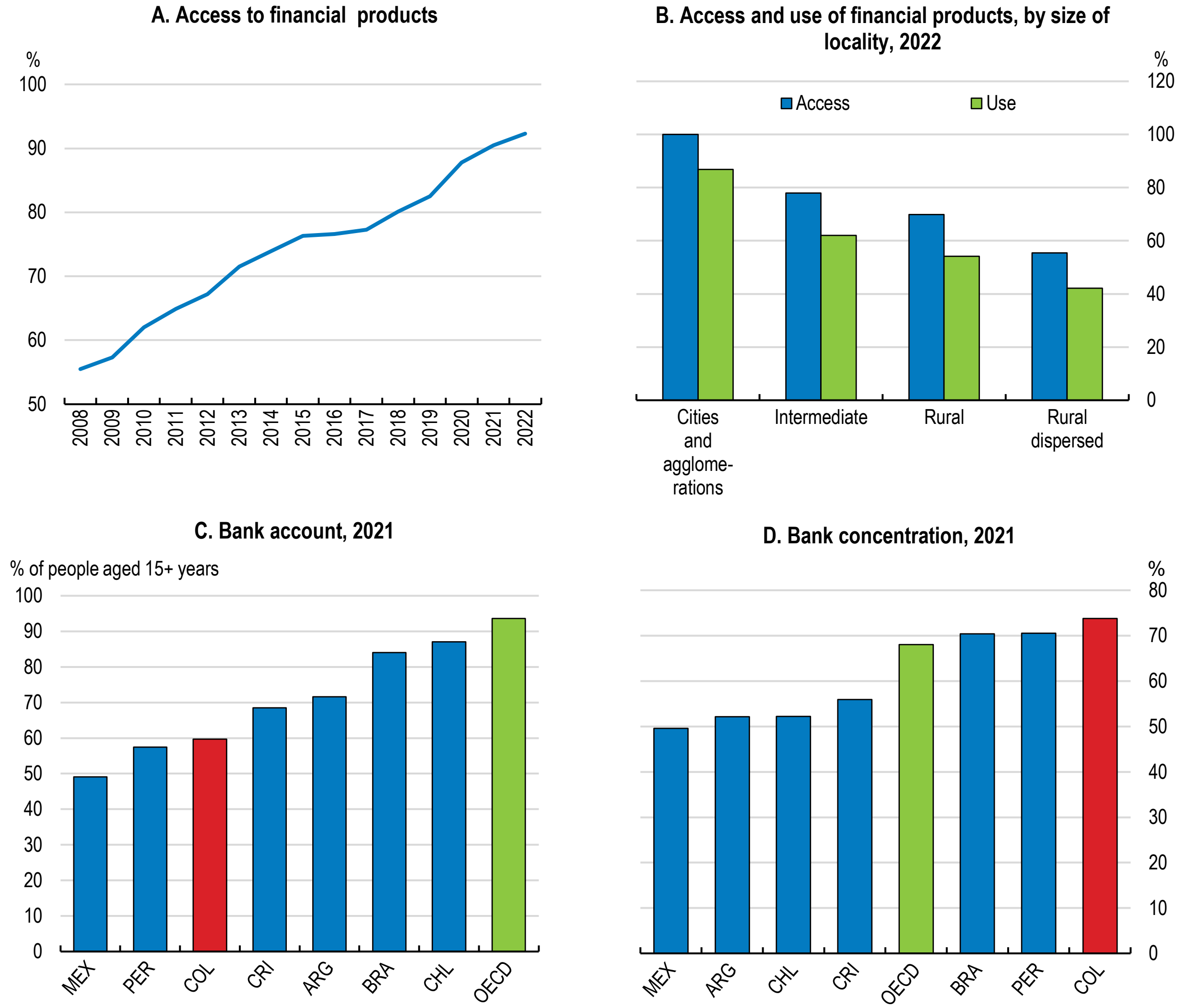
3.2.5. Ensuring inclusive access to finance

Access to finance has improved significantly in recent years, although significant regional gaps persist. In 2022, more than 90% of Colombians had access to finance – defined as having at least one financial product – whereas in 2008, only about half of the population did (Figure 3.14, Panel A). However, there are still large gaps in financial access across territories and regions (Figure 3.14, Panel B). Access to finance is 100% in cities – although use is somewhat lower – but decreases in more rural areas, with only 55% of Colombians in remote areas having any financial product. In some regions of the Amazon, access to finance is as low as 30% (Banca de las Oportunidades, 2023[47]).

Improving access to finance is important for removing constraints that hold back productivity, especially in regions with low financial access. Empirical evidence from Colombia points to several ways in which this can occur. Firms that experienced an increase in access to finance had higher productivity, investment, employment, and exports (Eslava, Maffioli and Meléndez, 2012[48]). By contrast, firms that face greater financial constraints import less (Restropo Angle, Niño Cuervo and Montes Uribe, 2012[49]). This could restrain productivity growth because it reduces the transfer of technology embedded in imported intermediate inputs (Amiti and Konings, 2007[20]; Gebrewolde et al., 2022[50]). In rural areas, access to credit allows producers – such as coffee farmers – to increase production, productive use of land and yields, which in turn improves their living standards (Echavarría, Villamizar-Villegas and McAllister, 2017[51]). Better access to finance is crucial in the context of climate change for both adaptation and mitigation efforts, as highlighted in Chapter 5. Finally, the government views financial inclusion, especially for the grassroots economy, as a cornerstone towards increased formalisation of the economy.

Bank penetration is low, with less than 60% of adults having a bank account (Figure 3.14, Panel C). Several Latin American countries including Mexico and Brazil have improved bank penetration by tying the payout of social benefits to tenancy of a bank account or card, often provided by state-owned banks. International evidence shows that this not only increased bank penetration but also improved the competitiveness of traditional retailers and tax compliance by bringing more activities into the formal sector (Higgins, forthcoming[52]). In Colombia, a key innovation of the pandemic emergency relief programme Ingreso Solidario was to disburse payments directly into bank accounts and mobile wallets (OECD, 2022[27]). While this increased bank penetration and uptake of mobile payment technologies somewhat, there is still room for improvement. For example, beneficiaries without a bank account or mobile wallet could be automatically provided with such a product, as was the case in Mexico and Brazil.

Figure 3.14. Financial access and inclusion could be improved



Note: In Panels A and B, access to financial products is defined as the share of adults that have at least one financial product. Panel C shows the share of people aged 15+ years with an account at a financial institution, a mobile money account, or both. Panel D shows the share of assets held by the largest 3 banks.
Source: Banca de las Oportunidades (2022), *Reporte de Inclusión Financiera*; World Bank, *Global Findex*; and World Bank, *Global Financial Development*.

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Bank competition is low (Figure 3.14, Panel D), and banks have historically enjoyed high margins as discussed in a previous *OECD Economic Survey* (OECD, 2019[22]). Although there are many domestic and foreign banks operating in the market, the top-3 banks have a combined market share above 70 percent, more than in other peer countries in the region. Moreover, financial conglomerates, comprising banks and non-bank companies including insurers, retail stores, and hospitals are very prominent in the Colombian banking sector (World Bank, 2021[53]). Their presence across different consumer goods and services markets gives conglomerates access to large amounts of costumer data that helps them gain a competitive advantage in many markets. Close monitoring of the evolution of competition among banking conglomerates is needed to deter anti-competitive practices. This requires strengthening inter-institutional cooperation among the competition authority, the banking regulator and the financial superintendence, including in merger reviews.

The state-owned financial conglomerate, *Grupo Bicentenario*, has become the third-largest financial group in Colombia (World Bank, 2021[53]). While this might be positive for financial inclusion, especially in areas currently underserved by commercial banks, the dominant position of *Grupo Bicentenario* raises challenges. Moreover, the government envisages a central role for *Grupo Bicentenario* in channeling access to finance to priority sectors in the grassroots economy and reindustrialisation strategies. *Grupo Bicentenario*'s activities and governance should be carefully monitored and regularly assessed by the competent authorities in matters of banking competition independent entities, including the competition authority and the banking supervisors, to ensure the government's role is limited to that of a shareholder, with full operational independence maintained by the entity.

Rural areas are especially underserved by commercial banks, resulting in high bank concentration and low competition. Many rural municipalities are only served by *Banco Agrario*, the largest retail bank within *Grupo Bicentenario* (World Bank, 2021[53]). Informal credit based on relational contracts is another important source of finance for many farmers. Colombia has an active formal microcredit market, which disbursed a little more than 1 million loans (about 1 per 50 inhabitants) in 2019 (Asomicrofinanzas & Banco de la República, 2023[54]). While this market has exhibited strong growth, it is smaller and less dynamic than those in other countries in the region such as Peru where 15 NGOs disburse microloans compared to 6 in Colombia. More than 40% of the microcredit portfolio belongs to *Banco Agrario* (Asomicrofinanzas & Banco de la República, 2023[54]).

Incentivising the creation of a vibrant ecosystem of private financial institutions in rural areas would improve rural access to finance. Creating incentives for rural financial institutions to join larger federations while improving their governance and regulatory oversight would help in this respect. In several OECD countries such as Austria, Germany and the Netherlands, federative credit and savings associations are among the largest financial institutions in terms of clients and a cornerstone of rural and agriculture finance. Creating incentives for financial innovation, including through regulatory sandboxes to encourage experimentation, is another policy lever to foster financial ecosystems, and recent policies have been going in this direction.

A major source of informal credit in Colombia is provided by organised criminal groups, with severe social consequences. These loans, known as *gota a gota* ("drop by drop"), are typically for low amounts, available immediately without any paperwork, and are paid back daily or weekly at very high implied annual interest rates (Padrón Jaramillo, 2023[55]). If not paid, lenders recur to violence against the borrower and their family members to recover the loan and interest. According to survey estimates, 20% of Colombians recur to *gota a gota* loans. This illegal market has become a major source of income and money laundering for organised criminal and armed groups.

To combat *gota a gota* markets, the government plans to increase credit access through various channels, including consumer credit via the *Banco Agrario* and second-tier loans and guarantees from *Grupo Bicentenario* to private financial institutions. It will be important to safeguard competition in consumer credit markets by maintaining a level playing field between state-owned and private lenders and by defining objective criteria for credit allocation that privilege loan repayment. The government's flagship programme CREO goes in this direction. It consists of a subsidised micro credit line of up to around USD 500 (USD 1,000 for agricultural loans) backed by a public guarantee for up to 70% of the loan amount, targeted at vulnerable households without prior credit records and offered through all major commercial banks, both public and private. Moreover, reviewing the maximum interest rates that financial institutions can charge on consumer and micro credit ("usury rates") could help to assess whether the policy that aims at preventing excessive costs for those accessing financial products and services is in fact spurring access to informal credit. Higher usury rate limits could also spur banking competition by incentivising new entry into high-risk or high-cost market segments.

Easing documentation requirements for loans, especially for small loans and those disbursed via mobile payment systems, is another essential element for offering viable legal alternatives to *gota a gota*. Recent policy action by the central bank and the government to make instant mobile payment systems interoperable is a step in the right direction. In Brazil and Mexico, integrated mobile payment systems were central to the development of mobile-based microloans, two thirds of which benefit customers with low access to finance (Sumlinski et al., 2023[56]). Authorities should undertake a review of potential regulatory barriers to access to credit, especially for small loans solutions based on mobile technologies.

A lack of credit records with one of the major credit bureaus is another major obstacle to financial inclusion of previously unbanked population segments. Ensuring the preservation of records with the credit bureaus would improve the information content of this data and enhance their role in helping the allocation of credit and expanding financial inclusion. The CREO programme will help individuals to start building a credit record, and it should be complemented with the development of an alternative credit scoring approach that uses public databases to collect individual information, for instance from the business register, social benefits register, and transactions registers such as from digital wallets and mobile phones. The government is working towards such an alternative credit scoring methodology, which it plans to roll out in collaboration with private credit bureaus. It has further recently issued open finance and open data regulations which may support innovation in this area.

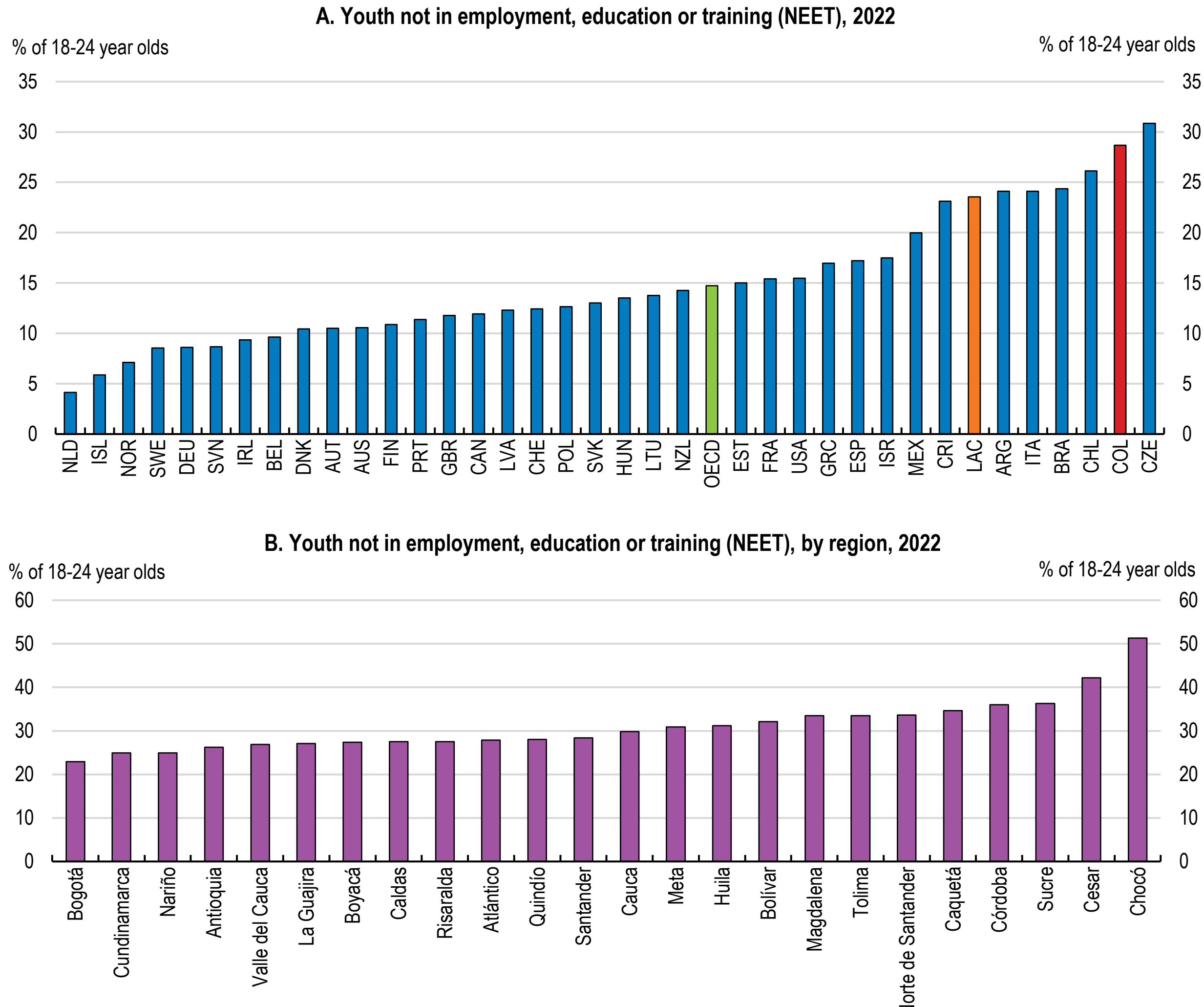
Educating the public about the risks associated with informal microcredit and the advantages of using regulated financial institutions would be another important element of channeling credit demand away from *gota a gota* to the formal financial system. Consumers may be attracted to *gota a gota* loans because they cannot compare what seems a low headline interest rate (e.g. a 10% *weekly* or 20% *monthly* interest rate) to effective annual rates offered by the formal financial system. Improving financial literacy both for the young population at school and through adult training programmes, for example through SENA's complementary education track and *Banca de las Oportunidades* financial education programmes should be a priority. This could be complemented with a review of financial regulations to make basic information of products simple and understandable especially for vulnerable populations. For example, the United Kingdom's Financial Conduct Authority has put in place a guidance for the fair treatment of vulnerable consumers and in 2023 introduced a "consumer duty" by which financial service providers need to abide.

3.2.6. Levelling up labour market relevant education and training across all regions

Low levels of skills and human capital, as well as skills mismatch, are key drivers of regional disparities in productivity and income. The same factors further result in one of the highest rates of youth neither in employment, education nor training (NEET) among all OECD countries, with important regional differences (Figure 3.15). For example, more than half of all young adults in Chocó are NEET, compared to below 30% in Bogotá. Providing Colombians in every region with the skills they need to take advantage of the opportunities in their labour markets requires levelling up differences in skills provision across regions. Moreover, developing the right skills is critical for achieving the structural transformation envisaged in the Reindustrialisation Strategy and to promote formalisation, growth, and access to high-quality jobs for the grassroots economy.

Vocational education and training (VET) is a powerful tool to bridge school-to-work transitions for young adults and thereby reducing NEET rates (OECD, 2023[57]). In Colombia, there is a strong regional component to this since VET programmes offered by the National Training Service (*Servicio Nacional de Aprendizaje*) SENA are in many rural areas the only local educational option beyond the lower secondary level, when mandatory schooling ends. SENA provides VET degree courses to about 1.3 million youth, mostly at the upper secondary and technical tertiary levels, and mostly geared towards technical professions in the service sector, such as administrative assistance, IT systems, technology and programming, data analysis, and accounting (SENA, 2022[58]). Expanding upper-secondary vocational programmes by SENA, starting with the regions where few upper-secondary alternatives exist and where NEET rates are the highest, seems one of the most immediate ways in which authorities could tackle the issue. VET students' performance is relatively good compared to those in general secondary education. For example, in the PISA 2022 aptitude tests, Colombia is one of the few OECD countries where at the secondary levels, VET students outperform those in general education, scoring on average 20 points higher in maths (Figure 3.16). These performance differences towards the start of upper secondary schooling still carry over to final exam scores upon graduation. However, enrolment of students in upper-secondary vocational programmes is one of the lowest among OECD countries (OECD, 2019[22]).

Figure 3.15. Many young adults are not in education, employment, or training (NEET)



Note: In Panel A, LAC is a simple average of Argentina, Brazil, Chile, Costa Rica, and Mexico.
Source: *OECD Transition from School to Work*; and *OECD Regional Education*.

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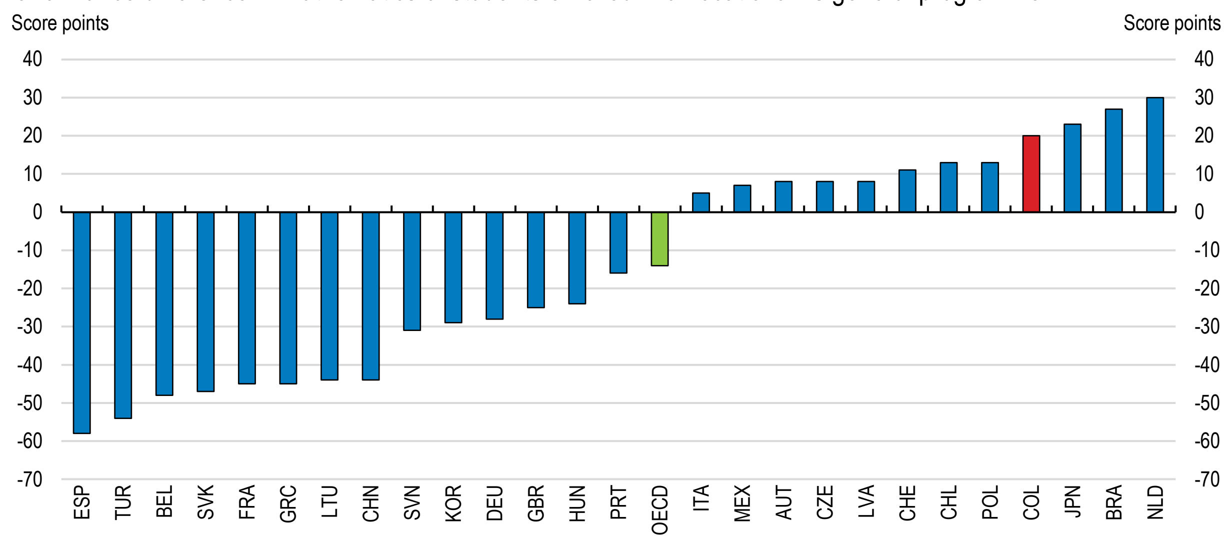
An important consideration, however, is that VET and especially full-time programmes leading to a degree or certificate should be offered in line with local and regional skills needs. Such programmes require substantial time investment by students as well as teaching resources and should be designed accordingly. Labour mobility is low, reflecting poor infrastructure and a high cost of housing relative to wages. Skills mismatch is high, and many employers cite an inadequately trained workforce as a major impediment for their operations (OECD, 2019[22]). Moreover, the absorption capacity of formal labour markets for VET graduates is very different across regions (Figure 3.17). Expanding upper-secondary VET should therefore be aligned at the local and regional level with both skills needs and the structure of local industries and labour markets. It should also be coordinated with other economic policies such as the Reindustrialisation Strategy. While sectoral roundtables (*mesas sectoriales*) are in principle the forum for local employers to provide input into course offerings, they seem to not be very effective (Gonzalez-Velosa and Rosas Shady, 2016[59]).

One channel through which the coordination and involvement of the local business sector could take place are the regional productivity commissions, as well as a close coordination with local chambers of commerce. In Switzerland, for example, professional organisations – trade associations, employer associations, and trade unions – have a leading role in defining the content and examination process of VET programmes. In Sweden, funding allocations to VET education providers are conditional on showing market demand for the skills taught and engaging employers. In Denmark, each upper secondary VET institution has to work with at least one local training committee, which serve as a link to both local employers and the national training committee. In France, subsidies to employers of apprentices are differentiated by region, allowing to target specific regions with a particular need for expanding such VET programmes.

Figure 3.16. Performance of VET students is good

Performance difference in mathematics of students enrolled in a vocational vs general programme



Note: Data refer to the PISA score in mathematics after accounting for students' and schools' socio-economic profile.
Source: *OECD PISA 2022*.

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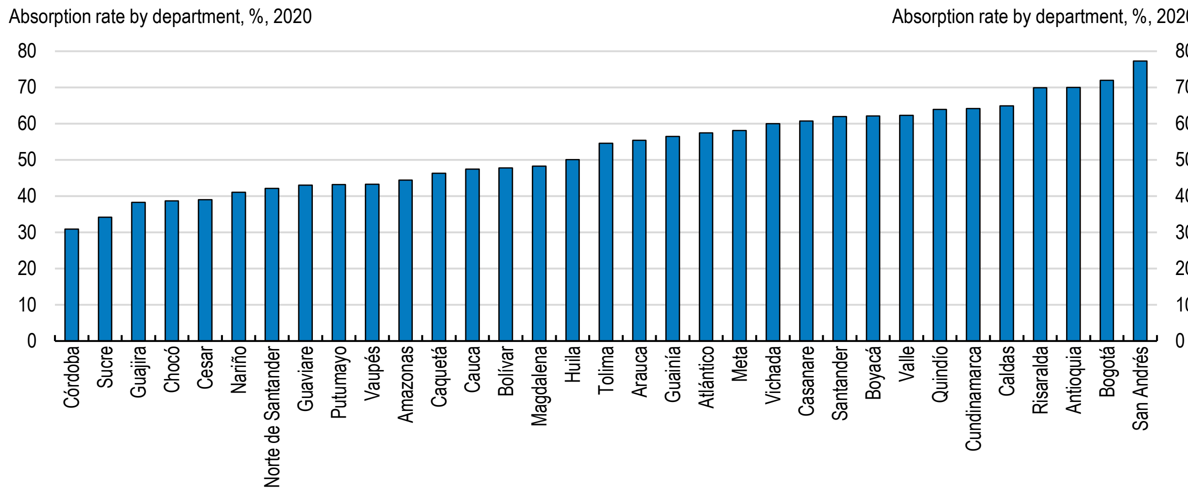
Increasing the reach of dual VET to more regions and towns might be a way to increase both the relevance of VET training for local businesses and to improve the absorption rate of VET graduates into the formal sector.Many apprentices are taken over onto regular contracts by their host firms once they finished their training. A dual VET system exists in Colombia, but its coverage is very limited. Only around 2000 apprentices were enrolled in a dual programme in 2021 (SENA, 2022[58]), largely to train machine operators for the textile sector. Moreover, around 80% of dual VET places were offered in the regions of the three largest cities, Bogotá, Medellín (Antioquia) and Cali (Valle del Cauca).

On-the-job training and lifelong learning are important elements to develop and keep up with the skills needs of a changing world of work, with advantages to both workers and firms. This is especially important in Colombia, where skills gaps are one factor that keep individuals stuck in informal jobs and prevent them from moving to more productive roles in the formal sector (OECD, 2022[27]; OECD, 2019[22]). The main on-the-job training programme is offered by SENA through its "complementary education" track in which more than 8 million Colombians participate each year. This track includes short-cycle programmes and courses that teach specific technical and general skills. For example, among the most popular courses in the complementary programme in 2021 were English, food preparation and hygiene, Microsoft Excel, and administration of COVID-19 vaccines (SENA, 2022[58]). Other programmes are offered by a multitude of organisations including compensation funds, non-governmental organisations, and private firms. Many such programmes and training providers lack quality certificates. Moreover, programmes are fragmented and lack integration into a common framework of learning pathways. Finally, workers that face no labour market difficulties, and those with more formal education, are much more likely to receive training than more vulnerable workers (OECD, 2019[22]).

Figure 3.17. The absorption capacity of formal labour markets differs across regions



Note: Data shows the share of SENA VET graduates who held a formal job registered in the social security system within one year of graduation.
Source: SENA (2022), "*Reporte de datos de la formación integral para el trabajo 2022*".

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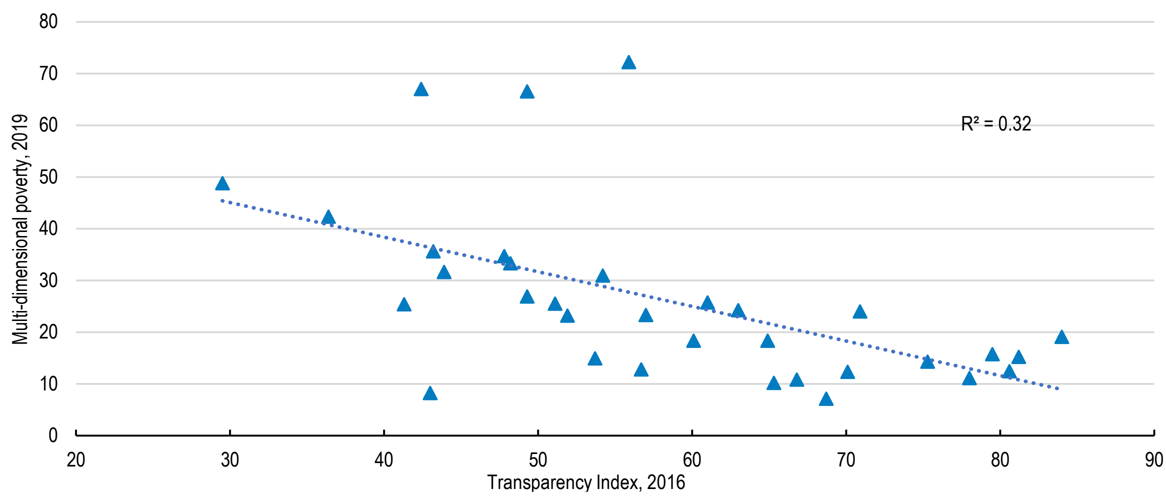
To further improve the quality and relevance of training, a national regulatory framework to accredit training providers and rationalise and clarify course offerings should be put in place (OECD, 2022[27]). The ongoing implementation of a National Qualifications Framework is a right step in this direction, allowing to map the standards, competencies, and skills a person should acquire from each unit of education. This in turn provides a baseline against which course offerings could be compared and assessed. As the large positive returns from a skills certification programme administered by SENA show, Colombian workers struggle to signal their skills, especially to employers in the formal sector (Mancino, Morales and Salazar, 2023[60]). Authorities should continue to pursue and monitor the implementation of the National Qualifications Framework. Another option to help workers better signal their skills, including those acquired informally, would be setting up a system for the recognition of prior learning (OECD, 2023[61]).

Measures to improve demand for education and training – by setting correct incentives and alleviating financial constraints – should complement the above measures to improve the supply of high-quality education and training programmes. *Renta Jóven* – formerly called *Jóvenes en Acción* – is a conditional cash transfer programme to vulnerable youth (14-28 years old) who have finished upper secondary vocational education. A subsidy is paid to cover tuition fees and a maintenance grant, conditional on attending a post-secondary course at SENA or another accredited institution. The programme has been previously found by an impact evaluation to increase post-secondary enrolment and decrease school non-completion (Gómez Gerena and Sánchez Torres, 2017[62]). Another programme, *Ser Pilo Paga*, provided merit-based university scholarships to high-performing upper-secondary graduates and increased university enrolment of eligible youth, especially at high-quality institutions (Londoño-Vélez, Rodríguez and Sánchez, 2020[63]). Although these programmes do not have a specific geographic focus, given the targeting of youth from poor and vulnerable households with eligibility criteria, they implicitly were geared towards youth from more rural areas.

3.2.7. Continuing the fight against corruption

Corruption reduces the attractiveness of Colombia's business environment and impinges on the ability of its state to provide high-quality infrastructure and services for all its citizens. Corruption especially affects poorer and more rural regions (Figure 3.18). A strong rule of law protects private property rights and underpins contract enforcement, necessary incentives for investment, innovation, and sustainable growth (Acemoglu, Johnson and Robinson, 2001[64]; Johnson, McMillan and Woodruff, 2002[65]). By contrast, corruption interferes with growth by reducing the provision of public goods and services, diverting public resources, distorting capital and labour allocation, reducing the government's ability to enforce the law, and lowering trust in public institutions (Olken and Pande, 2012[66]). Corruption tilts the playing field towards businesses and individuals that engage in corrupt practices or have privileged relationships, rather than those with strong performance in the marketplace. Excessively strong vested interests can also amplify political opposition to reforms. In the shadow of decades of conflict in Colombia, systemic corruption, state capture and organised crime were able to spread and connect, further undermining the state's legitimacy and capacity (OECD, 2017[67]).

Figure 3.18. Corruption is more likely to affect poorer regions



Note: For Bogotá, data for the Transparency Index refer to 2017.
Source: OECD calculations based on DANE; and Transparencia por Colombia.

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Over the years, Colombia has made significant progress with efforts and initiatives to foster integrity and combat corruption in the public sector (OECD, 2017[67]). The recent introduction of concomitant and preventive control at the supreme audit institution presents another advancement in building a modern integrity system (OECD, 2021[68]). However, according to corruption perceptions indicators, significant room for improvement remains relative to best performers in the region such as Chile and Costa Rica, and many other OECD countries (Figure 3.19).

Regulating financial contributions of individuals and businesses to political parties and candidates can help avoid policy capture by special interests, improving inclusiveness and fairness in public decision-making (OECD, 2021[69]; OECD, 2017[70]). Given the limited public financing, campaigns are highly dependent on private funds; and legal contribution limits are only weakly enforced (Transparencia por Colombia, 2019[71]). Moreover, there are no limits on the amounts individual candidates can privately contribute, opening room for contributions by third parties directly to the candidate. Candidates and parties also take on significant amounts of debt (Saavedra, Soto and Carvajal, 2023[72]). Private financing is particularly predominant in regional and local elections. This opens the door for nepotism and corruption when candidates start paying back campaign contributions with political favours once in office (Fedesarrollo, 2021[73]). Stricter enforcement of limits and transparency requirements for private campaign contributions would lessen the dependency of political candidates on special interests and thus reduce corruption incentives. Gradually, private campaign funding should be replaced by public funds, allocated in a transparent manner and with strict accountability rules.

Combatting corruption requires an active and effective civil society that make their voice heard. Unfortunately, despite much progress since the heights of the internal violent conflict, social, community, trade union and human rights leaders and activists still face high risks. Reducing violence against trade unionists has been recognised as a key issue for improving social and employment rights in Colombia (OECD, 2022[74]; OECD, 2016[75]). Despite significant increases in protective measures by authorities, and a prioritisation of the investigation of violence against trade unionists by the Prosecutor General's Office (OECD, 2022[27]) 8 to 16 trade unionists – depending on classifications – were assassinated in Colombia in 2023 (OECD, 2024[76]). Conviction rates for those crimes are still low. Moreover, violence affects social movements and community leaders in rural areas, many of them of Indigenous or African descent. In 2023, according to the Human Rights Ombudsman Office, 181 community leaders were victims of homicide. This represents a marked increase in violence since the signing of the Peace Agreement. Assassinations are concentrated in rural regions, especially in post-conflict areas where armed groups are still present (INDEPAZ, 2023[77]).

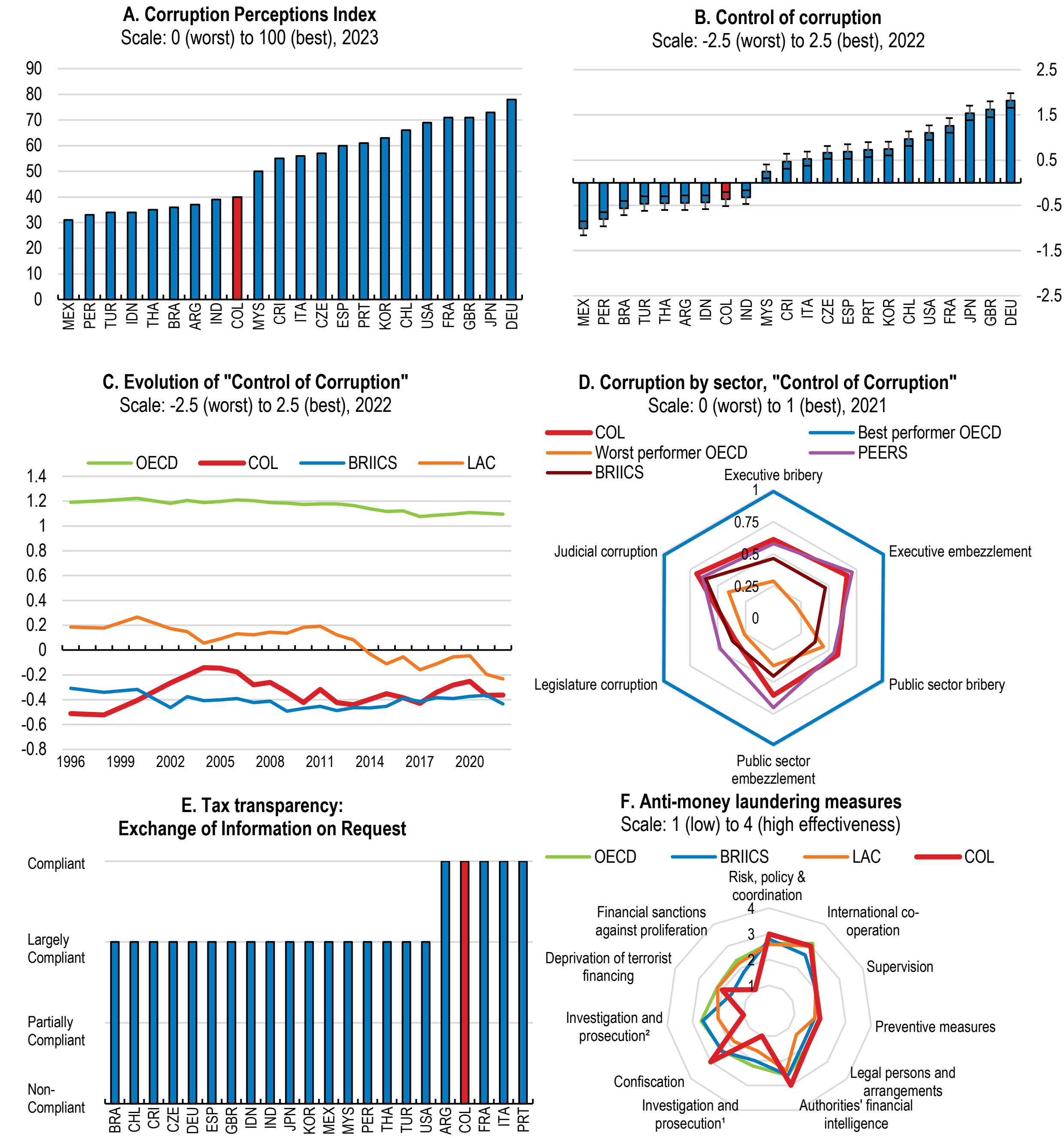
Effective vigilance by civil society further requires a greater degree of transparency in the use of public funds. Currently, accessibility to information on public budgets and spending is made difficult by lack of user-friendly data formats (Transparencia por Colombia, 2023[78]). Access to some data, especially at disaggregate levels, is restricted to due to privacy concerns. Improving dissemination of fiscal and financial information, including at very disaggregate levels including by region, would be a right step in this direction; for example by modernising the Ministry of Finance's Economic Transparency Portal,

Illicit financial flows – of money originating from corruption, crime, terrorism, and tax evasion – strip countries of important resources and contribute to the proliferation of unlawful and harmful activities. The first voluntary foreign asset disclosure programme organised by the Colombian tax authorities revealed assets hidden abroad worth almost 2% of GDP (Londoño-Vélez and Ávila-Mahecha, 2021[79]). Colombia fully participates in international information exchange for tax purposes (Figure 3.19, Panel E) including with countries that have historically been tax havens for Colombians. Colombia established its anti-money laundering convention early, in 1995, and takes effective anti-money laundering measures in many areas (Figure 3.19, Panel F). However, progress could be made in enforcement, specifically in investigation and prosecution and in the application of financial sanctions. Moreover, better implementation of standards that mandate the disclosure of final beneficiaries of financial transactions, including information exchange between different government entities, could improve transparency on financial flows and help combat corruption (Transparencia por Colombia, 2023[78]) including by facilitating the due diligence screening of potential suppliers and contracting partners by public entities.

Table 3.2. Past OECD recommendations on fighting corruption

Past recommendation	Actions taken since the 2022 survey
Continue the fight against corruption by establishing a dedicated whistle blower protection law and imposing stricter limits for private campaign contributions.	A bill in congress aims to establish norms, procedures, and mechanisms to protect whistleblowers within the private and public sector.
Set stricter limits and transparency requirements for private campaign contributions, for both political parties and independent candidates.	Private campaign contributions are limited and subject to registration in the new electoral code currently undergoing a final review. A register of private campaign contributions is being created.
Better define the scope for mandatory recourse to centralised purchasing, including at the subnational level.	No action taken
Eliminate fixed annual fees for participating in public tenders.	No action taken
Legislate provisions to frame the activities of lobbyist.	A bill of law to create a lobbyist register was introduced in 2022 and discussed by the Senate in 2023 but has not advanced past the Senate commission stage.
Strengthen the performance of the judicial system by enhancing court automation and electronic case management tools and reducing adjournments.	The implementation of the Strategic Plan for the Digital Transformation of the Judicial Branch is ongoing. 310 new court offices have been created..

Figure 3.19. Corruption perceptions remain high



Note: Panel B shows the point estimate and the margin of error. Panel D shows sector-based subcomponents of the "Control of Corruption" indicator by the Varieties of Democracy Project. Panel E summarises the overall assessment on the exchange of information in practice from peer reviews by the Global Forum on Transparency and Exchange of Information for Tax Purposes. Peer reviews assess member jurisdictions' ability to ensure the transparency of their legal entities and arrangements and to co-operate with other tax administrations in accordance with the internationally agreed standard. The figure shows results from the ongoing second round when available, otherwise first round results are displayed. Panel F shows ratings from the FATF peer reviews of each member to assess levels of implementation of the FATF Recommendations. The ratings reflect the extent to which a country's measures are effective against 11 immediate outcomes. "Investigation and prosecution¹" refers to money laundering. "Investigation and prosecution²" refers to terrorist financing.

Source: Panel A: Transparency International; Panels B & C: World Bank, Worldwide Governance Indicators; Panel D: Varieties of Democracy Project, V-Dem Dataset v12. Panels E & F: OECD Secretariat's own calculation based on the materials from the Global Forum on Transparency and Exchange of Information for Tax Purposes; and OECD, Financial Action Task Force (FATF).

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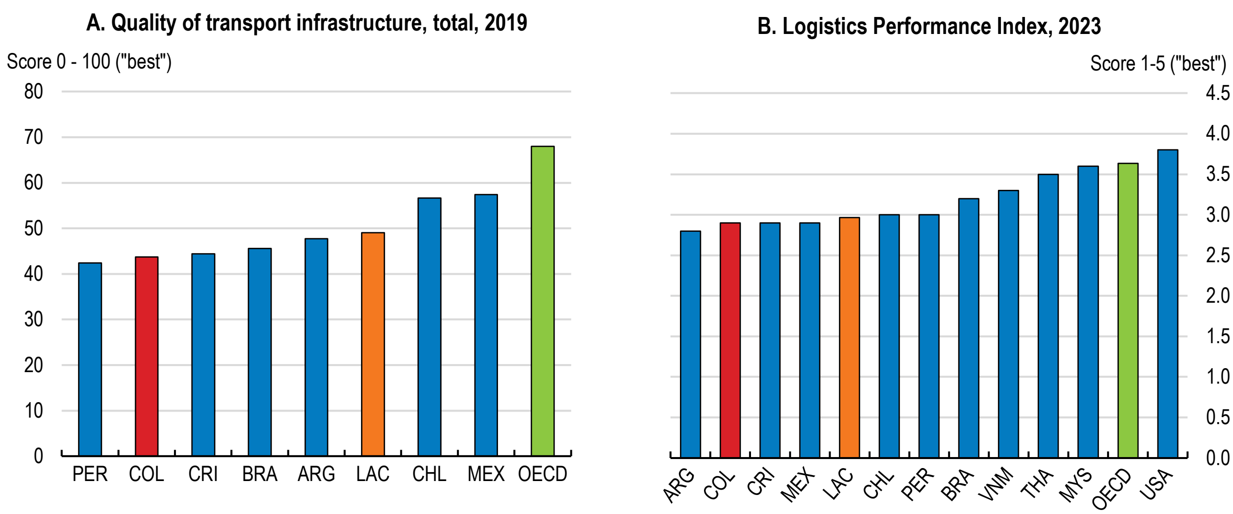
3.3. Fostering regional convergence and integration

3.3.1. Connecting cities and regions through better infrastructure

The quality of Colombia's transport infrastructure is low in international comparison (Figure 3.20). Road and especially railroad infrastructure is bad even compared to countries in the region, where infrastructure is typically less developed than in other OECD countries. This restricts economic activity, trade, regional specialisation, and the development of domestic and international value chains. Transport costs are high. According to the latest National Logistics Survey, the cost of logistics (largely made up of transport) amounts to 18% of the total shipment value. Colombia's cities are poorly integrated with their hinterland, which is largely explained by the poor quality of rural roads and transport connections (OECD, 2022[80]). As a result, there is a sizeable dispersion in logistics costs, which can reach 30% in some regions.

Figure 3.20. The quality of infrastructure is low



Note: In Panel A and B, LAC is the simple average of Argentina, Brazil, Chile, Costa Rica, Mexico, and Peru.
Source: World Economic Forum, *the Global Competitiveness Index 4.0 2019 dataset*; and World Bank, *Logistics Performance Index 2023*.

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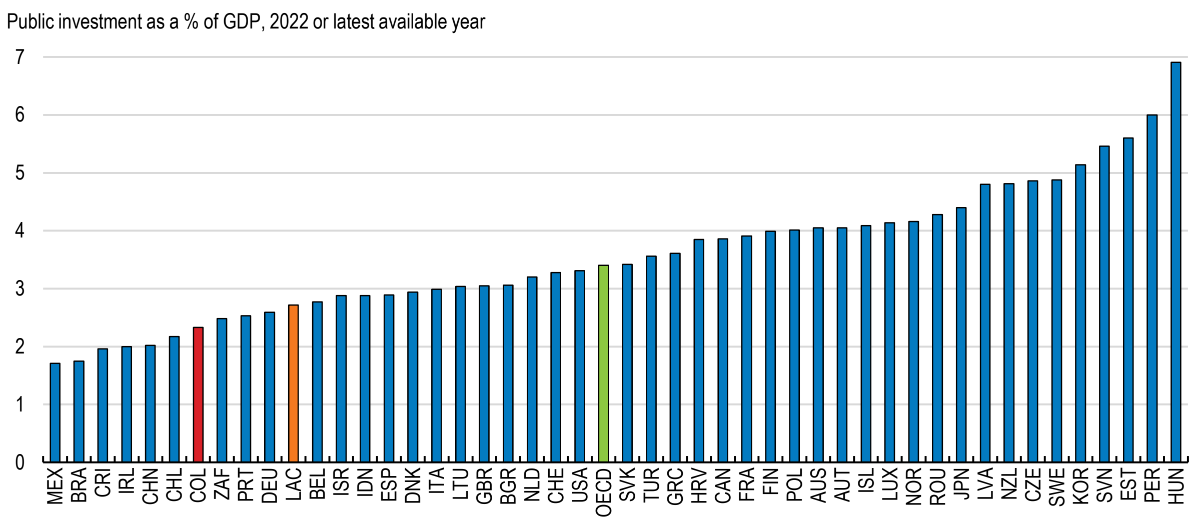
Mountainous geography contributes to high logistics costs but closing large gaps in road infrastructure can help reduce transport costs. While a well-established public-private roadbuilding progamme has helped improve many national trunk roads, transport infrastructure and connectivity are especially poor in rural regions. Most (94%) rural roads – which make up 70% of the country's road network – are unpaved, and often in poor state (OECD, 2022[80]; CONPES, 2023[30]). Some rural in-land areas are only reachable by river transport. The long-lasting violent conflict has left rural roads in the most affected areas underdeveloped. Developing rural roads would help connect vulnerable areas to government services – including healthcare, education, security, and justice – and to markets This would also help put forward alternatives to illicit crop growing which is still prevalent in many former conflict areas. The lack of connectivity in rural regions has further widened the development gap with urban areas and a feeling of abandonment (OECD, 2022[80]). Low public investment (Figure 3.21), making up only 2.3% of GDP compared to an OECD average of 3.3%, can explain Colombia's persistent infrastructure gap (Ramírez-Giraldo et al., 2021[81]).

Improving rural roads should be a priority for infrastructure policy. Since the construction and upkeep of rural roads – which connect the municipal seats with surrounding villages – is mainly under the responsibility of municipal governments, improving their capacity to implement, manage, and supervise projects (see below) would contribute to improving rural road transport. This can include involving the local community (OECD, 2022[80]). As part of its grassroots ("popular") economy strategy, the government promotes "public-popular associations", to involve rural communities and grassroots community associations in the upkeep and upgrading of rural roads and other public procurement projects. To succeed, the government will need to verify that the communities can execute projects, maintain project quality and technical standards, safeguard governance and competition, and prevent corruption. Considering previous experiences with "union service contracts" in Colombia, where associations were specifically formed to circumvent hiring under standard labour laws (OECD, 2016[75]), due diligence on community organisations will be required to ensure that these are genuine, democratic, and accountable associations of community members. Moreover, empirical evidence suggests that road contracts assigned in non-programmatic ways incurred a higher cost than those awarded competitively (Bonilla-Mejía and Morales, 2024[82]). To fully leverage cooperatives for improving rural infrastructure, it is essential to enhance their regulatory compliance and mitigate risks of failure or misuse by strengthening supervision (OECD, 2022[83]). Moreover, decisions on infrastructure investment, especially projects financed by public investment where a market-based business case based on user fees is often unfeasible, should be guided by sound cost-benefit analysis.

Figure 3.21. Public investment is low



Note: LAC is the simple average of Brazil, Chile, Costa Rica, Mexico, and Peru.
Source: OECD (2023), *Government at Glance 2023*.

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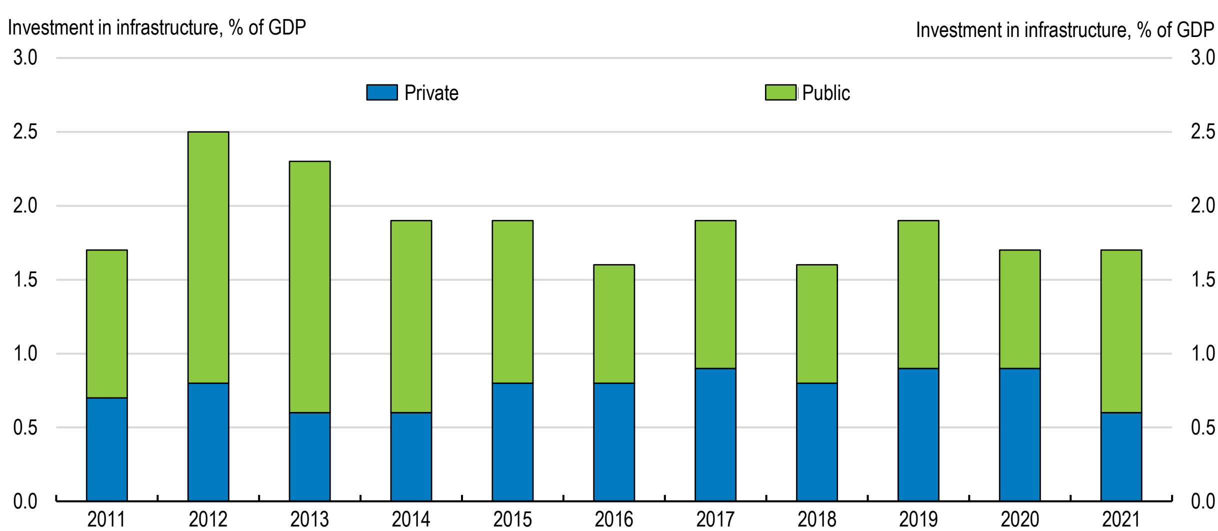
Rail and river transport offer a great potential to complement transport along the road network, as well as to aid with the government's decarbonisation and emissions reductions plans. However, rail and river transport other than for minerals and fuels are rarely sufficient by themselves to link markets but require connectivity with other transport modes to complete the logistics chain. Railroad development has been neglected at the expense of roads since at least the 1980s. As a result, Colombia's railway infrastructure is poor, with 49% of the rail network inactive and 5% dedicated exclusively to coal transport (OECD, 2022[80]). A 2020 Railway Master Plan promises improvements in the rail infrastructure, and the portfolio of the next generation of public-private infrastructure projects (see below) has been widened to also include railway projects. Authorities should be vigilant that these plans result in a meaningful transformation of and improvements to the country's rail infrastructure.

Colombia's rivers provide a passenger and freight transport alternative with great potential for use. Out of the almost 25,000 km of rivers, 74% are navigable and less than 20% allow for permanent year-round navigation. However, important sections of major rivers including the Magdalena – which provides a connection from the sea to within 100km of both Bogotá and Medellín – are not fully navigable year-round for larger boats without additional engineering works, and fluvial port infrastructure is often outdated.

Improving the smooth interplay among different modes of transport is a priority for the development of transport infrastructure (OECD, 2022[80]). While 99% of all imports (by weight) occur by ship, 77% of all internal shipments are by road, and only 18% by rail and 5% on rivers, according to the Ministry of Transports' National Register of Freight Shipments. Moreover, between 2015 and 2021 more than 80% of public transport investment went into roads, 9% into airports, and only 1% into rail and 0.2% into river transport. The 2023 update of the Intermodal Transport Master Plan envisages a greater connectivity among different forms of transport, with road development increasingly conceived as a complement, especially for the first or last miles of a cargo shipment, with rail and river infrastructure. Such welcome vision, however, requires the successful implementation of the rail and river transport masterplans, which should be a priority for authorities; including by ensuring the implementation of the multimodal transport projects included in the 2022-2026 pluriannual investment plan. It also requires resources: the implementation of the Master Plan would need funds equivalent to close to 20% of GDP, spread out until 2045 (DNP, 2023[84])

The private sector plays a significant role in infrastructure development (Figure 3.22). Colombia has a well-established framework for public-private partnerships (PPPs). The framework dates back to the 1990s and has been leveraged to improve primary roads in the past (OECD, 2019[22]). Projects currently under execution – mostly motorways and other national trunks roads – belong to the 4th generation of the programme ("4G"). Project execution under 4G has significantly slowed down in 2023, contributing to the decline in private investment. According to authorities, this is largely because 4G projects are either fully or largely completed (and hence room for additional investments is minor) or are still in the pre-construction phase, held up by environmental permits, delays in prior consultation with Indigenous communities, and similar issues. Moreover, tight financial conditions and high interest rates induce banks and builders to wait before closing project financing contracts, and uncertainty over the government's commitment to contractually agreed road toll increases might make companies more cautious. Projects in the 5th phase (5G) are currently under adjudication, and some first projects have already been adjudicated. They include not only roads but also other forms of transport (e.g., rehabilitation of a canal waterway). PPPs have also recently been extended to cover non-transport infrastructure such as water treatment plants and hospitals and are planned to cover other social infrastructure such as educational institutions. Expanding PPPs to renewable energy would further help advance the energy transition.

Figure 3.22. A substantial share of infrastructure investment is financed by the private sector



Source: Consejo Privado de Competitividad, *Informe Nacional de Competitividad 2023-2024*.

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Ambitious plans to improve transport infrastructure and to usher in the green transition all rely on the ability to crowd in private investment. While Colombia's framework is already strong, there is room for improvement in several dimensions to increase the efficiency and agility of PPP project implementation. Planned steps by authorities, including an institutional strengthening of the technical secretariat in the National Planning Department, and further increasing the application of value-for-money criteria to strengthen the cost-benefit analysis of projects, a strengthening of capacity in sub-national entities, and support for project structuring, are all appropriate steps in this direction. Despite the potential of PPP to deliver much-needed infrastructure investment under limited fiscal space, they require carefully designed frameworks to mitigate some of the inherent risks (Box 3.6).There is further a need for stronger standardisation of contracts to improve both the legal certainty and predictability for investors and to harmonise the conditions for public use of the infrastructure, for example the user fees of toll roads, which can vary strongly. Another area for improvement is the allocation of land rights on which infrastructure is built. Land disputes are a main reason for delays in the start of the construction phase. The planned rollout of the multipurpose land registry (see below) promises improvements in this area. Systematically involving communities in early stages of infrastructure projects, especially when formal prior consultation is required, would further reduce the incidence or intensity of land disputes.

Box 3.6. Best practices on public-private partnerships (PPPs)

PPPs help governments develop long-term infrastructure projects despite limited fiscal space and administrative capacities by leveraging the private sector's project management expertise and funding. However, the complex and long-term nature of PPPs contracts, which are inherently incomplete and cannot fully predict future conditions, creates risks that governments must manage.

Fiscal risks involve government guarantees for demand shortfalls, exchange rate risk, or early termination. On the other hand, the fact that PPP projects often cover critical infrastructure or services creates a moral hazard risk for the government to agree to renegotiation or even take over the project and all its liabilities in case of difficulties. A good practice to make contingent fiscal risks transparent are to incorporate them into the country's Medium-Term Fiscal Framework; a practice which Colombia adheres to. In addition, Colombia operates a fund to cover public sector contingent liabilities of PPPs.

Long-term project risks make it difficult to ensure value for money ex post if conditions change. Upfront commitment – by both the public party and the private operator – to all project costs along the lifecycle along with accountability is key. Accountability means that government payments are conditional on the private party providing the specified outputs at the agreed quality, quantity, and time frame. In most European countries, the grounds for termination due to fault of the private party are clearly defined, which adds to the predictability of PPPs contracts and improves financing conditions by increasing the acceptability of future PPPs payment streams as collateral (Allan & Ovary, 2013[85]).

Source: OECD (2012) Recommendation of the Council on Principles for Public Governance of Public-Private Partnerships; World Bank (2017) Public-Private Partnerships Reference Guide, Version 3.

Digital infrastructure is another area where an important share of investment is carried out by the private sector. However, higher construction costs and lower economies of scale in low density rural areas often reduce the business case for private sector providers. As pointed out by a previous *OECD Economic Survey* and the 2022 Rural Policy Review, Colombia is the OECD country with the largest rural-urban divide in digital connectivity (OECD, 2022[80]; OECD, 2019[22]). While a previous policy succeeded in creating a public broadband backbone to connect each municipal seat, a "last mile" problem of connecting individual users to the network persists. Improving individual internet connectivity requires a mix of solutions including addressing regulatory bottlenecks and improving coordination among stakeholders to lay local connections, exploring solutions based on satellite or mobile data networks, speeding up the implementation of public Wi-Fi access points and kiosks, and improving the regulatory framework to ease the creation of community networks, which in other countries such as Mexico and Brazil facilitate access on a non-profit basis in rural areas where the service offered by the main commercial providers is absent or prohibitively costly (OECD, 2022[80]). Cost is a major impediment for internet connectivity of poor households, with only 40% of poorest quintile households connected to the internet compared to 93% in the richest quintile, in addition to Colombia's complex geography.

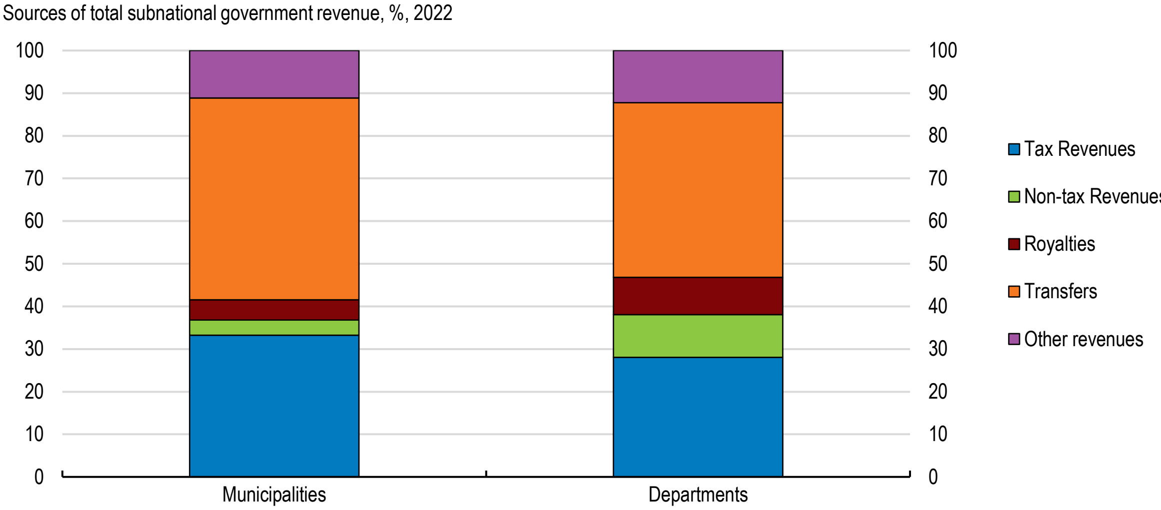
Logistic performance indexes suggest that, beyond improving infrastructure, Colombia has also room to improve the quality of logistics services (Figure 3.20, Panel B). As discussed in a previous *OECD Economic Survey* (OECD, 2019[22]), logistics performance has decreased over time and evidence suggests that this had a negative impact on exports. An area where Colombia performs particularly poorly is the customs clearance process. Clearing times are high. It takes ten times as many hours to comply with documentary requirements for importing and exporting in Colombia than it does in the average OECD country (World Bank, 2023[86]). According to the 2022 OECD Trade Facilitation Indicators, customs performance could be improved by expanding the acceptance of copies of documents, expanding the coverage of Authorised Economic Operator programmes, making greater use of advance rulings, and taking a more risk-based approach to controls.

3.3.2. Reforming fiscal decentralisation and subnational governance arrangements

Colombia's subnational governments – regions (called departments) and municipalities – have significant financial resources and spending responsibilities (OECD, 2015[87]). About half of subnational governments' income comes from inter-governmental transfers (Figure 3.23). However, subnational governments have little autonomy to decide on the use of transferred funds. There are two main transfer systems, the revenue sharing system that redistributes funds mostly earmarked for specific sectors – mainly health, education, and water sanitation – and the royalty transfer system, the main source of finance for public investment by subnational governments (Box 3.7).

Figure 3.23. Transfers make up half of subnational government revenues

Sources of total subnational government revenue, %, 2022



Note: The data refer to effective cash operations, i.e., the spending implemented from different sources of revenue, which might refer to the budget allocations defined ex ante.
Source: Departamento Nacional de Planeación (DNP).

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A high-level commission (*Misión de Decentralisación*) is reviewing subnational governance arrangements and providing reform recommendations to redefine the arrangements and responsibilities of subnational governments (Box 3.8). In all main aspects, the findings and recommendations in this subsection are aligned with those of the commission. These include the need for clarification of responsibilities and their differentiation according to the characteristics and capacities of territories and their administrations; a simplification of the revenue sharing system with a greater role for fiscal equalisation; an overhaul of the resource allocation mechanisms of the royalty transfer system; and the creation of a regional convergence fund.

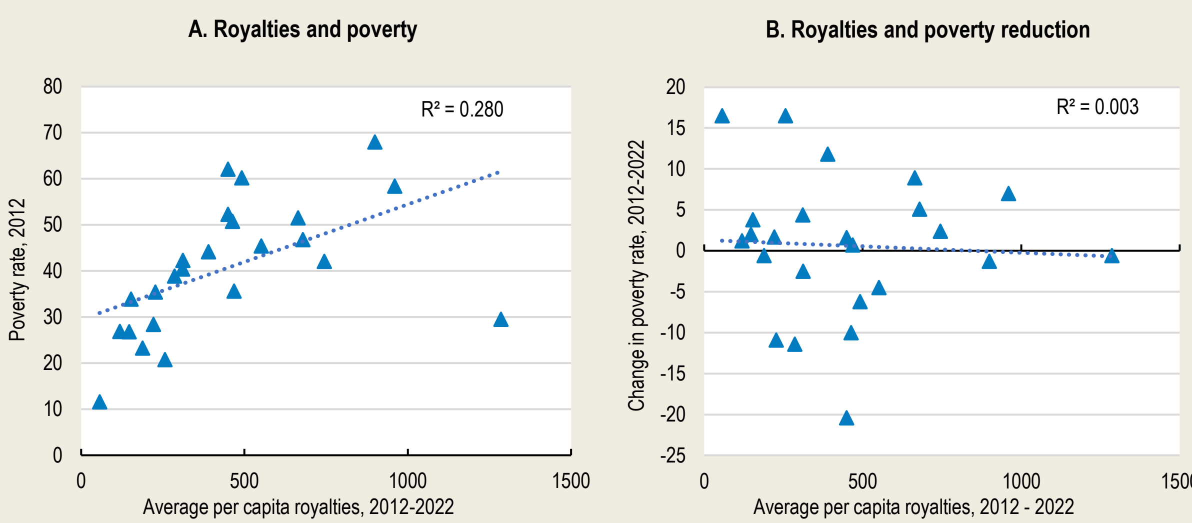
Box 3.7. Main features of fiscal decentralisation in Colombia

Colombia is one of the most decentralised unitary countries in Latin America (SNG-WOFI, 2022[88]). About half of the income of subnational governments are transfers, a share very similar to the average in OECD countries.

The **revenue sharing system** (*Sistema General de Participaciones*) regulates fiscal transfers from the national government to subnational authorities to finance current expenditure. Most of the transfers in this system are earmarked by the Constitution to sectors such as education, health, and sanitation as a fixed proportion of aggregate transfers. The allocation of aggregate transfers for each sector to individual subnational entities is based on a complex formula defined by law that includes different variables (e.g., test scores, enrolment rates, drop-out rates in education) and development indicators. Only about 10% of the transfer income is not pre-allocated to sectors. This leaves subnational governments with the role of implementing plans and budgets decided elsewhere.

Transfers from the **royalty transfer system** (*Sistema General de Regalías*) are the main source of finance for public investments in subnational governments. The system distributes royalties from the extraction of non-renewable natural resources, which according to the Constitution belong to the nation. After a reform in 2011, all subnational governments are eligible to receive royalty transfers, but those with a direct role in natural resource extraction receive a higher share than others. Some parts of royalties are earmarked. To receive royalties, subnational entities need to apply with specific investment projects, which need to be part of their respective official development plans. While poorer regions typically benefit from higher royalties – both for regional and municipal governments – those higher royalties have not been successful in reducing poverty over the last decade (Figure 3.24).

Figure 3.24. More royalties accrue to poorer regions, yet do not result in poverty reduction



Note: Each point corresponds to a region. Royalties per capita of a region represent all the revenues from the royalty transfer system (including both departmental and municipal revenues) in real terms (COP thousands, 2012 prices).
Source: OECD calculations based on data from the Ministry of Finance, Departamento Nacional de Planeación (DNP); and DANE.

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There is a large degree of duplicity of functions across levels of government (Bonet, Pérez V. and Ayala, 2014[89]; OECD, 2019[90]). This reflects the incomplete decentralisation process, which at times has been reversed (López-Murcia, 2022[91]). Some responsibilities such as education, health, water, sewage, and social assistance – which account for a majority of subnational government expenditure – are shared across all levels of government (SNG-WOFI, 2022[88]; OECD, 2019[90]). While such arrangements are not uncommon in OECD countries, a lack of a clear delineation of responsibilities may lead to fragmentation, inefficient overlap, and poor incentives for each level of government that may try to pass the blame for poor service quality to other entities (OECD, 2021[92]).

A successful clarification of responsibilities requires a transparent division of power, a corresponding level of revenues, and an assignment of responsibilities to the level of government which best corresponds to the intended user group and geographical reach (OECD, 2019[93]). For example, during the 2007 reform of subnational administrations in Denmark, regions were granted responsibilities for the most demanding healthcare services, while municipalities were assigned responsibilities for health promotion, social welfare, and public health education. To reduce cost-shifting, municipalities co-finance shared ressources at the regional level, such as rehabilitation facilities.

Box 3.8. Findings of the decentralisation commission

Commissioned in 2021, the *Misión de Descentralización*'s objectives were to carry out technical analysis and present proposals to redefine the arrangements and responsibilities of subnational governance. The commission was composed of academic experts, senior civil servants and elected officials and presented its draft report to Congress in February 2024.

Its main reform proposals are:

- A new typology of territorial entities that considers new delegation of responsibilities, technical assistance, and policy priorities.
- A reform of the law defining subnational governance arrangements to clarify responsibilities, strengthen collaboration, and allow for differentiation.
- Simplification of the revenue sharing system, with fiscal equalisation as the main criterion.
- Establishing a regional convergence fund.
- Defining a subnational fiscal framework.
- Strengthening information systems and collaboration mechanisms across entities.
- Strengthening open governance and citizen participation.
- Creating a new territorial entity for Indigenous territories.

Source: Misión de Descentralización (2024), "La misión de descentralización: Una oportunidad para el desarrollo regional."

The allocation of responsibilities across different levels of government would benefit from more clarification, considering both subsidiarity – i.e., the principle that local problems are best solved locally – and capacity. There can often be a vicious cycle that prevents capacity development – responsibilities are not delegated to local and regional authorities because of a lack of capacity, which in turn prevents those authorities from gaining experience to strengthen their capacity. Responsibilities should be linked with capacity development, including through mechanisms which allow for delegation of responsibility and capacity development to occur gradually and in tandem (see below). Given the large heterogeneity across Colombia's territory, there is scope for asymmetric decentralisation (OECD, 2019[90]), meaning differentiation in the delegation of responsibilities and decision-making based on regional characteristics. Metropolitan areas could be given greater responsibilities and autonomy – for example, to create metropolitan transport authorities, a model which is being piloted in Cali – whereas in remote rural areas, the distribution of capacities and economies of scale would imply that regions take over more responsibilities from municipalities. The development of typologies for territorial entities, such as the one recently developed by the National Planning Department, would provide an administrative tool to support such policy changes.

Colombia's parallel multiple fiscal transfer systems and their design (Box 3.7) contribute to the complexity of subnational government finances. Rules for assigning revenue transfers are complex, based on different income bases, and in many cases earmarked to specific spending categories. These rigidities restrict the possibility of local governments to plan and finance projects and initiatives that respond to local needs and priorities, such as in infrastructure and other public services, or accommodating migrants. At the same time, spending rigidities and complex assignment mechanisms limit the targeting of resources according to pro-development criteria. Moreover, the revenue transfer system, which in principle could play the role of a fiscal equalisation mechanism, achieves only limited equalisation. Inequality in revenues per capita before transfers is very high in Colombia, with a Gini coefficient of above 40 (Table 3.2), compared to about 20 on average across OECD countries. The revenue transfer system cuts the dispersion in municipal per capita revenues in half, but barely changes the revenue dispersion of regions.

The fiscal transfer systems should be reformed with several simultaneous objectives in mind: improving fiscal equalisation mechanisms, strengthening mechanisms to address development needs and promote convergence, and simplifying the system (OECD, 2019[90]). These objectives could be achieved in several ways, including consolidating into a single system or alternatively reforming the existing parallel systems but improving coordination between them (OECD, 2015[87]).

The formulas to assign transfers in the revenue sharing system could be simplified and consider tax revenue equalisation and closure of gaps in living standards or public services such as education and health coverage. For example, the Swiss fiscal equalisation system combines horizontal tax revenue equalisation with special funding allocations for regions with low tax-raising capacity or high spending needs due to a region's socio-demographic profile or challenging geography. The Swedish system combines an income equalisation system with cost-equalising grants that balance the cost differences in delivering a public service in rural or remote areas.

Table 3.3. There is large dispersion in subnational fiscal revenues

Gini Coefficient of per capita revenues across subnational governments, 2022

	Revenues before transfers and royalties	Revenues after transfers	Revenues after transfers and royalties
Municipalities	40.0	20.3	22.8
Regions	44.1	36.8	39.0

Source: OECD calculations based on data from Departamento Nacional de Planeación (DNP).

Allowing subnational governments to re-use unspent funds from one sector in another sector would make the revenue sharing more flexible and adaptive to local needs and improve overall budget execution in subnational governments. However, these considerations need to be carefully balanced against possible incentives for subnational governments to underspend earmarked funds to free resources for other purposes. At the same time, the system should offer higher flexibility to adapt spending to local needs and priorities, for example by combining a basic allocation with additional funds that could be awarded competitively based on needs and the quality of proposals. A reform of subnational finances could also create greater incentives for municipalities to invest into their own revenue collection, for example by offering rewards such as matching grants tied to above-average revenue collection. A reform could also condition some grants on the achievement of targets, such as improvements in coverage or quality.

Instruments for fiscal transfers to subnational entities can also be designed with the specific objective of regional convergence. For example, the European Union's (EU) cohesion policy aims at balanced territorial development, with three quarters of resources for investment allocated to regions with a GDP per capita below 75% of the EU average (OECD, 2021[94]). Many EU place-based policies contain transparently defined eligibility criteria which regulate the disbursement of subsidies, for example business investment subsidies, based on local criteria (i.e., the local unemployment rate or GDP per capita). An evaluation of such policies in the United Kingdom found that they increase employment especially in small firms in areas eligible for subsidies, but not productivity (Criscuolo et al., 2019[95]). Colombia could adapt these examples and provide some fiscal transfers or direct subsidies according to regional development indicators. The proposed regional convergence fund is indeed a step in this direction. Well-designed cohesion policies could further include incentives for structural transformation as well as institutional upgrading, such as making disbursement conditional on transparency and competition in public procurement (OECD, 2021[94]).

The capacity of subnational governments to directly raise revenue can be improved. Subnational tax revenue amounts to about 3-4% of GDP, or about a third of total subnational government revenue (see Figure 3.23) – similar to the OECD average (OECD, 2023[96]). There are important differences in revenue generation between departments and municipalities. The most important sources of tax revenues for municipalities are local business taxes and recurrent property taxes, which together made up around 70% of total municipal tax revenue in 2023. While those revenues have grown over time, they are often still low for the 90% of all municipalities classified as small (Bonet, Pérez V. and Ayala, 2014[89]). Many of these municipalities are not even able to cover their current administrative expenditure from their own income, relying on transfers instead. The roll-out of the land registry will improve municipal property tax collection, but the small tax base in smaller and poorer municipalities limits how much revenue can be raised. Revenue from recurrent immovable property taxes (0.8% of GDP) is already the highest among Latin American countries and close to the OECD average (Chapter 2).

The tax base is especially thin for regions. Most of their own tax revenues come from “sin taxes” (i.e., excise taxes on alcohol, tobacco products, etc.), in addition to stamp duties and vehicle taxes. Smuggling and other illegal activities significantly reduce the tax base that regions can rely upon. Overall, tax revenues of regions make up only 0.7% of GDP, and their total budgets 2.6% of GDP. This seems insufficient for regions to fulfil their roles, especially if they are expected to take a more active role in supporting rural municipalities, as recommended previously by the OECD (OECD, 2019[90]; OECD, 2016[97]). Several options exist to raise regional tax revenues, including increased efforts to tackle illicit trade in tobacco and alcohol products, promoting shared taxation between the national and subnational governments, or promoting more flexibility in terms of user tariffs and fees and optimising income from properties (OECD, 2019[90]; OECD, 2016[97]).

Capacity in many subnational governments remains low. Typically, large urban municipalities and wealthy departments with a strong economic base and a concentration of population, firms and economic actors, have good capacity to raise taxes, create impactful programmes and projects, and administer their resources. The certification system ensures that a greater share of responsibilities is devolved by them. By contrast, for many poorer and often rural municipalities the region takes over many responsibilities for implementing and executing programmes. While these arrangements are generally sensible, they perpetuate existing large differences in capacity. Colombia therefore needs mechanisms to gradually devolve responsibilities at the same time as developing capacities to fulfill them.

A good example that reunites these principles and that Colombia could consider mainstreamining into other areas are the Territorial Pacts (previously called *Contratos Plan*) used for infrastructure development. Those contracts are binding agreements between the national government and sub-national authorities to coordinate their investment agenda and jointly deliver a defined list of interventions (OECD, 2016[98]; OECD, 2014[7]). Within the contract framework, sub-national governments have certain autonomy to decide on how to allocate the given budget to achieve the plan’s objectives, while working together with national officials. This contributes to building implementation capacities and spending responsibilities at the subnational level.

The new land registry increases opportunities for municipalities for raising own fiscal revenue. This, however, requires sufficient administrative and human resource capacity in municipal governments, which have now become responsible for managing the registry and keeping it up to date. Authorities should ensure sufficient capacity-building takes place. Regional governments might further be able to assist municipalities by centralising tasks, for example by identifying properties based on the registry and determining applicable tax bills.

Decentralisation would also benefit from good co-ordination mechanisms across levels of government and cross-jurisdictional cooperation (OECD, 2019[93]). The 2019 Pact for Decentralisation promotes joint projects between individual subnational administrative entitites. The Pact strengthened the Administrative Planning Regions created by the 1991 constitution, which are associations of several departments and municipanities, and which since a 2022 legal change are now independent legal entities. In addition, municipalities can join Territorial Association Schemes to bid together for cross-municipality projects funded by the royalty transfer system. Both of these administrative innovations are steps in the right direction – and complement earlier initiatives for inter-municipal cooperation for example in urban transport – to create projects with a regional economic impact beyond the boundaries imposed by administrative divisions. However, incentives for participation and cooperation in these schemes could be improved (OECD, 2023[34]). In Finland, for example, where municipalities were until a 2023 reform the only subnational level of government, inter-municipal cooperation, in part faciliated by regional councils that are formed by associations of municipalities, is very common, with a trend towards larger co-operative units to benefit from economies of scale and scope. Colombia could consider providing financial incentives to support horizontal associations across municipalities and departments (OECD, 2016[97]).

3.3.3. Implementing the Peace Agreement to boost rural development

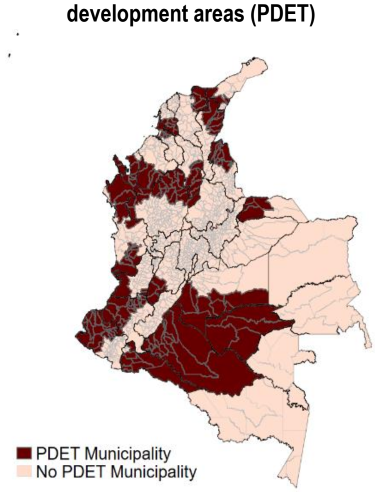
The armed conflict that Colombia suffered for many decades had severe consequences for livelihoods and the country's productive capacity, especially in conflict-prone areas. Infrastructure was destroyed, investment confidence was diminished, and 8.5 million Colombians were forcefully displaced, according to the National Registry of Victims, many of them rural farmers. Land concentration in Colombia is higher than in any other country of the region, with the top 1 percent of farms concentrating more than 80% of the land (World Bank Group, 2021[8]) and is both a source and a result of violent conflict (OECD, 2022[80]). The Peace Agreement that entered in force in 2017 between the government and the major insurgent group FARC marked an important milestone for advancing peace and development. There is room for advancing and improving the Peace Agreement's implementation and impact on economic catch-up and convergence of rural areas (OECD, 2022[80]). Evidence points to large and lasting effects of programmes related to the peace process, such as reparations for victims (Guarin, Londoño-Vélez and Posso, 2023[99]) and economic returns to peace – such as greater confidence, higher aggregate demand, and more investment especially from abroad (Gaviria et al., 2015[100]).

The development strategy laid down in the Peace Agreement has a strong territorial character. Special development areas, PDET (*Programas de Desarrollo con Enfoque Territorial*), have historically been most affected by armed conflict, poverty, institutional weaknesses, and the presence of illicit crops and receive earmarked funds and assistance. The 170 PDET municipalities make up 36% of the national territory and contain a quarter of the rural population. They are concentrated in rural mountain ranges and the Amazon basin (Figure 3.25, Panel A). However, since the signing of the Peace Agreement, the incidence of conflict has not seen any sustainable reduction due to the continued presence of different armed groups in the territory (Figure 3.25, Panel B).

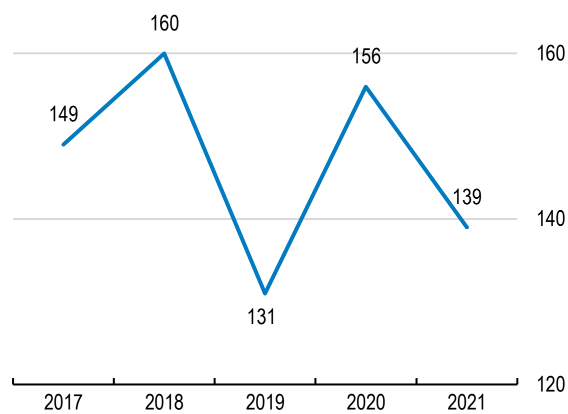
The rural reform (*Reforma Rural Integral*), a cornerstone of the rural development strategy in the Peace Agreement, seeks to improve access to land, promote rural productivity and competitiveness, strengthen rural institutions, and enhance the well-being of rural populations, particularly smallholder farmers, Indigenous people, and Afro-Colombian communities. This reform addresses long-standing challenges in the agricultural sector resulting from decades of conflict and poor policy choices (OECD, 2015[101]).The land reform seeks to provide over 3 million hectares of agricultural land to rural dwellers with no or insufficient land, and the formalisation (via land titles) of another 7 million hectares. Other components of the rural reform are focused on encouraging productive investments by farmers and include the provision of credit and agricultural extension services to newly formalised farmers, illicit crop substitution programmes, and a systematic horizontal integration of PDET into national policies, especially infrastructure plans and social protection policies. The 2022-2026 Multi-Annual Investment Plan allocates COP 50 trillion (around 3% of GDP) for the implementation of the Peace Agreement, about 80% is earmarked for rural development, in particular education, health, and infrastructure.

Figure 3.25. The Peace Agreement aims at fostering rural development in Colombia

A. Geographical distribution of special development areas (PDET)



B. Number of municipalities with high and very high conflict incidence



Note: PDET are special development areas designated by the Peace Agreement, made up of municipalities which have historically been the most affected by armed conflict, poverty, institutional weaknesses, and the presence of illicit crops.
Source: Agencia de Renovación al Territorio (ART), Programas de Desarrollo con Enfoque Territorial – PDET; and Departamento Nacional de Planeación (DNP).

StatLink https://stat.link/gku1jm

Implementation of the land reform has been slow and has not always brought about the desired structural transformation of post-conflict areas (CGR, 2023[102]). By March 2023, only about 20,000 ha (less than 1% of the final objective) of land had been restituted and only about 3m ha (45% of the objective) had been formalised. Accelerating this pace requires an adequate budget for land acquisition as well as enabling authorities to identify suitable agricultural land, as well as its owners. The 2024 budget contains a significant increase in current expenditure for the implementation of the Peace Agreement, with the objective of acquiring 500,000 ha of land for redistribution in 2024. COP 5tn (0.3% of GDP) have been allocated for this purpose from the national budget and special funds. Formalising the ownership of land would help remove distortions introduced by informal tenancy and displacement, help develop land markets for a more efficient allocation of productive land, and better inform public policy related to land and food security (OECD, 2023[34]).

The development of a modern cadastre system would help advance the implementation of the land reform. Land registers especially in rural areas plagued by conflict, and in which land might have frequently changed hands informally or unlawfully, are incomplete and outdated. This poses not only a constraint for the formalisation component of the land reform – which implies creating a land title for the rightful owner – but also in other areas. Infrastructure projects are often held up by uncertainties or litigation around ownership of the land where it should be built upon. Moreover, information on land valuation is often outdated, distorting tax collection and other public services. A functional and complete rural cadastre would be the starting point to promote a better use of land, as it would improve legal certainty and facilitate transactions, give incentives for a better use of land, and help attract private investment (OECD, 2019[22]). Moreover, the multipurpose land registry includes information of actual and potential use of each property, which would help implement the large-scale land agricultural land acquisition programme.

Colombia is introducing a multipurpose land registry and should accelerate its roll out. In contrast to traditional cadastres, which are often designed for specific purposes (e.g., tax), the multipurpose cadastre (*catastro multipropósito*) is a unified land registry for any purpose (legal, fiscal, statistical, etc.) offered as a public service to citizens. The registry covered 45.9 million hectares in June 2022, a significant increase from 2019 when only 2.5 million hectares were registered (CPC, 2023[103]). The authorities have committed to update at least 70% of the multipurpose cadastre by 2026 from 12.4% today. Further developing the multipurpose land registry requires harmonising information across sources, for example, the property tax database and the land tenancy registry which might not be aligned. To keep the cadastre up to date, interoperability across different systems and different user groups is needed. Strengthening capacities of local governments with technical assistance, ensuring permanent human and financial resources dedicated to the cadastre, and fostering close coordination with national and other local governments are other essential measures for sustaining an effective cadastre (OECD, 2022[80]). In the past, the political economy of an improved land registry which might lead to higher taxes on large landowners has also proved challenging (Vargas and Villaveces, 2016[104]).

The allocation of funds related to the Peace Agreement could be improved. A portion of funds from the royalty transfer system is earmarked for PDET municipalities, and allocation is decided by the OCAD PAZ committee. Historically, applications to access these funds were decided on a first-come, first-served basis, which resulted in a concentration of funds in some municipalities, while many of the poorer municipalities were left out. In 2023, the methodology for assigning funds was changed to a more technical scoring approach based on gaps in development indicators. Authorities should monitor whether the change in methodology brings local PDET plans and funding allocation closer to local needs.

Table 3.4. Past OECD recommendations on boosting productivity and growth

Past recommendation	Actions taken since the 2022 survey
Reduce domestic regulatory barriers to entrepreneurship and market entry.	Introduction of one-stop shops in 84 municipalities across all local chambers of commerce.
Continue investing in infrastructure improvements, including intermodal transport facilities such as rail-road connections.	Update of Intermodal Transport Master Plan in 2023. Intermodal transport projects are included in the new PPP infrastructure projects phase.
Reduce the handling times in ports, including those caused by customs and other agencies.	A National Port Policy was issued in 2023 (CONPES 4118) but implementation is pending.
Eliminate recurring business registration fees.	Lowered fees but not eliminated.
Scale up professional training programmes to help workers acquire the skills needed to move into new jobs.	No action taken
Actively engage in signing additional bilateral trade agreements to obtain better market access.	In 2024 an Economic Complementation Agreement was signed with the United Arab Emirates.

Table 3.5. Recommendations for boosting productivity of Colombia's regions

MAIN FINDINGS	CHAPTER 3 RECOMMENDATIONS (Key recommendations in bold)
Improving general framework conditions to lift productivity	
Productivity is low and stagnant and productivity gaps between regions are large. Business informality is high. Regulations on product markets and administrative barriers restrict entry of formal firms. Virtual one-stop shops have been introduced in larger cities.	**Reduce the costs of doing business formally, especially for small firms, by expanding one-stop shops that fully integrate national and sub-national procedures.** Encourage take-up of the simplified tax regime; and re-introduce the simplified insolvency regime. Systematically incorporate place-based targeting criteria into productive development policies.
Trade penetration is low and trade barriers are high. Non-traditional exports (i.e., exports other than agricultural and mineral commodities) are concentrated in a few regions.	Reduce tariff and non-tariff barriers to trade.
Colombia is geographically well-placed to take advantage of nearshoring opportunities. Foreign direct investment (FDI) is relatively diversified, although channeled mostly to a few relatively developed regions. There is a large Colombian diaspora abroad.	Promote productivity spillovers from FDI by actively creating linkages between foreign and local firms and improving coordination between investment promotion agencies and regional competitiveness councils.
R&D spending is among the lowest in the OECD, at about 0.3% of GDP and especially among businesses. There are large regional differences in innovation and exporting.	Strengthen synergies between different policy areas focused on productive development such as innovation and industrial policies, skills policies, and regional development policies.
There are large regional differences in access to finance. Bank concentration is high, and the third-largest financial group in the country is *Grupo Bicentenario*, a state-owned enterprise (SOE).	Strengthen cooperation among the competition authority, banking regulator and financial superintendence, including in merger reviews. Regularly assess the activities and governance of *Grupo Bicentenario* by the competition authority, banking regulator, and financial superintendence.
Colombia has an active microcredit market, but it is small compared to other countries in the region. Organised crime is a major source of informal credit, at very high interest rates and with severe social consequences. Barriers include financial education, lack of credit records, and high costs.	Reduce barriers to entry into formal micro and small credit markets, differentiating between rural and urban markets. Improve take-up of financial products by enhancing financial education in the school curriculum and improving credit records indicators. Increase the number of social programmes and benefits delivered through bank accounts.
The share of young adults not in education, employment, or training (NEET) is among the highest in the OECD, with large regional differences. Performance of VET students is relatively good.	**Expand upper-secondary VET programmes, starting with the regions where few upper-secondary alternatives exist and where NEET rates are the highest.**
Formal employment prospects of VET graduates vary significantly across regions.	Improve coordination of VET courses with skill needs of local businesses and labour markets.
Corruption reduces the attractiveness of the business environment and impinges on the ability of its state to provide high-quality infrastructure and services for all its citizens. Corruption especially affects poorer and more rural regions.	**Combat corruption by better enforcing regulations on private funding for political campaigns, strengthen civil society protection, and implement standards for disclosing final beneficiaries of financial transactions.**
Fostering regional convergence and integration	
The quality of infrastructure is low and transport costs are high, reducing the integration among regions and with global markets.	**Improve the interconnectivity of ports, river, road, and rail transport.** Strengthen the capacity of local governments to improve the rural road network. Lower customs clearance times with improved procedures.
The private sector plays a significant role in infrastructure development. Colombia has an established framework for public-private partnerships (PPP). There is a lack of projects advancing in the pipeline.	Continue improving the governance of public-private partnerships (PPP), for example through greater standardisation of contractual terms and expedited assignation of land rights.
Spending decentralisation to subnational governments is substantial, but few have strong revenue generating capacity. Different transfer systems are fragmented and uncoordinated. Responsibilities for education, health and social assistance overlap across all levels of government. Administrative capacity of many subnational governments is weak.	**Strengthen fiscal equalisation mechanisms and boost revenue-raising capacities among subnational governments.** Expand mechanisms that improve subnational governments' capacity and simultaneously increase delegation of authority. Clarify spending responsibilities of different levels of government. Improve horizontal and vertical cooperation mechanisms.
Many regions and municipalities lack the necessary scale for projects. Projects funded by the royalty transfer fund are excessively fragmented.	Continue strengthening frameworks for joint projects between subnational administrative entities such as Administrative Planning Regions and Territorial Association Schemes.
The Peace Agreement provides opportunities for advancing rural development, especially in areas affected by the conflict, and lays the basis for a comprehensive rural reform. Only 1% of planned land restitutions have taken place since 2017, largely due to insufficient resources.	**Allocate adequate resources to implement the Peace Agreement, including the rural reform.**

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4 All aboard: Reducing inequalities in Colombia

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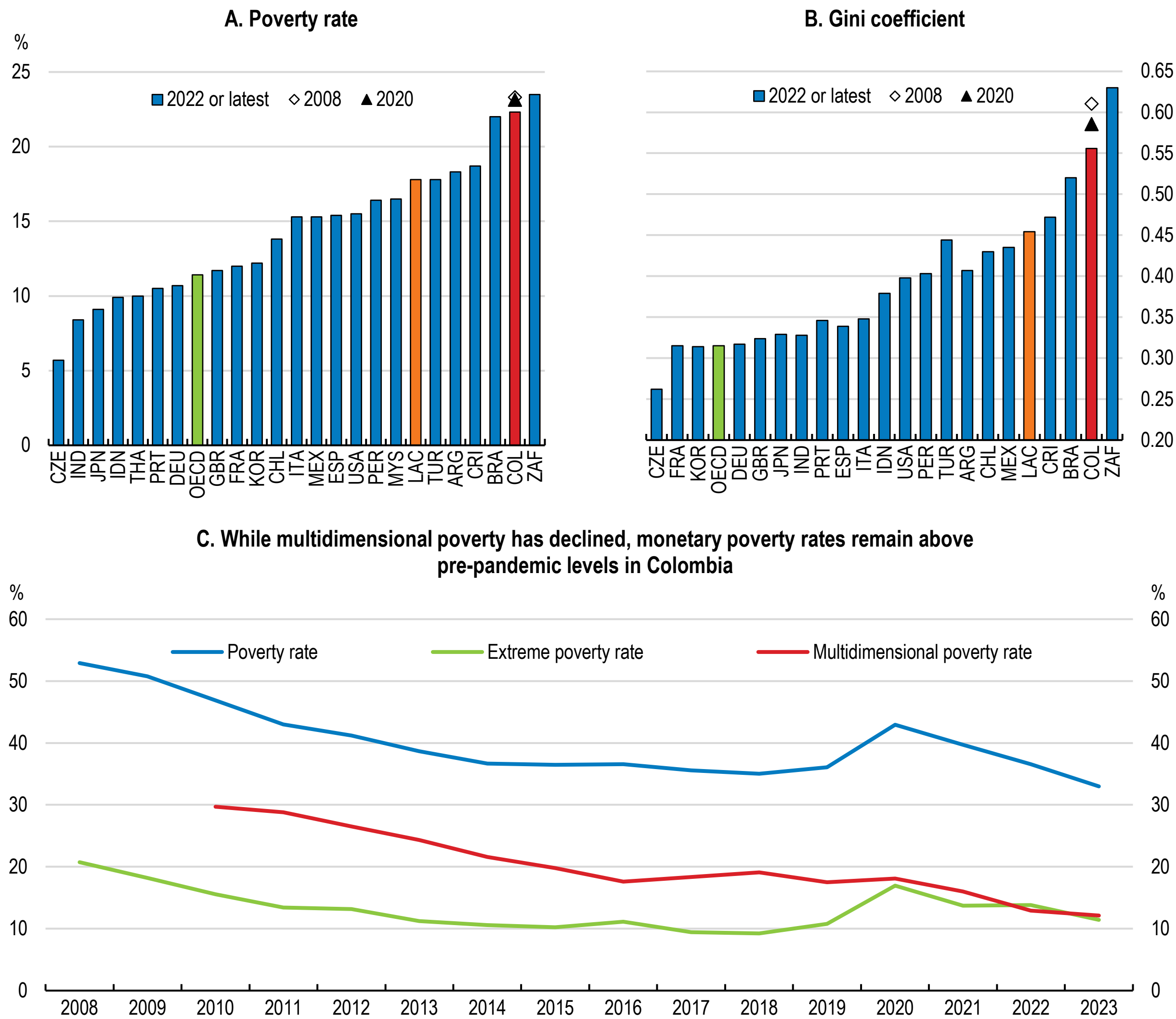
Reducing inequality and poverty remains a longstanding challenge for Colombia, despite recent improvements. Disparities in access to essential public services, education, and high-quality job opportunities, hinder upward social mobility, exacerbated by regional and demographic disparities. The government's ambitious social reform agenda holds promise for enhancing equity and opportunities. Strategies aimed at reducing informality, improving access to high-quality education, and closing gender gaps in the labour market would bolster this agenda and foster stronger long-term growth and a fairer distribution of income and opportunities.

Reducing income inequality and poverty are long-standing challenges for Colombia. Despite improvements following the pandemic driven by a strong economic recovery, minimum wage increases, social transfers and better targeting, both inequality and poverty rates remain the highest in the OECD (Figure 4.1). Multidimensional poverty has consistently fallen since 2010, but still reveals large disparities among individuals in its different dimensions, including access to health care, education, infrastructure, rural land, and adequate jobs. There are also wide disparities in income and other dimensions of wellbeing across regions (Chapter 3).

Figure 4.1. Income inequality and poverty have fallen but remain high



Note: In Panel A, poverty is defined as the share of people living in a household with income below 50% of the median disposable household per capita income. This poverty measure is different from the national definition of poverty by DANE, which is presented in Panel C. In Panel B, the Gini index measures the extent to which the distribution of income among households within an economy deviates from a perfectly equal distribution. In Panel A and B, LAC is a simple average of ARG, BRA, CHL, CRI, MEX and PER. Panel C shows poverty rates using the national definitions based on the calculation of the basic food consumption basket. Multidimensional poverty assesses various dimensions of deprivation, such as education, health, access to decent jobs, clean water, sanitation facilities, electricity, adequate housing, and other assets to provide a comprehensive understanding of poverty beyond income-based measures.
Source: *World Bank World Development Indicators*; and OECD calculations based on DANE.

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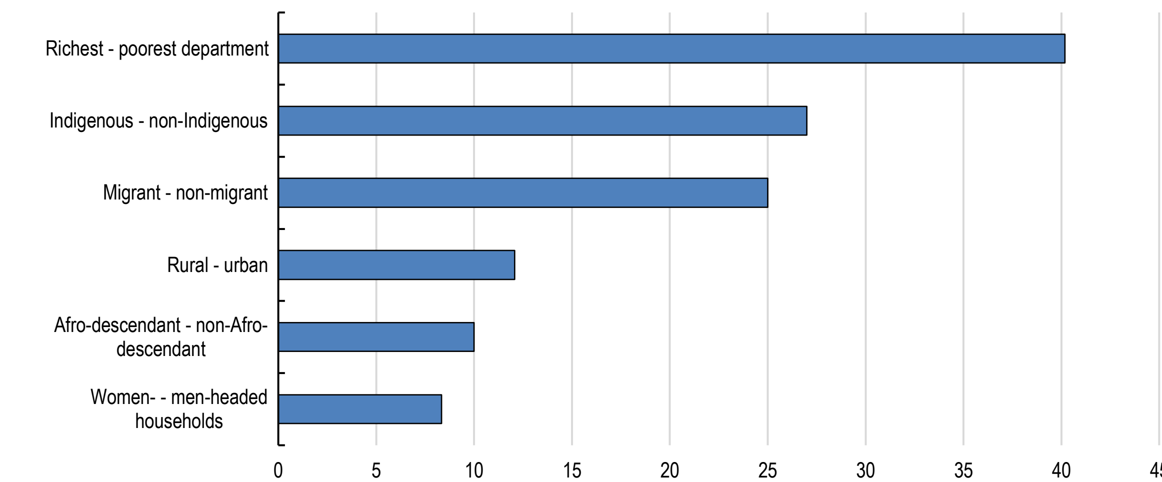
Poverty rates significantly differ among regions, rural and urban areas and demographic groups (Figure 4.2). Poverty and lower incomes particularly affect ethnic minorities and people displaced by Colombia's historical internal conflict, who are disproportionally concentrated in rural areas, as well as migrants, in particular from Venezuela. Women are also disproportionally affected by poverty, having lower employment levels and wages and a higher rate of informality when compared to men. The pension system, before the reform in 2024, left many old people in poverty and exacerbated inequalities due to low coverage of the non-contributory and contributory system and subsidies for high-income earners and low non-contributory benefits for low income retirees (OECD, 2022[1]; OECD, 2019[2]).

Figure 4.2. Poverty rates are notably higher among vulnerable groups

Gaps in total poverty rate between groups, percentage points



Note: Year 2019, except for the gap between the richest and poorest departments, rural and urban and women- and men-headed households (2022). Poverty rates are defined using the national definition based on the calculation of the basic food consumption basket.
Source: (World Bank, 2021[3]) and OECD calculations based on the Gran Encuesta Intregrada de Hogares (GEIH 2022).

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Box 4.1. The government's ambitious social reform agenda

Pension reform: The pension reform approved by Congress in June 2024 aims at expanding pension coverage and addressing competition between the two competing schemes in the contributory system. The reform will come into effect on July 1, 2025. The existing system allows members to choose between a state-run defined benefit plan, and an individual defined contributions savings account plan, managed by private pension funds (OECD, 2022[1]). The reform establishes three benefit pillars with an additional fourth voluntary pillar, as follows:

- Solidarity pensions: The non-contributory pillar is strengthened, offering eligibility to poor and vulnerable individuals aged 65 (60) or older for men (women) with minimal to no accrued pension benefits. They will receive a monthly benefit of the "extreme poverty line", currently estimated at COP 223 000 per month (EUR 53) nearly three times higher than the existing benefit level.
- Semi-contributory pensions: Individuals with 300 to 1 000 weeks of contributions but lacking the requisite of 1 300 weeks at age 65 for men or 1 000 weeks and 60 for women will receive a life annuity based on individual contributions and a state subsidy equivalent to 30% of savings for women and 20% for men. This pillar includes workers earning below one minimum monthly wage and those who contribute to the scheme BEPS who may now include these contributions in the calculation of their life annuity.

- Contributory pensions: Employees would contribute to the public pay-as-you-go scheme on earnings up to 2.3 times the monthly minimum wage and on earnings above this threshold to individual defined contribution accounts managed by private pension funds. Upon retirement, benefits from both sources would be combined into a single pension. A new public savings fund will accumulate the capital redirected from private funds and contributions to the public scheme. The normal retirement age (62 for men/57 for women) and most existing eligibility requirements remain unchanged, such as the required 1 300 weeks of contributions for men and 1000 for women. However, women with children will have shorter contribution periods, with required weeks reduced by 50 per child. Indigenous peoples, Afro-descendants, Palenqueras, and peasants have also lower required contributory weeks. Employer and employee contribution rates on earnings up to four times the monthly minimum wage will remain at 12% for employers and 4% for employees, but for earnings above this threshold, the employee contribution will increase to 6% on pay up to 25 times the minimum wage (the current earnings ceiling) to fund the solidarity pension. At retirement age, individuals with more than 1 000 weeks of contributions but less than the 1 300 weeks required for a contributory pension will qualify for an early old-age benefit equivalent to one minimum monthly wage, and the value equivalent to the missing contributions shall be deducted from their monthly allowance, until they attain 1 300 weeks. The reform introduces weekly pension contributions for self-employed and part-time workers. The transition system was set up with a requirement of less than 750 weeks for women and 900 for men.

Health: The proposed bill was shelved by Congress in early April. It aimed to improve healthcare access in rural and remote areas by reorganising the system around public primary care centres, expanding general practice clinics and bolstering diagnostic capabilities. The proposal sought to eliminate the role of Health Promoting Entities (*Entidades Promotoras de Salud*, EPS) as intermediaries, which currently collect mandatory monthly payments from employees and the government and use this funding to contract health providers to care for beneficiaries. The bill intended to consolidate all funds under a unified public entity responsible for direct payment to healthcare providers according to values set by the Ministry of Health. EPSs would transition to a new role, offering auditing, billing services, specialised technology, and advising public authorities. The government announced a new health reform with the same core elements will be presented to Congress.

Labour: The bill, in congress, aims to strengthen collective bargaining, improve overtime and severance pay, reduce working hours, and incrementally increase paternity leave. It also prohibits union service contracts and introduces part-time (weekly based) social security contributions for self-employed individuals, multi-job holders, workers in agriculture and platforms and other specific activities.

Education: The proposed bill which was shelved by Congress in June aimed to lower the mandatory education age to 3 and extend mandatory education to cover secondary education, ending at age 17. At the end of 2023, a presidential decree was enacted to extend free access to higher education in public institutions, starting from the first semester of the 2024 academic year. The legislation relaxes eligibility criteria, encompassing socioeconomic status, age, nationality, and prioritizing marginalized groups, victims of internal armed conflict, persons with disabilities, and single mothers. Notably, eligibility now includes those within the first three economic strata, representing 95% of Colombian households.

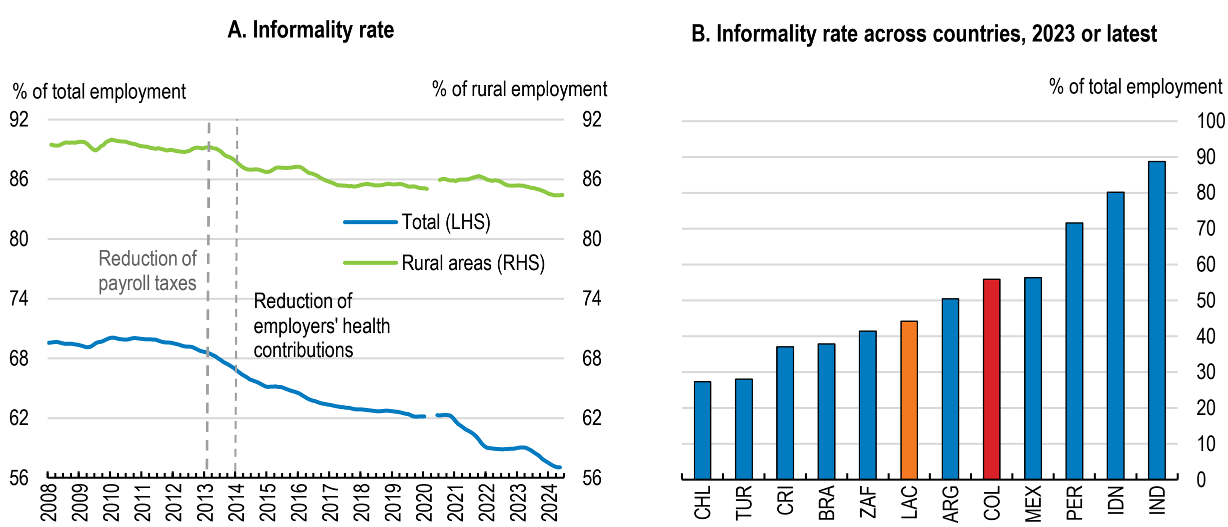
Citizen Income Programme (*Renta Ciudadana*): A new comprehensive conditional cash transfer programme that aims to consolidate all existing programmes (*Familias en Acción, Jovenes en Acción, Ingreso Solidario*) while enhancing coverage and benefits with the goal of progressively reaching all households in poverty or vulnerability is being implemented. The programme maintains conditionalities of cash transfers to achieve desired outcomes in education and health. By 2024, it is set to include all those facing extreme poverty.

4.1. Tackling informality to expand social protection and reduce inequities

Widespread labour informality contributes to exacerbating inequality and perpetuating poverty. Informal workers, often characterised by lower and unstable incomes, face significant challenges due to the absence of social contributory benefits and employment protections, such as access to pension plans, unemployment insurance, paid maternity leave or holidays. Rural, migrant, young, indigenous, and part-time workers as well as women and the self-employed tend to hold more frequently informal jobs (OECD, 2022[1]). Approximately 50% of the population resides in households where all working members are informal, especially affecting lower-income households (OECD et al., 2023[4]), rendering them highly vulnerable to shocks and leading to higher poverty rates among informal workers.

Labour informality has decreased considerably over the past decade in Colombia but remains higher than in many other large countries in the region (Figure 4.3). Informality declined from about 70% at the beginning of the 2010s to 56% in the first quarter of 2024, as a result of improved education, reduction in non-wage labour costs, and a series of measures to facilitate the formalisation of workers and companies (OECD, 2019[2]; OECD, 2022[1]). Notably, the 2012 tax reform, entailing a reduction in payroll taxes and employer's health contributions, resulted in an estimated 2 to 4 percentage-point decrease in the informality rate (Kugler et al., 2017[5]; Morales and Medina, 2017[6]; Fernández and Villar, 2017[7]; Bernal et al., 2017[8]). While informality declined in both urban and rural areas, the decline was much slower in rural areas where it remains very high, reaching 84% of rural employment at the end of 2023.

Figure 4.3. Informality has declined but remains high



Note: In Panel A, informality is defined as the percentage of workers in employment not contributing to the pension system. Data from April to August 2020 are missing because during the pandemic some questions were not asked in household surveys. Panel B shows the ILO definition of informal employment as self-employment in informal enterprises (small, unregistered enterprises) and wage employment in unprotected jobs, meaning jobs with no social contributions, in both formal and informal enterprises. The ILO statistical definition is different from the one followed by DANE. LAC represents the simple average of ARG, BRA, CHL, CRI, MEX, PER.
Source: OECD calculations based on DANE; and *ILOSTAT*.

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The fall in informality accelerated its pace between 2019 and 2023, falling by 4 percentage points overall and by 10 percentage points among women. This reduction was driven by the strong post-pandemic recovery and social security employment subsidies (Banrep, 2023[9]). These subsidies, introduced during the pandemic and extended until 2026 by the current government, offer subsidies of 30% of the minimum wage for youth, 20% for women, and 10% for men.

Further reducing labour informality is needed to reduce poverty and inequalities and boost productivity, as discussed in the 2022 Economic Survey (OECD, 2022[1]). The government efforts focus on supporting the grassroots (popular) economy, which encompasses a wide range of grassroots economic entities, including both individual and communal efforts, often informal and supported by familial and local networks (see Chapter 3). Measures aim to improve pathways to formalisation by enhancing the productivity of informal businesses and workers through vocational training, financial literacy, access to microcredit, and incorporating grassroot (popular) associations into public procurement. The reindustrialisation plan (see Chapter 3) also supports the grassroots economy. These efforts are welcome, but other measures will be needed.

Reducing informality requires a comprehensive strategy through better enforcement of tax and labour laws, and reduced non-wage labour costs, particularly for low-income workers (OECD, 2022[1]). The effectiveness of the current employment subsidies in Colombia in formalising workers underscores the need to reduce non-wage labour costs, particularly for vulnerable and low-income workers. Evidence from other countries, such as Chile and Türkiye, shows that targeted employment subsidies, which cover social security contributions for specific groups like women, youth, or small companies reduce informality (Aşık et al., 2022[10]; SENCE, 2022[11]; SENCE, 2022[12]). Other measures to reduce business informality should include lowering the tax burden, regulatory costs and the burden of setting up and growing firms, as discussed in Chapters 1 and 3. Enhancing access to education, as addressed later in this Chapter, should also be integrated into the overall strategy. As noted in the 2022 Colombia Economic Survey, ensuring minimum income protection for displaced workers would further enhance formalisation incentives.

A factor fostering informality is the relatively high minimum wage in Colombia. The minimum wage – at 90% of the median wage of full-time formal employees – is high in comparison with the OECD average of 55% in 2022. Only half of Colombian workers, and less than one in four in the poorest regions, earn at least the minimum wage (OECD, 2022[1]). Over time, the value of the minimum wage has increased faster than consumer prices and labour productivity. At its current high level, marginal increases in the real minimum wage are likely to reduce formal employment prospects for low-skilled workers, youth and people located in rural and less developed regions (OECD, 2015[13]). Aiming for adjustments in the minimum wage that take into consideration the impact on employment and informality would be a reasonable approach until it reaches a level that is friendlier to formal job creation, as recommended in the past Economic Survey of Colombia (OECD, 2022[1]). Past Colombia Economic Surveys have also recommended considering regional minimum wages.

4.2. Social reforms represent significant progress

The pension reform is a welcome step forward, offering improvements over the status quo (Box 4.2), aligning with past OECD recommendations (OECD, 2022[1]) as reflected in Table 4.1, and will help reduce inequities and poverty. The reform addresses two primary issues within the current pension system: low coverage and significant inequality, particularly evident in regressive pension subsidies and the existence of two competing systems providing different pension benefits for workers with the same career history. However, certain aspects will need improvement in the medium term.

Firstly, the pension reform increases benefits and coverage for all citizens by guaranteeing a pension to those unable to attain a contributory one, ensuring no elderly falls in extreme poverty. The reform also provides pension benefits for those workers that contributed but did not achieve the required minimum 1 300 weeks of contributions for men and 1 000 weeks for women though a new semi-contributory pillar (Box 4.1). Currently, these individuals are only entitled to the return of their contributions without any interest accrual. This is largely welcome as the current pension system exacerbates inequities leaving many elderly people in poverty given the low coverage among the most vulnerable. While this is an improvement from the previous scheme, in the medium term it would be advisable to enhance benefits within the non-contributory pillar to prevent anyone from falling into poverty, while ensuring fiscal responsibility in the process.

Box 4.2. The past Colombian pension system

Until the reform, the Colombia's pension system consisted of three main pillars: First, a non-contributory pillar, *Colombia Mayor*, funded by general taxes and targeted at the poorest. Coverage stands at a mere 29% among the population aged 65 and above, while benefits hover around 60% of the extreme poverty line. Second, a contributory pillar featuring both a pay-as-you-go system and an individually funded system, offering varying benefits for workers with similar careers; and a third voluntary savings pillar with tax incentives. Notably, the Constitution mandates that pension amounts cannot fall below the minimum wage, ensuring only those who meet contribution term conditions (25 years in public scheme; 22 in the private pension funds) receive a contributory pension. An alternative contribution pillar is provided by the BEPs (*Beneficios Económicos Periódicos*- a semi-contributory system) for informal workers or those earning less than a monthly minimum wage. Pensioners can convert savings and a state subsidy intro a periodic benefit. However, up-take has remained low, with the number of people who save (around 1.6% of the old aged in 2020) and the amounts saved low (at around 16% of extreme poverty line) (OECD, 2022[1]).

Secondly, the reform unifies the two current competing contributory schemes. The contributory system allowed members to choose between a state-run defined benefit plan and an individual defined contribution savings account plan managed by private pension fund administrators. The reform enlarges the public pay-as-you-go system by redirecting contributions from the private funds towards the public system. Only workers earning more than 2.3 times the minimum wage will contribute to the private pension funds for earnings above this threshold. Around 75% of all contributions to the contributory pillar will go to the public defined-benefit component. A new public savings fund, accumulating capital redirected from private funds and contributions to the public scheme after the reform, will be managed by the Banco de la República, whose independence ensures credibility in resource management. Thirdly, the reform improves targeting by increasing subsidies to low-income workers through the solidary and semi-contributory pillars and reducing them for high-income workers in the contributory pillar when contributions fall short of outlays.

In the medium to long term, given the current aging process and to ensure fiscal sustainability of the reform (see Chapter 2) the government will need to consider parametric reforms. There are two alternatives. First, lowering the threshold from which workers need to contribute to the private pension funds, as now it is relatively high with less than 15% of all workers earning above the 2.3-monthly minimum wages. This would have the advantage of encouraging national savings and capital market depth. Second, changing the calculation of pension replacement rates. Replacement rates are generous by international standards in the public scheme, at 72% of pre-retirement earnings in 2022, compared to an OECD average of 62% (OECD, 2022[1]). The average wage over lifetime could be used to calculate the pay base, instead of the last ten years of wages (OECD, 2019[2]). Additionally, Colombia could also consider raising the retirement age (currently 57 for women and 62 for men) and equalizing the retirement age for men and women (OECD, 2015[13]). Tying pension age to life expectancy would facilitate small and automatic adjustments as life expectancy increases.

Efforts to increase labour formality will be fundamental to expand the coverage of the contributory pension scheme. The low coverage of the current scheme (25% of all workers) is primarily due to high labour informality and that only workers with a full-time monthly minimum wage can contribute. The pension reform might encourage workers to contribute to the system by granting access to the semi-contributory pillar after 300 weeks of contributions. The pension reform also encourages contributions as contributions will be based on a daily minimum wage, with a minimum requirement of one week's worth of contributions, for independent and part-time workers. However, simulations indicate that by 2100 only 22% of the old-aged will belong to the contributory system (Universidad de los Andes, 2023[14]), and most workers will belong to the semi-contributory pillar. This suggests, there is a need of further measures to ensure workers have the incentives to contribute for the full earnings and working life, becoming fully formal, as discussed above.

The labour reform presented by the Government to the Congress aligns with previous OECD recommendations and Colombia's post accession commitments to improve formal workers' working conditions, ban union service contracts and support collective bargaining (OECD, 2016[15]; OECD, 2024[16]). In July 2024, Congress removed most articles related to union rights and strikes from the bill, posing a challenge to meeting post-accession OECD recommendations and commitments. Moreover, a careful assessment is needed as it may encourage informality and discourage formal employment by increasing non-wage labour costs. Some studies suggests that informality will increase because of the reform (Mejia, 2023[17]; Banrep, 2023[18]). On the upside, the provisions enabling social contributions for part-time work and other measures for self-employed and other vulnerable specific occupations could help them formalise. Furthermore, the Ministry of Labour is working on measures to improve labour productivity which could mitigate the impact of the increase in non-wage labour costs. A thorough analysis is required to understand how labour and pension reforms interact and impact informality. This analysis could inform and guide the development of measures to minimise any adverse effects on informality.

The Citizen Income Programme (*Renta Ciudadana*) aligns with past Surveys recommendations (see Box 4.1 and Table 4.1) by increasing benefits and coverage of conditional cash transfers programmes and will help reduce poverty. Moreover, efforts to improve the targeting of social policies by introducing a new social registry are welcome and should proceed, as discussed in Chapter 2. To sustain incentives for formal employment and prevent disincentivizing beneficiaries from seeking formal work due to fear of benefit loss, a tapering phase, where the reduction in transfer value is less than the additional income earned, would encourage formal work uptake. Cash transfers can also be linked to pro-formal employment behaviours such as skills training, and engagement with public employment services, facilitating poverty alleviation efforts (OECD, 2022[1]).

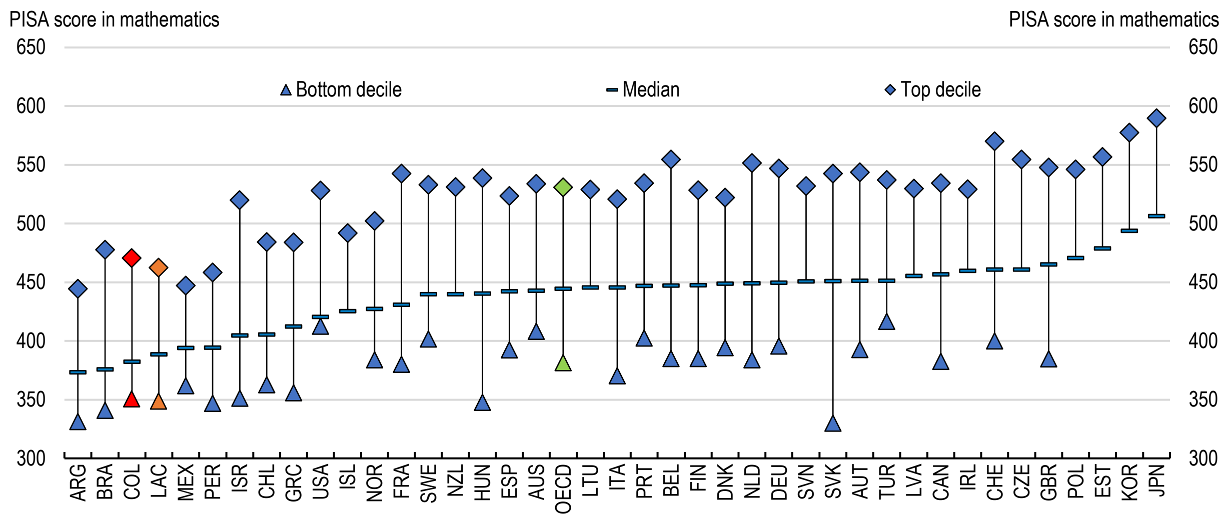
Table 4.1. Past OECD recommendations on social policies

Past recommendations	Actions taken since the 2022 survey
Establish a comprehensive strategy to foster formalisation, including lower non-wage costs, stronger enforcement, and improvements in tax administration.	Subsidies for formal employment introduced during the pandemic were extended several times, currently until 2026, focused on workers earning less than three minimum wages, youth and women, with incentives varying based on age and gender. Tax administration has been enhanced (see chapter 2). Increased budget allocation for labour inspection, higher numbers of inspectors, and more company visits. The government also continued training labour inspectors and improving mobile labour inspection in rural areas.
Create a basic non-contributory universal pension benefit and merge existing contributory pension schemes into a single mandatory contributory scheme complementing the basic universal pension.	The pension reform eliminates competition between the two contributory systems and creates the solidarity pillar for poor workers while increasing coverage for non-contributory pensions (see Box 2.1).
Reduce the tax burden on labour income by shifting the financing burden of social protection towards general taxation.	No actions taken.
Merge existing cash transfer schemes into a single cash benefit for poor households while maintaining conditionalities for families.	Implementation of Renta Ciudadana that merges existing cash transfers programmes in one maintaining conditionalities for families (See Box 2.1), expanding coverage and benefits. Benefits depend on socioeconomic group and household composition.
Provide targeted support to those out of school and those at risk of falling behind, including through full-day schooling and school meals.	Increased resources for the School Feeding Programme (PAE), expanding coverage, and offering training processes for suppliers. Introduction of PAE+ programme for meals during school breaks in the poorest regions.

4.3. Boosting education quality and equity

High-quality education is essential for fostering equal opportunities and providing individuals with the skills necessary to access formal employment opportunities. While access to education has increased over the last decade, with a 77% graduation rate from secondary education in 2019, education outcomes remain poor and are strongly influenced by socio-economic backgrounds (Figure 4.4). Significant regional disparities in enrolment and school outcomes exist, as highlighted in chapter 3. Moreover, Colombia's education system was severely impacted by the pandemic, which caused one of the longest schools' closures in the OECD and widened educational lags, particularly impacting students from more disadvantaged backgrounds (OECD, 2022[1]), with 2022 PISA results showing declines in mathematics, science, and reading compared to 2018 as in many other OECD countries.

Figure 4.4. Learning outcomes are poor and heavily influenced by socioeconomic status



Note: Deciles refer to the international deciles of socio-economic status calculated using the PISA 2022 index of economic, social, and cultural status (ESCS). LAC is a simple average of ARG, BRA, CHL, MEX, and PER.
Source: OECD (2022)," *PISA results 2022"*.

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The government should focus on improving both the coverage and quality of education from early to secondary levels to boost student performance, narrow learning gaps, and mitigate the influence of socioeconomic status. While the recent initiative to provide free tertiary education for vulnerable students (Box 4.1) will expand access, its effectiveness depends on ensuring equitable educational opportunities from early childhood through secondary schooling. For students from disadvantaged backgrounds, challenges like inadequate preparation and limited aspirations can hinder their pursuit of higher education as much as financial barriers.

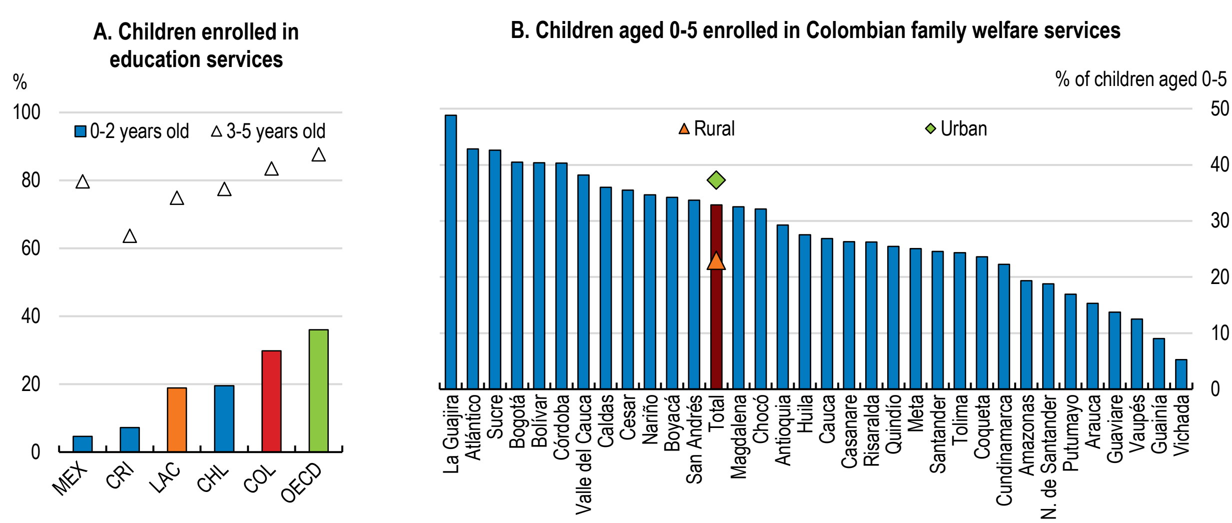
Addressing inequality in educational outcomes will require a stronger focus on disadvantaged children and schools. School dropout rates in secondary education are a concern, with only 44 out of 100 children completing high school on time, particularly among children from public schools and vulnerable households in rural areas. The education bill that plans to extend mandatory education to the age of 17 is a welcome step but more efforts are needed. Establishing a monitoring system to identify and support at-risk students early in their education is crucial but currently lacking (Fedesarrollo, 2022[19]). For example, in Finland, early intervention, additional instruction for lagging students and tailored learning helped lower grade repetition rates and dropouts (Välijärvi and Sahlberg, 2008[20]). In 2022, around 20% of enrolled children were in full-day programmes (Education Ministry, 2022[21]). Further extending elementary school schedules, can enhance education outcomes and reduce dropouts (Radinger and Boeskens, 2021[22]).

Moreover, experience in other OECD countries like Chile, Switzerland, and Japan shows that full-day programmes also boost women's labour force participation. A feasible transition to additional school time requires careful planning and funding. This includes ensuring sufficient investment in school infrastructure, subsidised meals for those not able to afford them and adequate compensation for teachers.

The quality of teaching is a key ingredient for good education outcomes, particularly in disadvantaged schools and regions where high-quality educators are often lacking. To address this, increasing incentives for skilled teachers to temporarily relocate can help mitigate inequalities, as noted in the (2022[1]) Colombia Economic Survey. Current measures, such as a 15% salary bonus, have proven insufficient. Raising salary bonuses, linked to the degree of remoteness and/or linked to performance, and offer accelerated career progression, automatic grade increases or freedom to choose the school were to teach for teachers who complete at least a 3-year tenure in disadvantaged areas would help (Forero and Saavedra, 2019[23]). Additionally, facilitating professional development and training, digital tools and resources can further support teacher development (Radinger et al., 2018[24]). Providing housing support and transportation subsidies to teachers could also enhance the attractiveness of teaching in these areas. Ensuring community support and creating mentorship programmes for new teachers can further strengthen their commitment and effectiveness in disadvantaged regions (Unesco, 2019[25]).

A high-quality, affordable early childhood education and care system is crucial for enhancing children's educational prospects and developing cognitive, social, and emotional skills for later success, especially among the most vulnerable. Additionally, it would encourage women labour force participation. Despite progress in early childhood education enrolment, Colombia remains below the OECD average (Figure 4.5, panel A). Enrolment gaps persist, even among five-year-olds for whom attendance is mandatory, varying by location and ethnicity. Public early childhood education predominantly relies on community homes (*Programa Hogar Comunitario de Bienestar*) managed by the Colombian Family Welfare Institute (OECD, 2016[26]), serving 25% of 0-5-year-olds. This initiative has effectively reached rural areas and supported mothers' labour market inclusion (Attanasio and Vera-Hernandez, 2004[27]). However, coverage discrepancies across departments are substantial, with urban areas at 40% and rural areas at 20% (Figure 4.5, panel B). Families lacking access tend to be poorer, with 60% being poor or extremely poor and 30% vulnerable in 2018 (World Bank, 2021[3]).

Figure 4.5. Access to early childhood education could be improved



Note: Panel A shows 2020 or the latest available year. LAC is a simple average of CHL, CRI, MEX. Panel B shows year 2022.
Source: OECD (2023), *Joining Forces for Gender Equality: What is Holding us Back?*; and OECD calculations based on Encuesta Nacional de Calidad de Vida 2022.

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The government's long-term goal is to make comprehensive early education and care accessible for all children and making mandatory education from the age of 3 (Box 4.1). This will require expanding community-based programmes to cover more families and areas, including those with indigenous backgrounds, and give priority to poorer ones through proper means testing. Initiatives like Medellín's *Buen Comienzo* programme, operating for children up to five years old, are good example to scale-up. To enhance accessibility, it is key to reduce entry barriers, such as simplifying documentation requirements and increasing awareness of how to access these services (World Bank, 2021[3]). Estimates put the cost of universal coverage in Colombia for children aged 3-5 at 0.3% of GDP (Forero and Saavedra, 2019[23]) financed by general taxation.

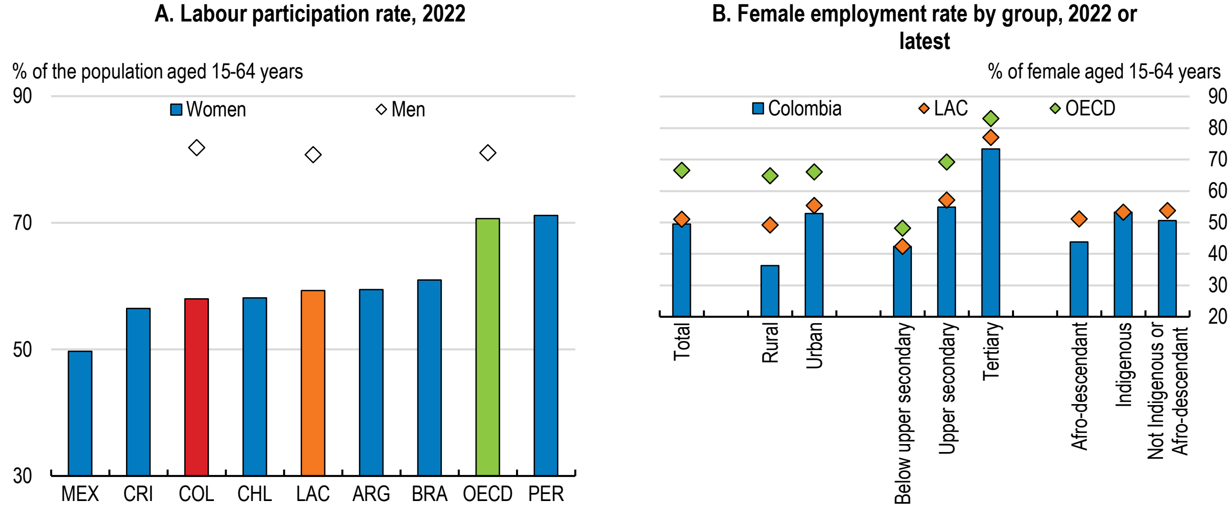
Ensuring adequate number of qualified educators to meet the educational needs and standards of preschool-aged children and enhancing the quality of early childhood education services is essential for addressing educational disparities. This includes recruiting, training, and retaining teachers capable of delivering quality early childhood education. These efforts should include to maintain appropriate student-teacher ratios, which at 33 children per one teacher in Colombia is twice as high than the OECD average (Finland, 2023[28]). Implementing rigorous methods to measure service quality, beyond self-reported data, is needed. Additionally, it's important to introduce performance incentives for childcare providers based on the quality of care they delivery. Countries like the United Kingdom, Chile, and India use specific child development monitoring indicators, such as standardized tests and age-appropriate qualitative assessments, to evaluate the quality of childcare (World Bank, 2021[3]). Offering short and regular continuous training programmes to childcare workers would improve quality, as seen in Vietnam (Neuman, Josephson and Chua, 2015[29]), particularly benefiting rural areas where well-trained workers are scarce and childcare needs are influenced by agricultural seasonality.

4.4. Promoting women's inclusion in the labour market

Female labour force participation has rebounded from the pandemic, but still lags behind other OECD countries (Figure 4.6, panel A). In 2022, the gender employment gap stood at 25 percentage points, surpassing the OECD average by 15 points (Figure 4.6, panel B). This gap is particularly pronounced among women with limited education, living in rural areas, mothers and indigenous populations. Closing gender gaps in labour force participation would give a significant boost to Colombia's GDP per capita, raising it by an estimated half percentage point yearly by 2050 (Figure 4.7).

Disparities also persist in job quality, with women more likely to be engaged in informal employment and part-time work and earning lower wages compared to men. Multiple factors contribute to gender gaps in the labour market, including career interruptions, educational choices, occupational segregation, employer discrimination, and women's disproportionate burden of unpaid domestic work (OECD, 2023[30]). Women in Colombia dedicate 22 more hours per week to unpaid tasks compared to men, primarily due to traditional norms and limited rural infrastructure and childcare services. This disparity significantly hampers women's capacity to secure and sustain high-quality employment opportunities. Enhancing early childhood education and childcare access and extending school hours is key to promote female labour force participation and formal employment as discussed above. Promoting and encouraging flexible working hours, the temporary use of part-time work for family reasons and remote work can also help women and men combine family responsibilities with paid work and help to reduce gender gaps. The recent reduction of weekly working hours to 46 can support women's labour market participation. The proposed pension reform reduces the required number of weeks for women to access pensions for each child, recognizing and rewarding caregiving periods. Extending this right to men who take time out of the workforce for caregiving would further promote equity. Addressing legal barriers to formal part-time work, such as Colombia's requirement to pay the full-time minimum wage, and adopting hourly contributions, as planned in the proposed labour market reform and done in countries like Chile, would promote labour formality and higher pension contributions.

Figure 4.6. Gender gaps in labour force participation and employment are pronounced in Colombia



Note: In Panel A, LAC is a simple average of ARG, BRA, CHL, CRI, MEX, and PER, and data for ARG refer to 2021. In Panel B, LAC is a simple average of ARG, BRA, CHL, CRI, and MEX, with ARG data for 2021. Education level data pertain to individuals aged 25-64 years, while race/ethnicity data for women aged 15 years and older are from 2021 or latest. For Afro-descendant women, the LAC average comprises BRA and PER, while for Indigenous and non-Indigenous or Afro-descendant women, it includes BRA, CHL, MEX, and PER.
Source: *OECD Labour Force Statistics*; DANE; *ILOSTAT*; *CEPALSTAT*; and *OECD Education at a Glance*.

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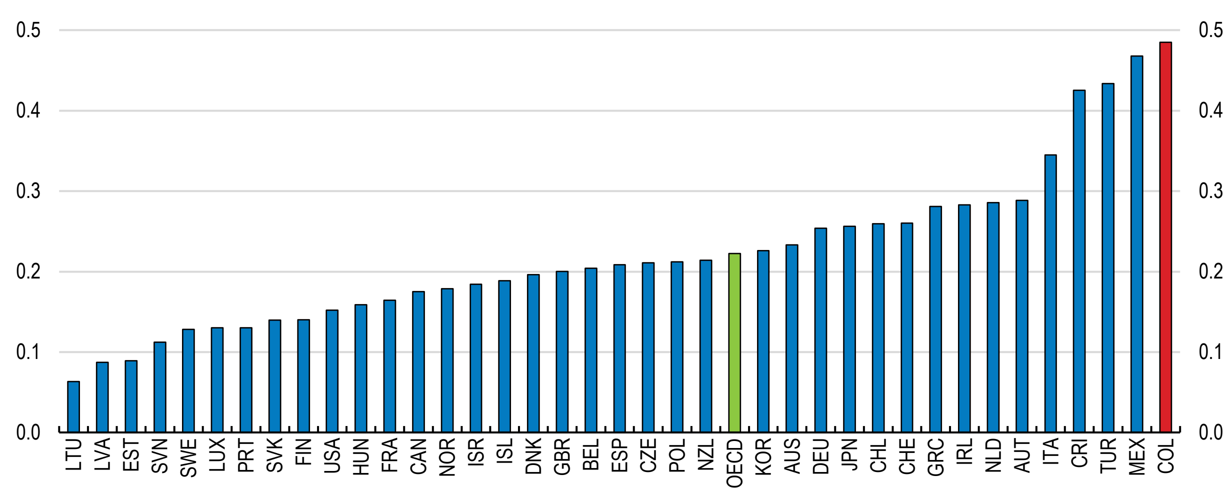
Figure 4.7. Colombia has much to gain from closing labour market gender gaps

Gain in GDP growth per capita from closing gender gaps on the labour market, percentage points



Note: The simulation assumes that gender gaps in labour market participation and hours worked will close by 2060. The figure reports the difference in potential per capita output growth relative to the baseline projection from the OECD Economics Department Long-Term Model; they refer to the average yearly difference in percentage points by the end of the projection period.
Source: Fluchtmann, Keese and Adema (2023) Gender equality and economic growth: Past progress and future potential.

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Although parental leave is generous in Colombia, in comparison to other Latin American countries, 60% of the workforce lack maternal or parental leave rights because they are informal workers. Colombia offers 2 weeks of paternity leave and 18 weeks of paid maternity leave, 12 of which are reserved to the mother and the other 6 to be voluntary shared. The labour bill aims to increase paternity leave gradually to 12 weeks in 2026, which will likely enhance uptake and balance caregiving roles as suggested by evidence from other OECD countries (OECD, 2023[30]). However, maternity and paternity leave will only benefit high-income female workers and not most female workers, who are informal.

Care responsibilities for the elderly disproportionately burden women. Expanding quality elderly care can boost female workforce participation and help address the challenges of Colombia's ageing population. Formal long-term care programmes and policies to address functional dependency remain scarce (OECD, 2023[30]). Only 35% of the municipalities in the country have at least one centre for the protection and care of the elderly. Colombia's introduction of the National Care System in 2023 is under development aiming to provide a new organisation of co-responsibilities for care and guaranteeing the rights of caregivers. The care system in Bogotá is part of the models under consideration for nationwide implementation (Box 4.3). It emphasizes caregiver support and training, and aids informal caregivers through accessible information channels, following successful models in advanced OECD countries like France and the Netherlands (OECD, 2023[30]). Depending on the target population and on the services to be provided, the estimated cost of a national long-term care system ranges between 0.3% and 1% of GDP for Latin American countries, but net costs could be lower as there are potential fiscal benefits from reduced healthcare costs and increased female labour force participation (Medellin, 2020[31]; Oliveira, Aranco and Stampini, 2021[32]).

Colombia has improved female political representation, with 30% of women elected to Congress in 2022, the minimum required under the quota law, a significant increase from 2018 (19.7%). Progress is notable in the executive branch and public management positions. However, gender disparities persist at the regional and local level, with only 6.3% female governors and 12% female mayors at the subnational level, where sanctions for non-compliance with the quota law do not appear to be enforced. The uneven implementation of the quota law, and the fact that sanctions are limited for non-compliance in electoral processes, can serve as a structural barrier for women's political participation. Spain offers an interesting example of legislation to promote gender parity in political parties. Compared to Colombia, Spain mandates a higher percentage of women candidates on party lists and imposes effective sanctions for non-compliance (OECD, 2020[33]). In the private sector, female participation on company boards is 12.9%, lower than the OECD average (28%), with most women-led businesses being SMEs (78.2%) (DANE, CPEM, ONU Mujeres, 2020[34]). Requiring listed companies to report progress on reducing gender imbalances and establishing targets for women's representation in private firms has been successful in Germany, Italy and Spain (ILO, 2020[35]). Certification schemes acknowledging companies promoting gender equality can incentivise broader adoption of these initiatives (OECD, 2023[30]).

Box 4.3. Bogota's Districts Care System (SIDICU)

Bogotá's SIDICU (Sistema Distrital de Cuidado) seeks to mitigate the burden of both paid and unpaid caregiving duties, addressing the needs of both caregivers and care recipients. Care recipients may include children under five, people with disabilities, and the elderly. The system has two components: 1) "Manzanas de Cuidado" (Blocks of Care), an initiative that centralises key care services to help reduce the time women dedicate to unpaid jobs/tasks. Each block care offers services like laundry, childcare, elderly care, and support for people with disabilities. The block also provides offers learning services for men where they undergo through several home tasks. The first Care Block was piloted in Ciudad Bolivar and, nowadays, there are 11 of such Blocks across Bogotá. For citizens that live in rural and peripheral areas of Bogotá, far from a Care Block, the city has implemented Care Buses to guarantee mobility and access to services. 2) "Unidades Móviles de Cuidado" (Mobile Units of Care) are equipped vehicles offering care in remote areas where "Manzanas de Cuidado" aren't available, proving in-home care. A pilot project with two mobile units began in 2020. Both modalities offer flexible training options for caregivers, such as personal development, self-care, income generation and engagement / political participation. Currently Bogotá counts with 23 Care Blocks. 45 Care Blocks are expected to be launched by 2035, of which 20 of them are expect to be completely implemented by the end of the current administration.

Source: (OECD, 2023[30]; OPSI, 2022[36])

Table 4.2. Policy recommendations to reduce inequalities and poverty

Tackling informality	
Around 56% of workers are in informal jobs and many are women. This deprives them from access to many social security benefits and employment protection, while reducing productivity and tax revenues.	**Pursue a comprehensive strategy to reduce informality, including enhancing skills, strengthening the enforcement of labour and tax laws, reducing corporate tax and regulatory burdens and lowering social security contributions for lower-income workers.**
The minimum wage, at 90% of the median, is relatively high incentivising informality.	Promote adjustments to the minimum wage that weigh the impact on formal and informal employment.
Enhancing education quality and equity and reducing gender disparities	
Colombia faces significant educational disparities, driven by socioeconomic status and geographic location. School non-completion rates in secondary education are high.	**Identify students in need of support, establish a system to support those at risk of leaving the education system and provide them with targeted tutoring.** Expand full-day schooling programmes, prioritizing vulnerable children. Improve financial incentives such as salary bonuses for teachers in remote rural areas.
Early childhood education and care enrolment has improved but lags OECD countries, with 20% of 3-5-years-old and 70% of the 0-2-years-old not enrolled, hindering female labour market participation.	**Continue expanding access to early education and care facilities, prioritizing rural areas and vulnerable children.** Improve early education quality by providing continuous training to childcare workers. Implement more effective quality-assessment strategies for early childhood and care services.
Female labour force participation, at 58%, lags other OECD countries and there is a significant 25-percentage points gap compared to men. Domestic and care responsibilities fall disproportionally on women.	Expand elderly formal care services, prioritizing vulnerable households. Promote the use of flexible work hours, temporary part-time work for family reasons and remote work.
Female political representation has improved, yet the mandatory 30% quota for female participation is not adhered to at the subnational level. There is room for increasing female participation in private company boards.	Ensure adherence to the 30% female representation quota at all levels of government, by enhancing monitoring mechanisms and enforcing penalties. Mandate listed companies to report on gender gaps and progress to reduce gender imbalances.

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5 Facilitating the green transition and seizing new opportunities

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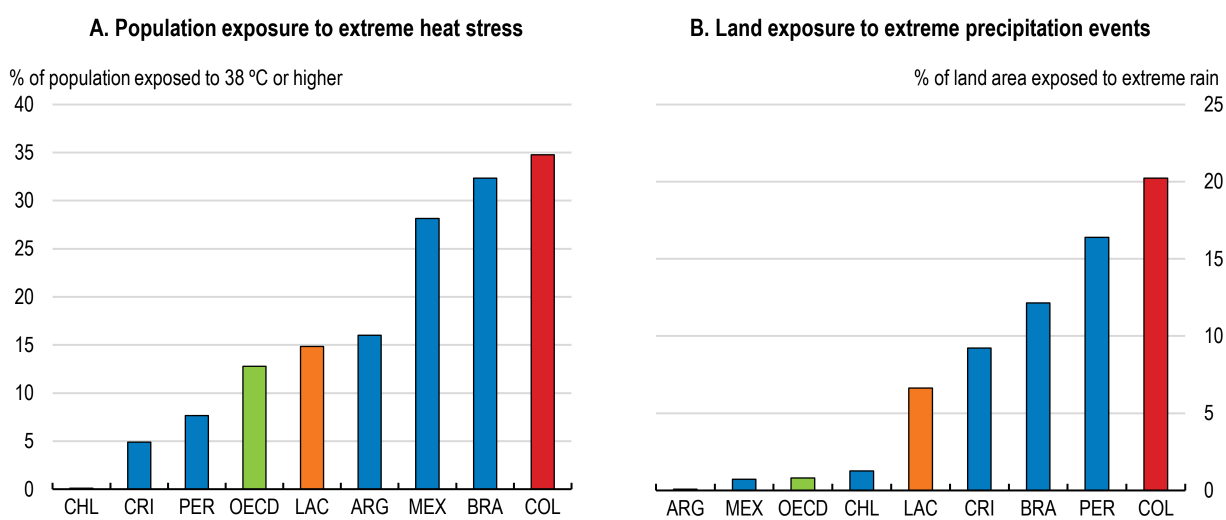
Climate change poses significant risks to Colombia due to the country's high exposure to climate-related extreme events, including floods, wildfires, landslides, and extreme heat days. Additionally, as a major exporter of oil and coal, Colombia faces substantial economic challenges as demand for fossil fuels will decline amid the global energy transition. Colombia has ambitious greenhouse gas emission reduction targets supported by a robust energy transition strategy that also aims at gradually phasing out the extraction of fossil fuels and is working to diversify exports and fiscal revenues. Achieving emission reduction targets requires swift action but also offers opportunities to leverage the global green energy transition, given Colombia's rich biodiversity, abundant renewable energy potential and minerals. Strengthening climate adaptation policies, reining in deforestation, and boosting measures to effectively decarbonise the economy, including stepping up renewables by developing green financial instruments, a stable regulatory framework and more ambitious price signals for abatement are required.

5.1. The climate transition entails important challenges and opportunities for Colombia

As Colombia charts its path towards a more prosperous and equitable future, it faces three pivotal climate transitions. Firstly, it must shift from a climate-vulnerable to a resilient economy, implementing robust climate adaptation measures. Secondly, guided by its ambitious climate mitigation goals, it needs to transit towards net-zero greenhouse gas emissions by 2050. Lastly, with declining global demand for oil and coal, Colombia must undergo a transformative economic shift.

Colombia is highly vulnerable to climate change (Figure 5.1) and faces increasing frequency and intensity of climate-related extreme events such as floods, wildfires, landslides, and extreme heat days. The incidence of slow-onset climate hazards such as drought and sea-level rise is increasing. These events often have devastating impacts, including damage to infrastructure and other assets, disruptions in electricity generation and supply, human capital losses, negative health impacts, agricultural losses, and financial risks. A significant majority (94%) of Colombians acknowledge the impacts of climate change on their daily lives (EIB, 2023[1]). Adaptation to climate change is crucial to managing these challenges and limiting economic and fiscal costs. Without investments in adaptation, climate change could reduce Colombia's GDP by 1.5% to 2.5% by 2050, disproportionately affecting the poorest and most vulnerable populations (World Bank, 2023[2]).

Figure 5.1. Colombia is highly exposed to extreme weather events



Note: Data in Panels A and B are averages from 2010 to 2022. LAC is a simple average of ARG, BRA, CHL, CRI, MEX, and PER.
Source: *OECD Environmental Risks and Health*.

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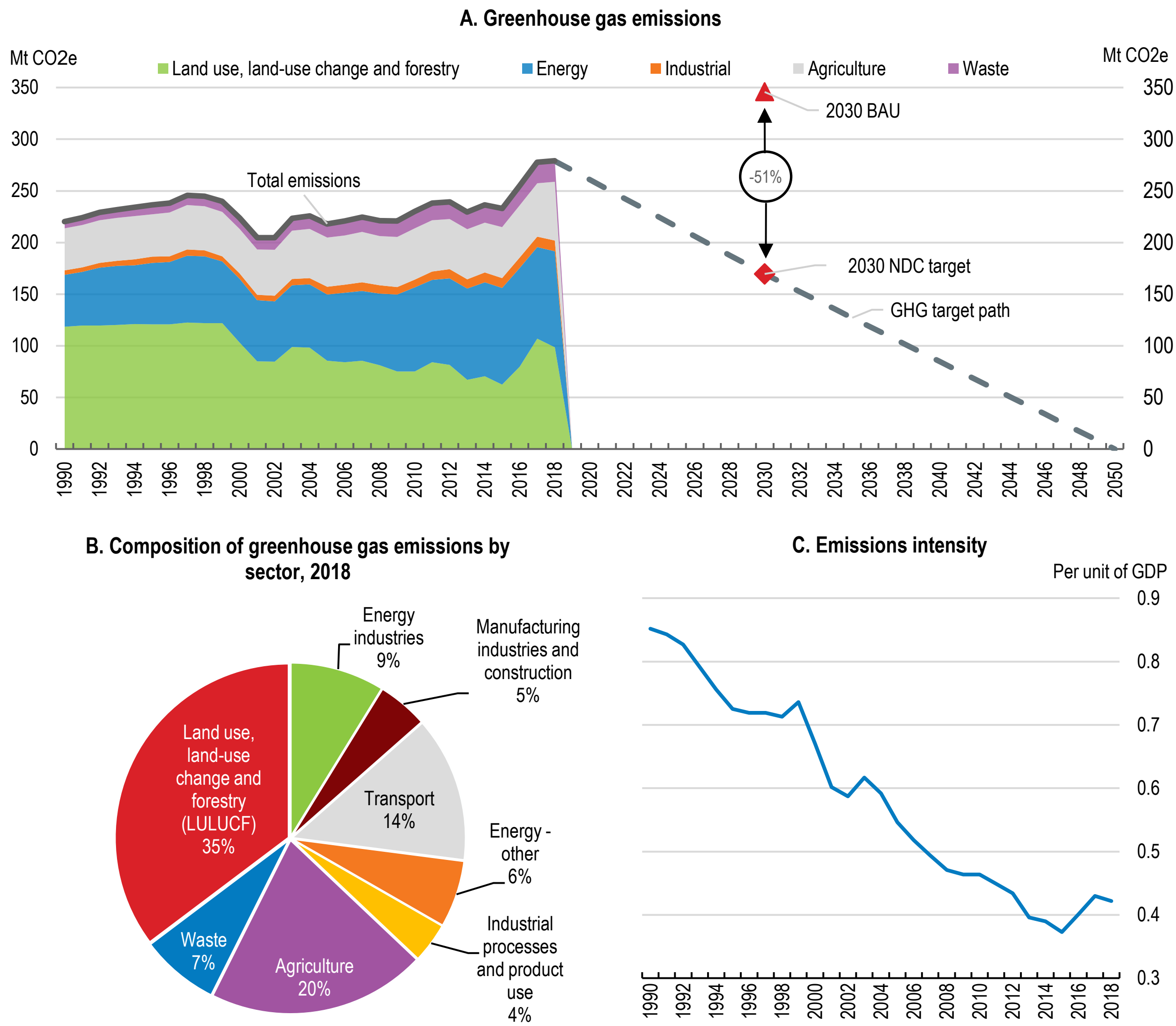
Despite accounting for only 0.6% of global CO2 emissions, Colombia has ambitious greenhouse gas emission reduction targets, including updated targets in its Nationally Determined Contribution (NDC), which targets a 51% reduction in emissions by 2030, and a commitment to achieving carbon neutrality by 2050. Colombia has also announced a plan to ban new hydrocarbon exploration permits, while continuing with current oil and gas exploratory contracts. Proven oil reserves decreased by 2.6% during 2023, while proven gas reserves decreased by 15.7%. However, current measures fail to align with the 1.5°C temperature increase limit established in the Paris Agreement (Climate Action Tracker, 2022[3]). Since the 2000s, Colombia's greenhouse emissions have not decreased and have grown in absolute terms (Figure 5.2, Panel A). The primary sources of emissions are the land use sector, including land-use change and forestry, accounting for 35% of the country's greenhouse gas emissions in 2018, and the energy sector which account for 33%, particularly from transport and energy industries (Figure 5.2, panel B). During the pandemic, total greenhouse gas emissions declined in Colombia as in many other countries, but they started rising again in 2021 (DANE, 2023[4]). However, greenhouse gas emissions have continuously decoupled from GDP growth since the 1990s (Figure 5.2, Panel C).

Figure 5.2. Colombia's total greenhouse gas emissions are increasing despite a decrease in the carbon intensity of its economy



Note: Data are available until 2018. Panel A, BAU refers to the 'Business-as-usual' scenario, and NDC refers to 'National Determined Contributions'. Panel C, emissions intensity is measured as the kilograms (in thousands) of GHG emissions including LULUCF per 1 000 USD.
Source: *OECD Greenhouse Gas Emissions*.

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Colombia faces significant economic challenges amid the global green transition and declining global demand for fossil fuels. With oil constituting 32% of total exports and coal 18% in 2023, Colombia could potentially lose up to 10% of its export revenues, 6% of government revenues, and 8% of its GDP by 2050 due to global decarbonisation efforts (World Bank, 2023[2]). Oil accounts for a fifth of foreign direct investment. These changes could lead to labour reallocation and job dismissals in fossil fuel-dependent sectors, impacting mostly the vulnerable.

Although navigating these transitions will be challenging, it presents an opportunity for Colombia to diversify its productive and export structures. By leveraging its renewable energy potential, mineral resources, protecting its biodiversity, and ecotourism potential, Colombia can foster long-term growth, create formal employment opportunities, and alleviate poverty. By protecting the rich biodiversity and ecosystems, Colombia can not only combat climate change but also support sustainable development and community well-being.

This chapter discusses priority measures for Colombia's three climate transitions. These include climate adaptation policies, achieving climate neutrality by 2050 by addressing deforestation, accelerating the clean energy transition, reducing greenhouse gas emissions from transport, and strategies to turn the global green transition into opportunities.

5.2. Adapting to climate change

Colombia has a comprehensive and proactive approach to climate adaptation. It has a multi-sector governance framework, a disaster risk management system and has prioritised integrating climate adaptation measures into its national development plans. The country has implemented various climate adaptation initiatives, such as a comprehensive management plan to help agricultural producers address the impacts of climate change, guidelines for sustainable cattle farming, and a roadmap for the agricultural sector to reduce environmental impact and implement climate-smart practices. Additionally, both Colombia's National Adaptation Plan and the 2050 resilient net zero pathway strategy commit to reduce vulnerability and enhance the adaptability of critical sectors such as transport, energy, and construction, while emphasizing landscape conservation. The National Development Plan also focuses on water management, which is beneficial for climate change adaptation and deforestation prevention. Nature-based solutions also play a crucial role in the national strategy for climate adaptation.

Significant challenges persist, however, particularly at the subnational level, where obstacles hinder effective implementation of climate adaptation measures. Subnational governments are responsible for the bulk of public investments in adaptation, but they encounter difficulties in project design and execution, and municipalities face financial constraints to allocate resources to disaster risk management (World Bank, 2023[2]). Furthermore, territorial plans do not always follow the legal requirements of incorporating climate adaptation actions and because of that infrastructure projects often overlook climate adaptation and resilience measures. Addressing these challenges necessitates coordinated efforts between the central government and subnational entities, focusing on enhancing local capacities and providing support for effective local adaptation planning and implementation. There is also a need to ensure climate adaptation measures integrate traditional knowledge and ancestral practices of ethnic communities, with policies to enhance their participation and create intercultural dialogue spaces. Climate adaptation investments can have high returns, with cost-benefit ratios ranging from 2:1 to 10:1 (Global Commission on Adaptation, 2019[5]). Investments in adaptation not only reduce the risks and impacts posed by climate change but also enhance productivity and foster innovation (Cárdenas, Bonilla and Brusa, 2021[6]). Colombia has significant financing needs for climate change adaptation, and green and sustainable bonds can help address these needs by providing capital for environmental projects. These bonds are increasingly used in Colombia to support sustainability initiatives, including climate change adaptation.

Efforts to expand and enhance nationwide early warning systems must persist to improve disaster preparedness and response capabilities (OECD, 2019[7]). Warning systems exist for certain hazards and in specific areas, but there is a need to achieve a comprehensive coverage of hazards and to upgrade existing systems to make them real-time. This can be done building on good practices that exist at the local level, such as the integrated Landslide Early Warning System in place to protect Medellín's informal settlements (Gamperl et al., 2023[8]). There is a need to develop training and awareness programmes on the use of early warning systems in ethnic communities, using their languages and traditional communication methods. Ensuring the interoperability between the social registry (*Sisbén*) and the Disaster Risk Management registry would help identify and alert vulnerable populations promptly, as well as help to implement targeted interventions depending on specific risk factors and needs.

Colombia, a biodiversity hotspot, faces significant challenges from climate change and habitat loss. Nature-based solutions could contribute up to 30% of the reduction in climate change vulnerability by 2050 globally, supporting the Paris Agreement's goal of limiting global warming (IUCN, 2022[9]). Nature-based solutions are crucial for managing water resources, preserving biodiversity, and preventing deforestation in Colombia. These approaches include reforestation, afforestation, and sustainable land management activities, which help offset greenhouse gas emissions and enhance the resilience of local ecosystems. Colombia's participation in COP28 highlights its commitment to addressing biodiversity loss through initiatives like the forest protection fund and emphasizing the importance of integrating nature-based solutions.

The insurance sector can critically provide insurance mechanisms to manage climate-related risks. To date, insurance schemes against climate risks have limited penetration and geographical coverage in Colombia (UNDP, 2023[10]). A pilot scheme that could be scaled up is the InsuResilience initiative in place in Medellín, a public-private partnership to build urban resilience against climate risks. The project uses predetermined triggers, such as specified rainfall levels, which immediately activate financial assistance without the necessity for extensive damage assessments. The National Development Plan includes regulatory adjustments to stimulate the parametric insurance market. Expanding access to insurance schemes would be particularly important for the agricultural sector, especially among small-scale farmers. The take up of agricultural insurance is low, even if the government subsidises up to 80% of the cost of insurance premiums. To increase insurance uptake, the government can raise awareness among small farmers. It can also learn from the successful experiences of other countries, including Guatemala, which fully covers insurance premiums and pays out based on predefined triggering events, such as satellite-measured rainfall levels or natural disaster events, rather than indemnifying actual losses (World Bank, 2024[11]). Insurance based on weather-based indices bundled with improved targeted farming practices can boost farmers' adoption of technologies that strengthen their resilience to climate change, as seen in Malawi where it raised incomes by combining insurance with crop-specific loans (Le and Panella, n.d.[12]).

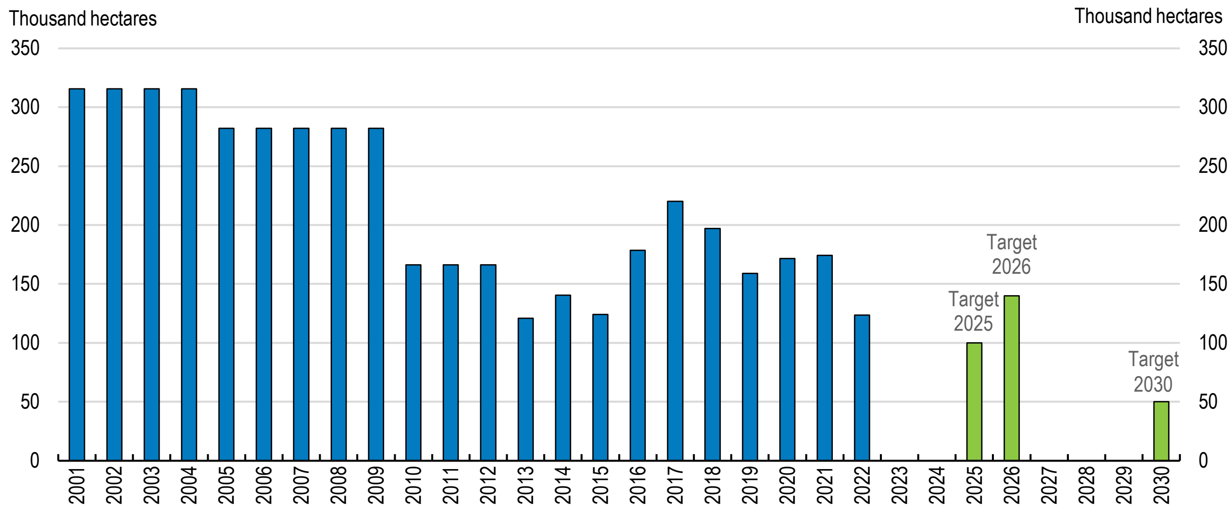
5.3. Accelerating efforts to reduce deforestation

Colombia needs to significantly reduce deforestation to meet its greenhouse gas emission reduction targets, as deforestation is the primary contributor to carbon emissions (OECD, 2022[13]) (Figure 5.2, panel A). Furthermore, reducing deforestation would help to preserve Colombia's biodiversity, safeguarding water resources, protecting the rights of indigenous and local communities, and promoting sustainable development. Between 2001 and 2022, Colombia lost 3.3 million hectares of forest, with a notable acceleration following the signing of the Peace Agreement in 2016 (Figure 5.3). The main causes of deforestation include extensive cattle farming, the expansion of agriculture, illicit drug cultivation, illegal mining, illegal logging, and road construction (Fedesarrollo, 2022[14]).

Colombia has a strong commitment and sound framework to combat deforestation (OECD, 2022[13]), and is targeting to more than halve deforestation to 50 thousand hectares per year by 2030. The National Development Plan 2022-2026 contains several measures to curb deforestation, focusing on the main deforestation hotspots in the Amazon. It also aims at creating forest development and bioeconomy hubs in some municipalities targeted for territorial development in the peace agreement. The current government aims to combat deforestation by fostering dialogue and agreements with poor farming communities. These efforts aim to preserve forests, deter illegal gold mining and coca cultivation and enhance access to state services in remote rural regions. Deforestation efforts in 2022 were effective, achieving the 2026 reduction target in the National Development Plan ahead of schedule. The National

Development Plan 2022-2026 focuses on territorial planning around water, incorporating sustainable water management into policies, regulations, and legislation. This approach enhances resilience to climate impacts like droughts and floods, helps protect ecosystems, and reduces deforestation by maintaining biodiversity. Additionally, water-focused planning ensures communities are better prepared for climate change.

Figure 5.3. Colombia needs to step up its efforts to meet ambitious deforestation targets



Note: 2025 and 2030 targets are from the NDC. The target for 2026 is from the 2022–2026 National Development Plan.
Source: OECD calculations based on Institute of Hydrology, Meteorology, and Environmental Studies (IDEAM).

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While an effective control of deforestation is key, in Colombia efforts are hampered by its decentralised environmental management system and the disconnection between central government policy and on-the-ground deforestation control. The new national council for the fight against deforestation can help better coordinate efforts, if it has sufficient resources and is able to streamline the institutional setup (World Bank, 2023[2]). Additional resources for effective law enforcement should be deployed permanently to accelerate the fight against deforestation, particularly to combat illegal mining, as recommended in past Surveys (Table 5.1, (OECD, 2022[13]). Enhancing criminal intelligence capabilities to identify and target illegal mining operations properly would be essential, requiring increasing state presence and control of the Amazon. Additionally, strengthening cooperation with neighbouring countries like Brazil is crucial to address transnational illegal mining networks operating in border regions. Furthermore, enhancing legal frameworks and regulations to impose stricter penalties for illegal mining activities, deter perpetrators, and provide clearer guidelines for law enforcement actions would help. Furthermore, uncertainties regarding land ownership due to incomplete land registries in remote areas must be addressed to prevent opportunistic deforestation, particularly around natural parks.

Accelerating and expanding the payment of environmental services as outlined in the national development plan 2022-2026 is warranted. Costa Rica's success in reversing deforestation shows that paying for environmental services is an important ingredient of a successful multipronged strategy (Box 5.1), but should also include strong institutions, fiscal incentives for reforestation, or effective land title enforcement, as relying only on payments for environmental services is expensive and may not prove sustainable. Colombia is actively working on completing and updating land registries and resolving land-use conflicts (see Chapter 3). They should continue these efforts to prevent opportunistic deforestation and encourage farmers to invest in sustainable agriculture, as recommended in the 2022 Economic Survey (Table 5.1). To be successful, payment for environmental services programmes need to be accessible and beneficial to ethnic communities, and designed with their direct participation, promoting co-creation and valuing their traditional environmental management practices.

Better control of deforestation and productive sustainable agriculture can help curb deforestation (World Bank, 2023[2]). Redirecting extensive cattle breeding, an important source of greenhouse gas emissions and a key driver of deforestation, towards modern production techniques could also help, as discussed in the 2022 Economic Survey. Sustainable agricultural practices provide alternative livelihoods, reducing the need of clearing forests for farming. Fostering the adoption of climate-smart agriculture practices, such as cultivating-climate resilient crop varieties or efficient use of nitrogen fertilizers, could help boost productivity and resilience, as only 15% of agricultural units in Colombia used these technologies in 2020 (Gaviria González, 2022[15]). To further expand the use of these practices, facilitating sharing of best practices and capacity-building initiatives through famers associations and local institutions would help to scale up practices that are already implemented in some sectors (coffee), to other crops and farmers (Argote, 2014[16]). Assistance from public institutions to access financial services and fostering the development of agriculture insurance could also help overcome adoption barriers.

Table 5.1. Past OECD recommendations on green growth

Recommendations in previous Survey	Actions taken since previous Survey (Feb 2022)
Increase resources dedicated to anti-deforestation enforcement activities to follow up on more cases of detected deforestation.	The government has increased the budget allocated to deforestation control. The Fund for Life and Biodiversity will allocate resources to the Integral Plan to Contain Deforestation in 22 Amazon nuclei, invest significantly in the 13 prioritised territories outlined in the National Development Plan, expand the Payments for Environmental Services programme, and promote environmental education initiatives.
Accelerate progress in expanding the land registry, especially into remote areas.	The government is making efforts to complete the multipurpose cadastre. See chapter 3.
Expand the carbon tax to cover all uses of coal, natural gas and LPG and consider aligning its rate with OECD averages.	The 2022 tax reform is expanding gradually the carbon tax to coal and increasing the tax rate annually in real terms (CPI inflation +1% annually) See chapter 2.

Box 5.1. How Costa Rica reversed deforestation

Costa Rica managed to significantly reverse deforestation since the 1980s, raising its forests from 30% to 60% currently due to reforestation efforts. The main pillars of this strategy were as follows:

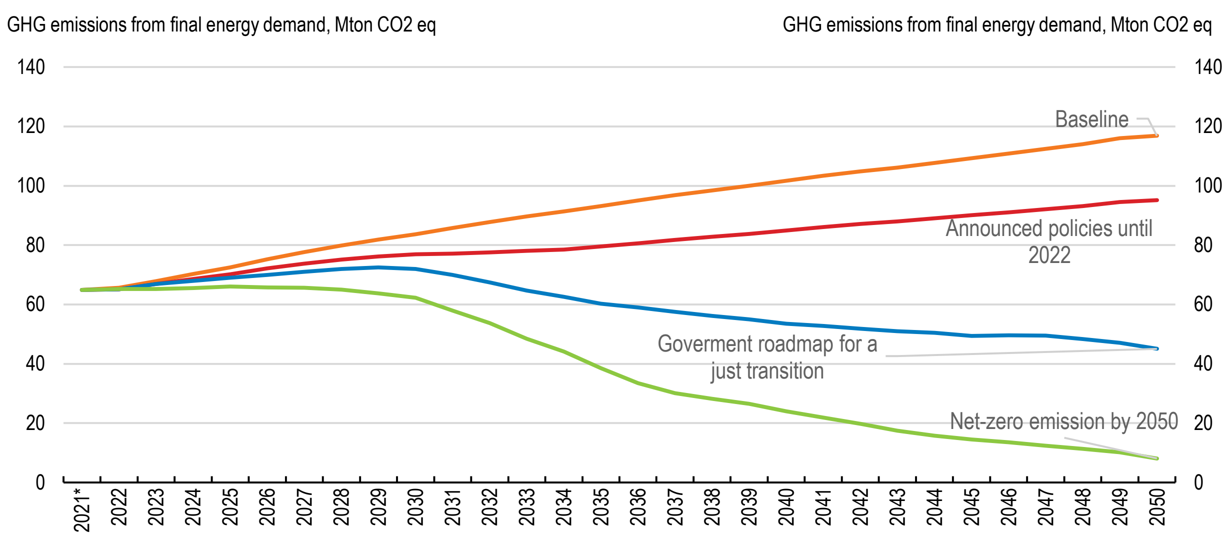
- The country established a national “Reducing Emissions from Deforestation and Forest Degradation” strategy in 2008, including reference emission levels from forests, and monitoring systems. The strategy involved broad public consultation to understand deforestation drivers.
- Success factors of the deforestation strategy included: strong institutions, fiscal incentives for reforestation, payment for environmental services, elimination of cattle ranch subsidies, and effective land title enforcement.
- Payment for environmental services played a crucial role, investing approximately USD 200 million from 1997 to 2004, protecting over 460,000 hectares of forests and providing additional income for over 8,000 forest owners.
- Moreover, the development of ecotourism contributed to revenue generation and conservation incentives.

5.4. Accelerating the clean energy transition and reducing fossil fuel emissions

Colombia's energy transition policy is a priority, shifting away from an extractive industry model heavily dependent on oil and coal exports towards a more diversified clean energy economy based on investments in renewable energy sources, critical minerals and hydrogen. Energy related greenhouse emissions, mostly from transport, energy production and manufacturing, account for 33% of the country's total greenhouse emissions (Figure 5.2, panel A and B). To accelerate the energy transition and transform the energy mix, the government is prioritizing non-conventional renewable energy sources, such as wind, solar, biomass and geothermal. Authorities have announced it will not grant new licenses for hydrocarbon exploration. The government's reindustrialisation policy agenda (see Chapter 3) is the primary mechanism to drive the energy transition while facilitating a shift away from oil and carbon dependency and fostering diversification of exports and fiscal revenues.

In 2023, Colombia announced a robust roadmap for a just energy transition that requires a six-fold increase in wind and solar capacity, from below 0.4% of total energy generation today, halving oil demand in refineries by 2050, complete reliance on imported gas by 2027 and no thermal coal production by 2040 respectively. Additionally, it calls for a 75% reduction in fossil fuel consumption in transportation, a modal shift to public and non-motorised transport (such as buses, trains, bikes or walking), higher emphasis in multimodal cargo transportation, adoption of green hydrogen and green technologies, and improved energy efficiency in industry, households, and services. Another piece of Colombia's renewable transition strategy are the so-called energy communities, to promote renewable energy use, enabling self-generation for unserved users and reducing costs by avoiding extra charges from distribution or transmission assets. This roadmap is welcome and if implemented will help to curb greenhouse gas emissions significantly (Figure 5.4), however it will not be enough to meet Colombia's commitment to carbon neutrality by 2050. To achieve carbon neutrality by 2050, greater emphasis is needed to accelerate the deployment of renewable energy and the reduction in transport emissions (Gonzalez, forthcoming[17]).

Figure 5.4. More efforts are needed to achieve energy decarbonisation by 2050



Note: *2021 is simulated, as the latest available emissions inventory for Colombia is for 2018. The 'Trend' scenario maintains current trends in energy production and consumption, the 'Announced Policies' scenario reflects announced policies to 2022, the 'Just Energy Transition' scenario reflects the government roadmap for a just transition, and the 'COP26' scenario is consistent with Colombia's commitments under the Paris Agreement.
Source: (Gonzalez, forthcoming[17]) and Energy Ministry (2023), National scenarios, Just energy transition.

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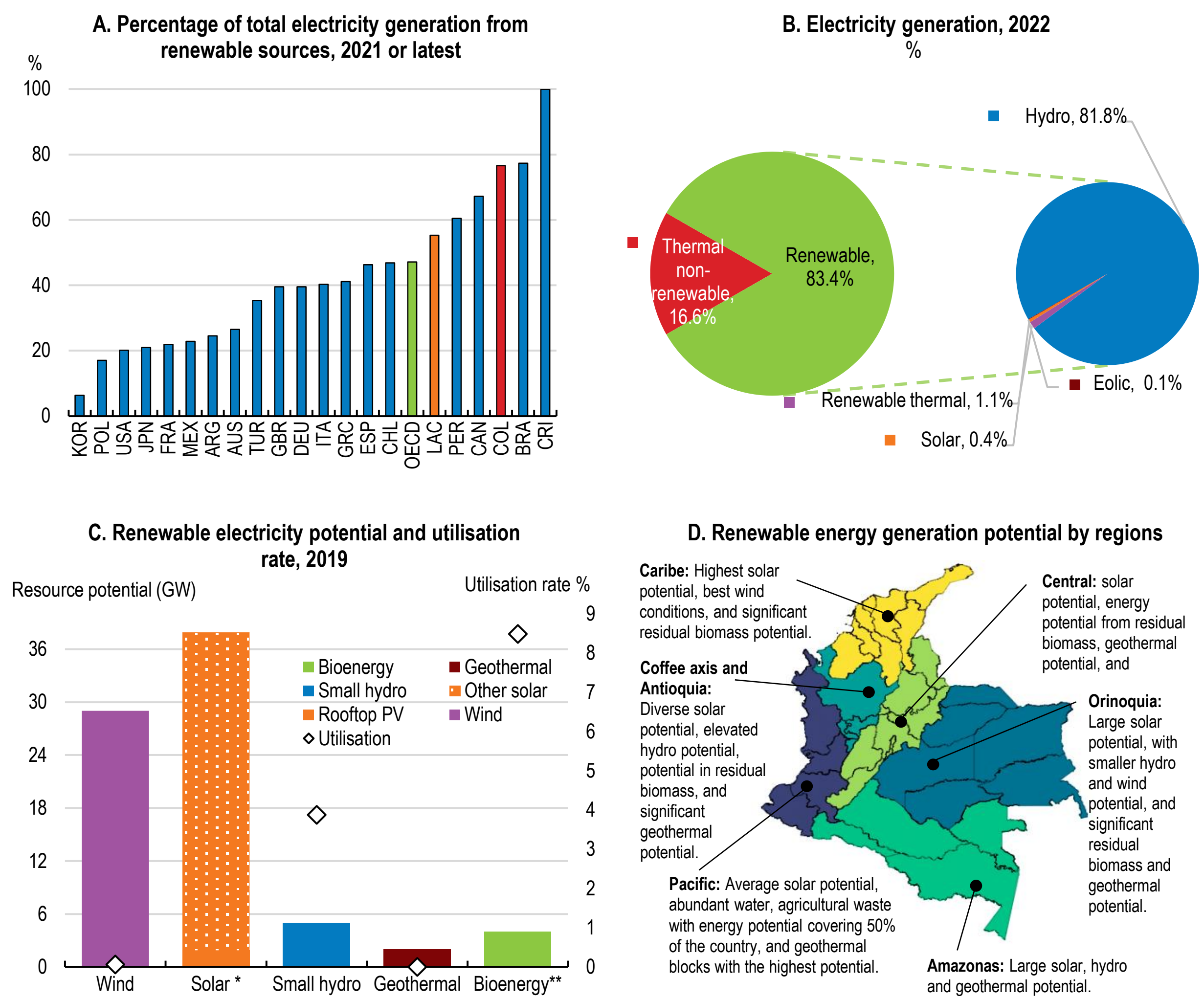
5.4.1. Accelerating the adoption of renewable energies

Colombia's energy generation from renewable sources, at 29% of total primary energy supply, is relatively high compared to the OECD average of 12%. In the case of electricity, generation from renewable resources is higher than regional peers and the OECD average (Figure 5.5, Panel A), accounting for 83% of total energy generation, largely hydropower (Figure 5.5, Panel B), but there is scope to further develop solar, wind, geothermal and bioenergy. Colombia has significant potential for renewable energies (Figure 5.5, Panels C and D). Regions like La Guajira in the Caribbean have significant potential for wind and solar power generation, with wind speeds three times higher than the global average and solar irradiation levels 60% higher than the global average. Bioenergy opportunities remain largely untapped (OECD, 2022[18]). Enhancing the renewable energy mix would also help diversify energy resources and ensure a more reliable energy supply, as frequent weather events such as El Niño can create power supply restrictions.

Figure 5.5. The share of electricity generated from renewable sources in Colombia is substantial



Note: LAC is a simple average of ARG, BRA, CHL, CRI, MEX, and PER. PV = photovoltaic. Solar * potential includes specific estimates for rooftop PV installations in large cities (solid), while other solar (dotted) potential is purely illustrative, given average solar radiation in Colombia in comparison with Germany. Bioenergy** only includes estimates for electricity generation capacity from agricultural residues.
Source: *OECD Green growth Indicators* ; OLADE; OECD (2022), *Enabling Conditions for Bioenergy Finance and Investment in Colombia, Green Finance and Investment*; DANE; and Ministry of Mines and Energy.

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To capitalise on this potential and achieve decarbonisation by 2050, Colombia must implement regulations that foster private sector investment in renewable projects and ensure regulatory and policy certainty. Recently, there have been significant delays in the completion of renewable energy projects and transmission lines due to regulatory bottlenecks and delays and low support for projects among local communities. Addressing these challenges, requires improved environmental licensing processes to reduce bureaucratic hurdles (OECD, 2023[19]), early engagement and informed consultations with communities and effectively integrating their concerns into project planning and execution to avoid negatively impacting their territories and ways of life. To alleviate adverse effects of renewable projects, it is essential to evaluate and mitigate the negative consequences of renewable energy sources on ecosystems, the quality of life and employment opportunities of communities most directly impacted.

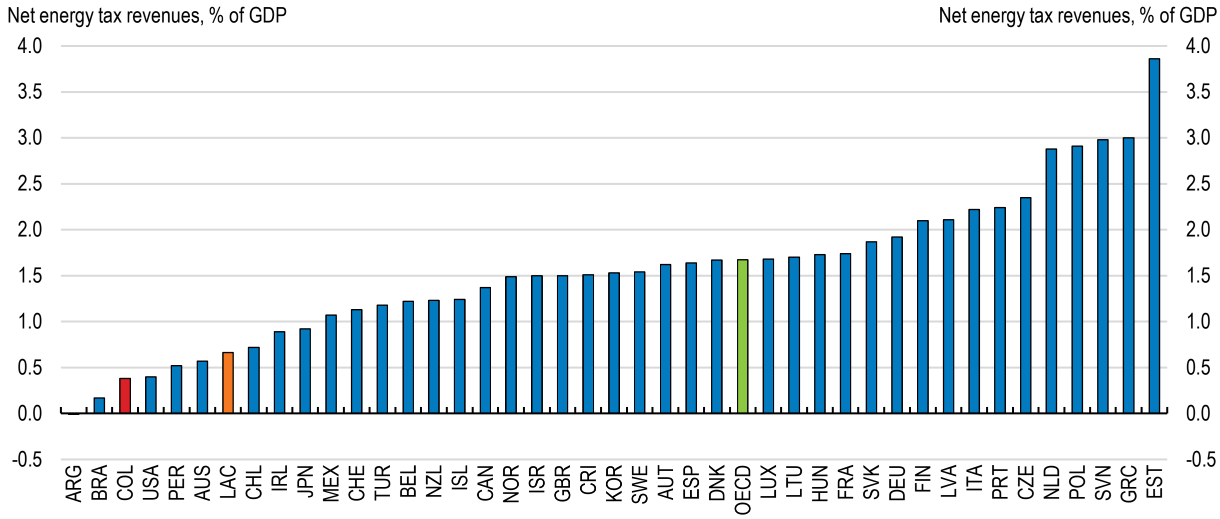
Significant additional investment is needed for the energy transition, with the private sector being a critical source of funding and innovation to drive the necessary advancements. Colombia needs to at least triple its annual investment, that is three times more than it currently invests in the petroleum sector (BloomberNEF, n.d.[20]). Foreign direct investment (FDI) can play an important role to reduce greenhouse gas emissions in key sectors. Foreign firms in the mining and quarrying industry are on average 16% less carbon intensive than domestic competitors in Colombia. Nevertheless, Colombia is one of the countries that attracts the smallest share of FDI for renewable energy production in the region (OECD, 2022[21]).

Stepping up investment will surely require a mix of public funding, private investment, and innovative financing mechanisms. Given limited fiscal space, attracting private investment and developing innovative financing mechanisms become crucial for stepping up investment. One challenge is that there is no clear government policy to secure the required funding for the energy transition nor a government assessment of how much it will cost. Green bonds and public-private partnerships have proven successful in Colombia, showcasing positive experiences in sustainable investment. Colombia has made strides in green finance, including the 2021 emission of a green bond in the local market, the first such issuance in Latin America, and the adoption of a national green taxonomy in 2022 that has spurred growth in the green finance market. This growth is evidenced by increased green credits and offerings, such as green mortgages and financing for sustainable construction, provided by commercial banks. However, these initiatives are still in their early stages and remain relatively small in scale. The number of private sustainable and green bond issuances has remained modest (5 sustainability bonds and 10 green bonds) and green credits at 5% of the total in 2023 (World Bank, 2023[2]). Further efforts to strengthen regulation to accelerate climate-focused PPPs, deepen and diversify green financing instruments, particularly from local banks will also be needed. Further expanding the role of public development banks in green financing is also needed. The underdevelopment of green capital market instruments is partly due to a shortage of investment-ready projects (World Bank, 2023[2]). Sector platforms integrating the real, finance, and public sectors can address this, while project preparation facilities can cultivate a pipeline of viable projects.

Additional robust policy signals are needed to further promote renewable energy. Colombia lacks targets for renewable energy sources, which reduces investment predictability. Establishing mid-term targets based on cost-benefit analysis of renewable installations, together with a defined schedule of auctions for long-term power purchase agreements would encourage private investment. Strengthening international cooperation to access funds and benefit from technology transfer in renewables generation is also essential (IEA, 2023[22]). Finally, tapping the potential of bioenergy, requires robust policy signals like deployment targets and fiscal incentives to stimulate early market uptake (OECD, 2022[18]).

Enhancing carbon pricing is a crucial element of a stronger decarbonisation strategy. Tax revenues from energy use, discounting subsidies, are only 0.4% of GDP, the lowest among OECD countries (Figure 5.6), primarily from levies on fuels, carbon, electricity, and emissions trading. The explicit carbon tax covers various fuels, including gasoline, diesel, kerosene, fuel oil, and liquefied petroleum gas. The 2022 tax reform expended it to include coal, but other fuels such as natural gas remain uncovered. Furthermore, it remains very low at around EUR 6 (or COP 25799 in 2024) per tonne of emissions (IEA, 2023[22]) well below estimated climate-related costs and other similar-income countries' rates (Federsarrollo, 2021[23]).

Figure 5.6. Large opportunities exist to boost tax revenues from energy use



Note: Year 2021. Net energy tax revenues represent the estimated net revenues derived from taxes and subsidies applied to fuels, carbon taxes, emissions trading systems (ETS), and electricity. LAC is a simple average of Argentina, Brazil, Chile, Costa Rica, Mexico, and Peru.
Source: OECD Tax and Climate.

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In a commendable decision, in 2023, authorities eliminated petrol subsidies and announced a plan to gradually reduce subsidies for diesel during 2024 and 2025, although the political economy is proving to be more complex. This initiative led to a significant increase in petrol prices, more than doubling them, amidst a backdrop of elevated inflation and economic deceleration. Eliminating all fossil fuel subsidies and increasing gradually the carbon tax to align it with decarbonisation goals, as discussed in Chapter 2 and recommended in the 2022 Economic Survey, can incentivize the substitution of fossil fuels and accelerate the transition to cleaner energy sources by removing artificial price advantages that fossil fuels enjoy due to subsidies. Raising the carbon tax gradually creates a clear economic signal for businesses and consumers to reduce their carbon footprint, thereby stimulating the adoption of energy-efficient practices and the development of sustainable alternatives. Additionally, aligning the carbon tax with decarbonisation goals and broadening the tax base helps internalise the true cost of carbon emissions, reflecting their environmental and societal impacts, while also generating additional revenue to support investment in clean energy and mitigate the effects on the most vulnerable.

Under the current carbon tax design, emissions could decrease by 2.6% from the Nationally Determined Contributions baseline scenario by 2030. However, with a carbon tax reaching USD 67/tCO2e by 2030, emissions could potentially drop by up to 40%, which would be consistent with a slow decarbonisation scenario targeting net zero by 2060 (OECD, 2021[24]). Revenues, under this scenario, could temporarily increase by up to 0.7% of GDP annually by 2030 (OECD, 2021[24]). Phasing the increase in a gradual manner and using the additional revenues to support vulnerable households with targeted and temporary transfers while investing in projects for clean energy technology development, such as energy efficiency initiatives, could enhance acceptance and support.

The establishment of emissions trading system could provide an additional mechanism for incentivizing emissions reductions and fostering investment in carbon-reducing projects. By creating a market-based system where companies can buy and sell tradeable permits, Colombia can further drive innovation, attract international investment, and achieve its decarbonisation objectives in a cost-effective manner.

While Colombia has a legal framework for a regulated carbon market, is not fully operational. The introduction of a pilot of Emissions Trading System has been planned for 2024 but has not yet started (CPC, 2023[25]). Transparent and effective carbon markets are needed to attract international emitters for mitigation efforts.

A well-planned strategy to communicate how revenues from higher carbon taxes will be spent could help garner political support. Carbon tax revenues can provide fiscal space for the green transition and for offering support to vulnerable households and businesses, mitigating short-term adverse economic and distributional effects of higher carbon prices and the phasing out of fossil fuel subsidies. These revenues can fund targeted social assistance, energy efficiency tax incentives, job retraining programmes or productive investments. For instance, British Columbia’s carbon tax, introduced in 2008, increased from approximately USD 7.5 per tonne of CO2 equivalent to around USD 60 per tonne in 2024. It is designed to be revenue-neutral, reallocating tax revenues through tax credits for low and middle-income families. Similarly, South Africa launched a carbon tax in June 2019, targeting about 90% of its emissions. It has plans for gradual future increases to advance its decarbonisation goals, despite current low effective rates due to transitional measures aimed at preserving competitiveness and protecting low-income households until 2025.

5.4.2. Enhancing energy security

Ensuring a secure energy supply must be a government priority (IEA, 2023[22]). It is crucial to maintain resilience in electricity and natural gas and oil provision, especially during drought periods and in remote regions. Addressing energy gaps requires providing electricity to 820,000 homes and transitioning 1.7 million households from firewood to efficient cooking fuels.

Diversifying the energy mix is key to enhance energy security, especially given Colombia's heavy reliance on hydropower for energy production (Figure 5.4, panel B), which makes it vulnerable to fluctuations in rainfall and climate change impacts, as seen during events like El Niño. Colombia could use natural gas as a transition energy to sustain energy security until renewables gradually play a larger role. Such approach would help curb greenhouse gas emissions, as natural gas emits 40% less CO_2 than coal and up to 20% less than oil, while complementing renewable energy sources. However, a current concern is a growing reliance on natural gas imports, which poses risks to energy security. Estimates indicate Colombia may lose natural gas self-sufficiency by 2026. By 2034, demand for natural gas is projected to outstrip supply, even with planned import facilities in place (Fedesarrollo, 2022[14]; Gonzalez, forthcoming[17]). This will require a plan and financing to enhance gas supply and demand flexibility, maximizing production from current fields, investing in gas storage facilities, reducing harmful emissions caused by certain gas extraction practices, and expanding the country's gas supply alternatives through the development of additional LNG terminals (IEA, 2023[22]).

5.4.3. Reducing greenhouse gas emissions from the transport sector

Decarbonising the transport sector, a major contributor to the country’s greenhouse gas emissions, will be critical towards achieving its net zero target. To achieve it, the transport sector needs a large transformation. The transport sector is primarily dominated by road transport, which serves as the main mode of transportation for both passengers and freight due to the country's mountainous terrain and dispersed population. More than 80% of transport emissions are generated by road transport, from which 65% comes from freight, reflecting the freight sector’s dependence on road transport, use of diesel, and the poor state of vehicles.

The decarbonisation of freight transport requires increasing substantially the participation of rail in freight operations. Government efforts for the next decade prioritise fluvial and rail modes in the new 5G, public-private partnership pipeline programmes, as highlighted in Chapter 3, but it not expected to reduce emissions by mid-2030s. The road freight sector underperforms regional peers in terms of emission standards, fleet modernisation, fuel technologies, intermodality, and advanced logistics management (World Bank, 2023[2]). Implementing the scrappage schemes to all the heavy-duty transport fleet and expending it to all older polluting vehicles should be implemented as a priority (IEA, 2023[22]). The adoption of strict emission standards for new trucks entering the market would ensure that vehicle replacement leads to the introduction of cleaner, more efficient alternatives, while incentives for fleet modernisation would also help. Accelerating innovation and adoption of alternative sustainable fuel technologies is also key.

The national development plan 2022-2026 (IEA, 2023[22]) aims at improving transportation and the National Electric Mobility Strategy and tax incentives have shown progress, but further mitigation actions are needed. These include further electrification of the private and public vehicle fleet and developing a robust network of charging stations. Expanding public transport infrastructure, promoting alternative modes like walking and cycling, would also help reduce pollutant emissions and improve air quality. Colombia stands out as a global frontrunner in bus-based public transportation, boasting mass urban transport systems in seven cities, including bus rapid transit, cable cars, and a metro system in Medellín, collectively serving 17 percent of the population. By 2025, Bogotá's deployment of electric buses is expected to create the largest electric bus fleet in the region (World Bank, 2023[2]). There are also plans for intermediate cities to incorporate passenger electric buses into their fleet. Prioritizing further electrification of buses is paramount, given its financial feasibility and significant contributions to enhanced air quality and public health.

5.5. Strengthening the fiscal framework to account for climate change risks

Colombia has significant spending needs for adaptation and mitigation, and green medium-term fiscal frameworks could be instrumental in creating the needed fiscal space and helping to prioritise spending. Strengthening the medium-term fiscal framework to systematically include climate change considerations would help mitigate the significant economic risks and fiscal costs (OECD, EU Comission & IMF, 2022[26]), following the example of some OECD countries (Box 5.2). Colombia's medium-term fiscal framework provides transparent planning over several years (MinHacienda, 2024[27]), but could be strengthened by integrating fiscal risks associated with climate change in fiscal strategies, medium-term budget frameworks, and long-term fiscal sustainability analyses to create sufficient fiscal space to absorb losses.

Since 2021, Colombia national budget law includes green budgeting requirements to assess the environmental impact of budgetary and fiscal policies (OECD, EU Comission & IMF, 2022[26]). Yet, Colombia has only started to do ex-post environmental impact assessment of some measures. Moving forward, Colombia could prioritise incorporating climate-related expenditures and revenue measures into the budget and medium-term fiscal framework to align fiscal policies with climate objectives. One approach is to include green forecasts, such as emissions, alongside projections related to renewable energy deployment, energy efficiency improvements, biodiversity conservation efforts, and sustainable land use practices, like some OECD countries (Box 2.3). These climate impact assessments can inform the evaluation and selection process of public investment projects, enhancing alignment with climate goals.

Box 5.2. Green medium-term fiscal frameworks in OECD countries

Denmark adopted macro-fiscal forecasting and modelling tools that incorporate climate and environmental impacts to inform the preparation of the country's fiscal strategy and budget. Moreover, its GreenREFORM macroeconomic model makes projections extending to 2100, facilitating medium-to-long-term analysis, ensuring alignment with climate targets and enhancing Denmark's fiscal framework with a central focus on environmental policy. The model accounts for factors like energy usage, pollutant emissions, and the effects of environmental taxes and subsidies.

New Zealand incorporates climate change considerations into its long-term fiscal reports, such as the Long-term Fiscal and Investment Statements published every four years, along with aging considerations. Additionally, New Zealand has introduced a Climate Economic and Fiscal Assessment to assist decision-makers in both the public and private sectors in identifying and managing the risks and opportunities of climate change, facilitating a transition to a low-emissions and climate-resilient future.

The **Scottish** government provides a carbon footprint assessment of its draft budgets, which estimates the GHG emissions associated with planned government purchases of goods and services.

In **Sweden,** the government integrates climate targets and budgetary targets, presenting a climate report in its budget bill annually as mandated by law. Additionally, every fourth years, it formulates a climate policy action plan detailing strategies for achieving climate targets.

Source: IMF (2022[28]) and OECD, EU Commission, IMF (2022[26])

5.6. Turning the green transition into an opportunity for development

Transitioning to carbon neutrality can drive long-term output growth compared to a scenario with no climate action, thanks to substantial investments, enhanced energy efficiency, and increased productivity (World Bank, 2023[2]). OECD analysis indicates that while decarbonizing, investing in green sectors, both physical and human capital, could lead to a net increase in formal employment (OECD, 2023[29]), although certain industries like coal and oil are expected to face job losses. The green transition also presents an opportunity to enhance development in lagging regions and closing regional gaps (as highlighted in Chapter 3) by involving local communities and ensuring the benefits of the transition are equitably distributed. The government Just Energy Transition roadmap aims to close regional gaps and ensuring equitable benefits across diverse areas of the country.

A successful green transition requires diversifying exports and the economy to raise new sources of tax revenues, boosting growth and creating high-quality job opportunities. The government reindustrialisation plans prioritise tourism, culture, agroindustry, and renewable energy to diversify its activities (see chapter 3). A well-executed export diversification plan is crucial for facilitating the green transition, but a comprehensive set of reforms needs to complement it to ensure the success of reindustrialisation and diversification efforts. These reforms encompass improvements in infrastructure, enhanced logistics, continued emphasis on high-quality education and training, measures to reduce informality, and the lowering of both tariff and non-tariff barriers, as discussed in Chapters 3 and 4 of this Survey. A more innovative economy is crucial for supporting Colombia's diversification away from oil and coal. The effective use of science, technology, and innovative solutions can significantly enhance environmental sustainability, drive economic growth, and help the country achieve its net-zero targets.

Renewable energy is a promising option to reconvert the mining regions in the north, as noted above, benefiting from abundant wind and solar resources. Colombia can also leverage its established mining sector to diversify into minerals like copper, nickel, and cobalt, all needed in the global energy transition. The latest National Development Plan 2022-2026 foresees a new mining policy aimed at improving geological knowledge of Colombia's mineral resources. More exploration and permitting clarity are required to ramp up production, while mining activities must adhere to rigorous environmental, social, and governance standards while benefiting local communities. The bioeconomy presents significant opportunities for Colombia to achieve economic development aligned with decarbonisation goals and the transition in the productive structure, aligned with the National Development Plan.

Fully realizing these opportunities also requires support to those who will need to transition to other jobs. Deploying comprehensive training programmes for displaced workers, equipping them with the necessary skills to access job opportunities in new sectors, is key to minimise the social impact of potential job displacements. It is also required to address the skill shortages in thriving sectors that will probably arise, such as those related to with the deployment of renewable energy parks. For example, repurposing skilled coal mining labour to develop critical mineral industries can ease the green transition. Flexible, short training programmes are needed to address time constraints and labour-market relevance (OECD, 2024[30]). On-site and work-based learning provide practical hands-on experience while allowing workers to get financially compensated, making training accessible. Financial incentives play a crucial role in facilitating training participation, while career guidance is essential for individuals to understand the benefits and risks of transitioning to green employment. For example, the United States and Sweden provide holistic support, including work-based training, financial aid, and career guidance for green jobs. Gender imbalances in the green economy need attention, as women are usually underrepresented. Spain, Austria, and Sweden address this through targeted training and financial support to promote an inclusive green transition.

The labour reform bill being discussed in Congress (see chapter 4) stipulates that all firms undergoing decarbonisation must implement labour reconversion plans for affected workers. The 2019 OECD Economic Survey of Colombia highlights the need for improvements in the quality and pertinence of training systems and public employment services. Additionally, compensatory transfers and insurance programmes can serve as a safety net for workers transitioning to new job opportunities. Facilitating voluntary spatial reallocation of workers may enhance outcomes, especially as job opportunities in growing industries may not be concentrated in regions experiencing job losses.

Table 5.2. Policy recommendations for facilitating the green transition

MAIN FINDINGS	CHAPTER 5 RECOMMENDATIONS (Key recommendations in bold)
Adapting to climate change	
Colombia faces increasing climate-related risks. Failure to adapt can result in significant economic losses, damage to infrastructure, increased vulnerability to extreme weather events, and threats to food and water security.	**Coordinate and monitor climate adaptation measures across all government levels, while conducting and regularly updating detailed risk assessments to inform subnational planning.** Expand the coverage of early warning systems to all types of hazards and ensure interoperability with the social registry to effectively reach vulnerable populations. Expand access to insurance schemes, particularly in the agricultural sector.
Achieving decarbonisation by 2050 requires substantial fiscal policy efforts. Colombia's medium-term fiscal framework offers transparent planning over several years, but it does not include climate change risks or green forecasts systematically.	Integrate climate and environmental forecasts and risks into the medium-term fiscal framework to ensure alignment with targets and effective mitigation and adaptation to climate-related economic risks.
Accelerating efforts to reduce deforestation	
Deforestation, driven by activities such as cattle ranching, agriculture, mining, and logging, is a major source of greenhouse gas emissions in Colombia.	**Increase enforcement efforts to combat illegal deforestation while ensuring the effective coordination of deforestation control efforts across different levels of government by the new national council.** Promote the widespread adoption of climate-smart agriculture practices through targeted policies and capacity-building initiatives.
Shifting to clean energy and reducing greenhouse gas emissions from fossil fuels	
The Just Energy Transition roadmap is welcome and will help to curb greenhouse gas emissions, however it is not enough to meet Colombia's commitment to carbon neutrality by 2050. To achieve it larger investment in renewable energies are needed. Colombia's renewable resources potential are large. Renewable energy and transmission line projects have faced delays, attributed to insufficient local community support and regulatory hurdles. The carbon tax rate at USD 6 per tonne of CO2 is low, yet climate change targets are ambitious.	Streamline environmental licensing processes and require early engagement with communities and consideration of their concerns and suggestions in project planning and execution. **Strengthen the regulatory framework to incentivise investment in renewable energy, and schedule regular auctions for long-term power contracts.** Deepen and diversify green financing instruments to support private investment. **Increase and broaden the carbon tax rate and broaden its base to align it with the desired emission reduction targets, while supporting vulnerable households with targeted and temporary transfers.**
The transport sector contributes 14% of total greenhouse gas emissions, with over 80% coming from road transport, particularly freight.	Adopt strict emission standards for new trucks entering the market to ensure cleaner vehicle replacements. Continue electrifying public transport systems.
Turning the green transition into an opportunity	
Greener sectors will create job opportunities, albeit requiring a different set of skills, while workers in fossil fuel-intensive sectors may face job displacements.	Invest in workforce development and retraining programmes. Expand social assistance programmes to support displaced workers.

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OECD Economic Surveys

COLOMBIA

After a robust recovery from the COVID-19 crisis, Colombia's economic growth is returning to a low potential. Medium-term growth prospects depend on maintaining Colombia's strong macroeconomic framework and enacting reforms to create a business-friendly environment which can attract high levels of investment. Implementing fiscal consolidation and adhering to fiscal rules would prevent rising financing costs and safeguard debt sustainability. Reforms to raise tax revenues and improve spending efficiency are needed to create fiscal space for social and productive investment needs. Enhancing the investment climate requires reducing regulatory uncertainties and tackling corruption. Creating connected transport infrastructure, strengthening subnational government capacities and improving equalisation mechanisms in the fiscal transfer system would foster balanced development across the country. Addressing informality, gender gaps, and improving education quality would boost productivity and reduce social disparities. Investing in climate adaptation, renewable energy, and establishing stable regulatory frameworks are key for a climate-resilient economy and achieving carbon neutrality by 2050.

SPECIAL FEATURES: RAISING PRODUCTIVITY; REDUCING LABOUR INFORMALITY; REGIONAL CONVERGENCE

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