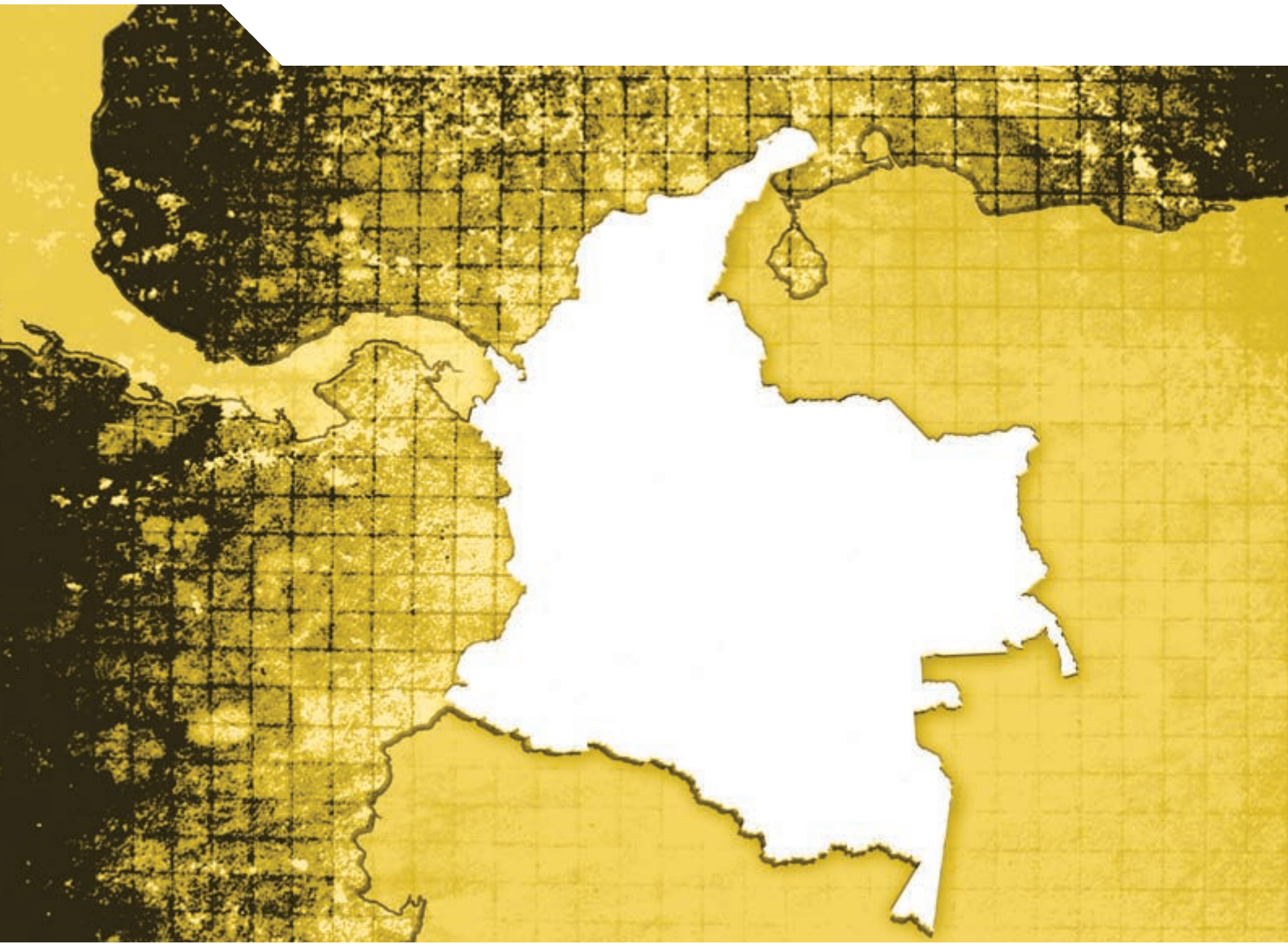
OECD Territorial Reviews

COLOMBIA



OECD

OECD Territorial Reviews: Colombia 2014



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Foreword

Responding to a need to study and spread innovative territorial development strategies and governance in a more systematic way, in 1999 the OECD created the Territorial Development Policy Committee (TDPC) as a unique forum for international exchange and debate. The TDPC has developed a number of activities, including a series of national Territorial Reviews. These studies follow a standard methodology and a common conceptual framework, allowing countries to share their experiences and disseminate information on good practices.

Policies for growth, jobs, equity and environmental sustainability have greater impact when they recognise the different economic and social realities where people live and work. National governments are thus challenged to rethink how to harness the potential of different types of cities and regions to prepare for the future. Policies for regions and cities can generate opportunities for skills development, investment and innovation, and directly contribute to improving quality of life. Such policies actively complement traditional macro and structural approaches in enhancing national performance.

OECD ministers endorsed this policy framework on 5-6 December 2013, during the meeting "Regions and Cities: Where Policy and People Meet" in Marseille, France. In particular, they endorsed the design of a national urban policy framework to address the economic, social and environmental needs and opportunities in cities of all sizes and the need to develop new data, policy and governance tools that enable governments to better fit policies to places, thereby promoting policy action at the relevant scale, including for key sectors, such as innovation, water and transport.

The *OECD Territorial Review of Colombia* sheds light on regional dynamics in a country that is experiencing tremendous progress and structural change. The overall improvement of the country, however, does not extend evenly to all regions. There are territories, especially rural ones, where citizens and business have limited access to key services. In this situation, national authorities have engaged in an ambitious process of regionalisation of policy design and delivery to tailor public investment to local needs and opportunities. This review illustrates the evolution of the regional development policy in the country and also provides national authorities with guidance and good policy practices from OECD membership to make such a process more effective and efficient.

This report is a collection of thematic policy papers, and therefore does not reflect the usual structure that characterises the OECD Territorial Reviews. The reason for this difference comes from the need of providing Colombian authorities with policy recommendations at the time the assessment was being carried out, between March 2013 and June 2014. This enabled the OECD recommendations to inform the National Plan 2014-2018, which organises investment in the country and plays a fundamental role for regional development.

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Acronyms and abbreviations

BRIICS	Brazil, Russian Federation, India, Indonesia and China
CAN	Andean Community (*Comunidad Andina*)
CAR	Regional autonomous corporation
CMDR	Municipal councils for rural development
CONSEA	Department councils for rural development
COP	Colombian peso (currency)
COT	Land-use Planning Commission
DAFP	Administrative Department of the Civil Service (*Departamento Administrativo de la Función Pública*)
DANE	National Administrative Department of Statistics (*Departamento Administrativo Nacional de Estadística*)
DNP	National Planning Department
FAE	Savings and Stabilisation Fund *(Fondo de Ahorro y Estabilización)*
FARC	Revolutionary Armed Forces of Colombia
FDI	Foreign direct investment
FTA	Free trade agreement
FTZ	Free trade zone
FUA	Functional urban area
GDP	Gross domestic product
GVC	Global value chain
Hi	Herfindahl indices
ICDE	Colombian Infrastructure of Spatial Data (*Infraestructura Colombiana de Datos Espaciales*)
ICO	Internal control office
ICT	Information and communication technology
IMF	International Monetary Fund
IRS	Increasing returns to scale
LAC	Latin America and Caribbean
LDP	Local development plan

LOOT	Organic Law governing the Territorial Organisation in Colombia (*Ley Orgánica de Ordenamiento Territorial*)
LQ	Location quotient
MEs	Marshallian externalities
MIZ	Metropolitan Influenced Zone
MPR	Multidimensional poverty rate
NDP	National Development Plan
NGO	Non-governmental organisation
NRF	National Royalty Fund
NRP	New Rural Paradigm
OCAD	Collegiate bodies of administration connected with the reform of royalty payments (*Órganos Colegiados de Administración y Decisión*)
OGP	Open Government Partnership
PDRIET	Integrated Programme of Rural Development with Territorial Approach (*Programa de Desarrollo Rural Integral con Enfoque Territorial*)
PMR	Product-market regulation
PTP	Programme for Productive Transformation (*Programa de transformación productive*)
RCF	Regional Compensation Fund
RDF	Regional Development Fund
REER	Real effective exchange rate
RURBAN	Rural-Urban Partnership
SGP	General System of Transfers (*Sistema General de Participaciones*)
SGR	General System of Royalties (*Sistema General de Regalías*)
SIGOT	Geographic Information System for the National Planning and Territorial Structure (*Sistema de Información Geográfica para la Planeación y el Ordenamiento y del Territorial Nacional*)
SME	Small and medium-sized enterprise
SSF	Savings and Stabilisation Fund
STI	Science, Technology and Innovation Fund
TDPC	Territorial Development Policy Committee (OECD)

Executive summary

Colombia's economic success in recent decades reflects the development of its hydrocarbon resources, its increased integration into the world economy, the pacification of the country after a generation of armed conflict, and improved governance. Economic growth has benefited an increasing number of citizens. Poverty rates have fallen in the past decade, and unemployment rates, though still high, have started to come down. These positive trends have paved the way for an ambitious reform agenda, in all areas of public policy.

Inclusive regional development is a top national priority. High and spatially concentrated income disparities may hinder national performance in the medium term. Colombia is a large country, whose topography, climate, regional accessibility, industrial specialisation, the legacy of the armed conflict and illegal activities, and also wide variations in sub-national governments' capacities, have generated a "mega-diversity" of regional economies. Some territories are prospering, but others are experiencing depletion of their assets, including human capital. In this context, the OECD has identified some strategic challenges and recommends four actions.

First, improve the quantity and quality of regional statistics, and formulate a territorial classification that helps tailor policies to places. Evidence-based policy making is impeded by the lack of information and by outdated urban and rural taxonomies. Colombia should better define urban functional areas and classify rural communities according to their population density, proximity to cities and regional accessibility.

Second, reform the planning process by streamlining objectives, regionalising policy design and implementation, and better connecting capital investment with current expenditure. The quadrennial National Development Plan (NDP) sets investment priorities and co-ordinates sectorial policies. As Colombia has become more decentralised and its economy more complex, the central government has not found it easy to strike a balance between the internal coherence of the plan and its implementation. To align investment agendas across levels of governments, national authorities might identify a few key policy goals and delegate to sub-national authorities the task of tailoring the national strategy to territorial needs and opportunities. Finally, national authorities should take into consideration that capital investment, as laid down in the NDP, increase current expenditures, and that better co-ordination of these two elements is needed.

Third, encourage scaling up of investment and policy delivery in territories by maximising the use of existing regional development bodies. Regional development policy in Colombia has involved a large number of small-scale projects, and this fragmentation of investment has complicated the recent reform of royalty payments, among other things. Sub-national governments have too few incentives, capacities and tools to co-ordinate among themselves. Intermediate institutions are needed to assist regions, based on groups of departments, to integrate plans for development, identify policy complementarities and allocate the available funding appropriately. Scaling up

regional development policy will also be beneficial for urban and rural policies and help to connect these two agendas and the budgets associated with them.

Fourth, Colombia needs to reform central government transfers to sub-national governments, re-evaluate sub-national taxation and reframe the oversight process. A mismatch exists between the responsibilities of sub-national governments in Colombia and the funding they receive. National authorities may consider implementing a flexible system in which sub-national governments with enough capacity are given the autonomy to tailor expenditures to local needs, assume responsibility for service delivery and incentivise citizen engagement. Better co-ordination across levels of government could help promote a multi-annual budgeting/planning framework at the sub-national level and better management of investment projects, including those on a large scale and funded by royalty payments. In this context, the oversight system needs to focus more on results and less on formal requirements. This would increase flexibility and fiscal co-responsibility and create incentives and capacity for the sound management of public finances across all levels of government.

Key policy recommendations

Organise statistics within a spatial framework and improve the territorial classification of urban and rural

- Develop regional statistics. This will require an improved Census system and a better territorial classification, defining urban (functional urban areas) and rural (remote and predominantly rural, accessible rural, rural within functional urban regions) in a way that matches reality and aligns with OECD standards. This will facilitate comparison with international benchmarks.

Strengthen a place-based approach both in the National Development Plan (NDP) and industrial policy

- Regionalise the design, implementation and monitoring of the NDP. The central level may set broad policy goals and allocate the responsibility of adapting the national strategy to local challenges and opportunities to lower administrative levels. The next NDP should adopt a territorial approach and determine its impacts, expected results and evaluation indicators accordingly.
- Gradually abandon the sectorial approach of national industrial policy and enhance the current focus on enabling conditions for business at the regional level. Support for specific industries (in the form of cluster policies, for instance) may be delegated to sub-national government.

Scale up policies and investment for regional development

- Create (or capitalise on existing) intermediate institutions to help co-ordinate policy interventions at a larger territorial scale. These technical bodies should provide support and capacity building to sub-national levels. Their aim should be to scale up regional investment, with a specific focus on royalty payments. These bodies should also provide information and analysis for policy making, identify potential policy complementarities in regions, and direct the evaluation and monitoring of projects at the regional level. Finally, they could play a pivotal role and assist a broad range of policies across levels of government.

Key policy recommendations (*cont.*)

Connect urban and rural development agendas

- There are several reasons why more co-ordination between urban and rural policy is needed. It is possible that the current policy to connect Colombia's main cities (*Misión de Ciudades*) will lead to an agglomeration of factors of production in core hubs. This may also increase rural-to-urban migration, which is already intense. The negative impacts of the policy can be mitigated by promoting human capital, innovation and entrepreneurship in all regions, rural areas included. This will also require a holistic approach to rural development that reduces the current focus on subsidies to farmers. Finally, urban-rural linkages should be enhanced to provide rural dwellers with access to basic services, thus reducing migration flows.

Improve local finance to provide sub-national authorities with more autonomy and responsibility

- Reform the system of transfers from the centre (earmarks) to improve autonomy, flexibility, responsibility and solidarity among sub-national governments. Better regional data and institutions can help fine-tune transfers, to respond better to local needs without endangering Colombia's fiscal sustainability.
- Reform tax collection at the sub-national level to increase tax revenues in departments and municipalities. In particular, review the portfolio of taxes levied by departments and municipalities; improve the performance of the municipal property tax by updating cadastral and land values; establish incentives to enhance tax collection at sub-national level (e.g. linking the amount of transfers from the centre with the fiscal effort of sub-national governments).
- Promote a fiscal framework that is conducive to public investment. This will require reinforcing co-ordination across levels of government; implementing multi-annual budgeting at the sub-national level; and introducing a "golden rule" in the sub-national fiscal discipline framework.

Adopt a control system focused on results rather than rules, that engages citizens

- Consider experimenting with a self-assessment tool to analyse weaknesses of the institutional framework from a sub-national viewpoint.
- Enhance co-ordination among the oversight bodies at sub-national level and clarify roles and responsibilities. In particular, promote the role of the recently created regional "commissions for moralisation" led by the Secretary of Transparency.
- Match devolution of power to sub-national levels and control activities with tools to enhance citizen engagement. Participation needs a scope of action and should focus on sectors selected in consultation with citizens.

Assessment and recommendations

A "mega-diverse" country with limited regional data.

Colombia is a large country that covers an area of 1.14 million square kilometres (almost twice the size of Texas or France), bordering two oceans and encompassing part of Amazonia and of the Andes. The country's ethnic minorities include Afro-Colombian and indigenous communities, which enjoy special status in the nation. Regional economies specialise in activities like intensive (tropical) agriculture, extractive industries, manufacturing and services (especially in urban areas). This regional diversity, however, is not reflected in the territorial statistics. An abundance of administrative data is available at the national and municipal level, but Colombia has no spatial framework for organising regional data. This has been something of an obstacle to a more thorough analysis. In Colombia, the data for the OECD's smallest unit of territorial analysis, Territorial Level 3 (TL3), is not available. Such data could have been useful for comparison with TL3 regions in the OECD as a whole (1 791 regions in 34 countries). Most of the analysis in this review was carried out at Territorial Level 2 (TL2), which, in Colombia, includes the 32 departments and the capital, Bogotá. This report should be considered the first step in a process to help bring Colombia up to OECD standards in terms of regional statistics and indicators.

An administrative structure based on three levels of government.

Colombia's administrative units include 32 departments and the district of Bogotá. The departments are subdivided into municipalities, for a total of 1 102 local governments. The national government classifies municipalities into seven different categories. This includes a "special category" of the largest cities, which are able to deliver an integrated basket of services to their citizens, and six other categories that classify cities according to their accessibility to services. Departments and municipalities are the main territorial units for which most of the demographic, social and economic statistics on Colombia are available. Some aboriginal and Afro-Colombian communities are included within this system of local governance. The Colombian Constitution, which was enacted in 1991, grants departments and municipalities a high degree of autonomy, and defines Colombia as a unitary decentralised country. It requires the central government to earmark funds for allocation to sub-national levels for such services as education, healthcare, infrastructure and water sanitation.

Colombia is growing, but regional disparities remain a concern, suggesting that the development model is not inclusive. Colombia, with its population of 46 million, has managed to become Latin America's fourth-largest economy in terms of GDP. The International Monetary Fund (IMF) ranked it 20th in the world in 2013, with a total gross domestic product (GDP) of USD/PPP 500 billion. Its GDP grew at an average of 4.4%

between 2008 and 2013. Economic growth has generated new job opportunities, although the unemployment rate is still high (approximately 10% in 2013). The biggest challenge remains a high degree of income inequality. Colombia is a fractured country. When compared to OECD member and selected non-member countries, Colombia displays the eighth-highest level of regional inequality in GDP per capita. Regional inequalities are not only 42 times higher than in Australia and more than 5 times higher than in Canada or the United States, but also higher than in most neighbouring Latin American countries. This suggests that development may fail to include large groups across the country.

Colombia's territorial classification distinguishes urban territory from *resto rural* (residual rural areas). Under this schema, about 75% of the population is considered urban. The failure to capture the true diversity of rural conditions may make it difficult to deliver services in sparsely populated areas. Since 2010, several attempts have been made to rectify this. The *National Human Development Report of Colombia* proposes an index of rurality, inspired by the OECD methodology, which classifies as rural more than 75% of municipalities and 32% of the national population. If groups of municipalities were used as building blocks to develop a TL3 classification, they could be used to apply the OECD regional typology. For the 1 102 municipalities for which data are available, 970 have population densities of below 150 inhabitants/km². This suggests that many of the TL3 regions of Colombia would qualify as "predominantly rural".

Urban networks are disconnected due to gaps in transport infrastructure.

Settlement patterns involve an archipelago of urban regions surrounded by poorly connected rural areas. Colombia has an unusual polycentric urban system in the Latin American context, comparable to Brazil and to some extent, Mexico. It has five main urban agglomerations that serve as hubs for the surrounding region. However, urban networks are disconnected because Colombia still has one of the biggest gaps in transport infrastructure in Latin America. Its network of roads and railways is low by Latin American standards given its per capita GDP, and it lags well behind Asia and OECD countries in transport infrastructure. Due to the lack of transport infrastructure, the functional area of each urban hub tends to be relatively small and isolated. Colombia's major cities have essentially become production and service centres, developing too many functions relative to their size. New cities have emerged in this structure (47 cities had a population larger than 100 000 in 2014), but the split between rural and urban is evident.

Social unrest has caused a rural diaspora to cities (*desplazados*). Many rural areas have been dangerous places for several decades, sheltering guerrilla groups and the cultivation of illicit crops (opium poppies and coca). Rural residents forced off their land moved to cities, regardless of their ability to participate in the urban labour pool. No official data are available on the number of *desplazados* living in urban areas, but the flows have resulted in informal settlements and increased urban poverty.

Resource-rich departments perform well in GDP growth but display large income disparities.

Resource-rich departments display the best performance in terms of GDP growth, but also the highest income disparities. Despite the high spatial concentration of GDP in urban areas, it is not urbanisation that drives rapid GDP growth, but the resource-based

economy. Bogotá had the highest population density in 2000, but its average GDP growth was comparable to departments with the lowest population densities. Colombia has become a net exporter of energy commodities: petrol represented 32% of total exports in 2010. Ten departments produce oil, but the three largest producers, Meta, Casanare and Arauca, produce more than 70% of national output. These departments are also sparsely populated. Despite robust regional GDP growth, resource-rich departments show large income disparities.

Distractive activities are drivers for growth but pose certain challenges.

Colombia's specialisation in extractive activities and openness to international trade act as drivers for growth, but also pose certain challenges. Over the past two decades, the focus of the economy has shifted, from specialising in agro-industry and manufacturing to dealing in energy commodities. The increasing production of oil and coal attracted substantial foreign direct investment, particularly between 2002 and 2012. The commodity boom helped the economy rebound from a sharp deceleration in growth in 2009, caused by natural disasters and the temporary loss of the Venezuelan export market. However, the success of extractive industries has pushed up the real effective exchange rate (REER). Compared with other resource-rich economies (Australia, Canada, Chile, Norway and the United States), the Colombian peso experienced the highest appreciation over the period. This squeezed the manufacturing and agricultural sectors on the international market, as did higher input prices driven by the mining industry and low overall labour productivity between 1990 and 2011. Colombia exhibits three-tier economic growth, with a rapidly growing but increasingly vulnerable mining sector leading the way, non-tradable services also growing and non-mining tradable sectors falling behind.

Extractive activities are capital intensive and may not generate the number of jobs needed for inclusive growth. Total employment in mining represents less than 1.5% of overall employment. The loss of jobs in the manufacturing sector and agriculture has not been offset by gains in the service sector. Most employment in services involves low-skilled and low-wage jobs, whereas manufacturing often requires medium and high-level skills. Manufacturing offers opportunities for entrepreneurship (small and medium-sized enterprises, SMEs) and self-employment which can help reduce informal labour and are associated with strong local multiplier effects in non-tradable employment. At the sub-national level, urban agglomerations have increased their economic diversification, and resource-rich departments have become more specialised in the extractive sector. Most departments have experienced some diversification, but certain departments, typically those that experienced strong growth in mining industries, have shown a substantial increase in economic specialisation.

Agricultural activities could become an engine of growth.

Agriculture remains the backbone of most departmental economies. Agriculture, forestry and fishing are well represented in most departments, except for the four urban departments with over 50% of the national GDP and a few others. Agricultural activities could become one of the engines of a distributed growth process. Some of the fastest-growing departments, such as Cauca and Cundinamarca, are progressing both in agriculture and manufacturing, and could possibly capitalise on synergies by integrating

different supply chains. These findings, however, need further territorial analysis by the Census of Agriculture.

Colombia has put in place a broad set of policies to promote regional development.

Colombian authorities are aware of the challenges facing national development, and have put in place a broad set of policy strategies to promote more inclusive regional economies. The foundation of this strategy is laid out in the National Development Plan (NDP), "*Prosperidad para Todos*", or "Prosperity for All". The plan provides a four-year framework (2010-14) and introduces a regional perspective in policy making. The plan also deals with Colombia's industrial policy, promoting the diversification of its productive industries to mitigate distortions introduced by the success of extractive activities. In the same vein, a radical reform of the system of royalty payments is now the basis for regional development policy, and a series of tools to improve multi-level governance has been introduced. This should help sub-national governments and regional stakeholders pool information on territorial challenges and opportunities, and to take ownership of policy interventions. Finally, the government is promoting the integration of spatial and economic planning.

Regional development is a critical tool in Colombia's NDP. The NDP is a roadmap of the government's key economic and strategic activities. Its overall investment is USD 7.8 trillion, of which 40% is private investment. Each department and municipality is charged with formulating a programming document based on the key priorities identified by the national document. This means that, on paper, investment agendas at all levels of government are aligned towards a common goal. The recent shift in the royalties system has promoted integrated development, strategic planning and a focus on the regional. The National Planning Department (DNP) has made a concerted effort to gather information at the sub-national level to encourage strategic planning and an integrated territorial development strategy. The DNP's formulation of so-called regional profiles is an attempt to diagnose regional development problems and potential, identifying bottlenecks and promoting a vision for the development of each region.

The planning system faces two key challenges, the first of which is the lack of ownership and partnership at the sub-national level. Colombia's first NDP, formulated in 1961, was intended to co-ordinate production and investment to improve the production of coffee, the backbone of the national economy. Since then, Colombia has been transforming into a modern economy, with a complex web of economic concerns. The reform of the administrative structure under the new Constitution in 1991 delegated government responsibilities and autonomy to sub-national government, multiplying the number of public stakeholders (departments and municipalities) involved in the planning process. However, while many sub-national authorities collaborate with the central level, some mayors and governors still treat these plans as a formality, or worse, as a bureaucratic burden imposed by the central level. A second challenge is the scarcity of data on regional and local trends. The statistics available are inadequate to inform policy making for the NDP and to facilitate monitoring and evaluation of policy at the local level. So far, the central level assesses the implementation of policy, focusing on investment flows at departmental and municipal level. These flows, however, do not reveal much about the regional economies' capacity to absorb the investments and turn them into productive activity.

Key recommendations to improve the planning system

Few OECD countries compile multi-year development plans at the level of detail Colombia requires. In general, the government, or supra-national authority, sets general goals, and investment plans have a sectorial focus, referring to a specific public good such as education, healthcare or innovation capacity. In this context, the OECD recommends the following:

- Simplify objectives. "Prosperity for All" is a remarkable effort of design and co-ordination of different policy agendas, with a coherent development vision. However, this coherence does not necessarily map onto reality, particularly as the actions listed in the plan percolate to the regions. Colombia might consider identifying some key strategic goals at the central level, then allocating more responsibility to lower tiers to adapt the national strategy to regional conditions.
- Regionalise the design, implementation and monitoring of the plan. Streamlining national planning will require a series of structural changes and could benefit from a place-based approach. Colombia's regions face disparate challenges, depending on their location, economic specialisation and the incidence of social unrest and armed conflict.
  1. First, the territorial scale best suited to the plan must be determined. Departments may be too small for this role, given the number of functional economic areas that include different departments. The six regions created by the reform of royalty payments might be considered for this, since they were identified in co-operation with departments that self-selected territories for their economic and social homogeneity.
  2. Second, capacity building and technical assistance are needed to accompany the transition from national- to regional-level planning. Colombia is about to institute a series of regional observatories to collect territorial information. These fall under the National Planning Department, which could allocate technical skills to them to transfer planning capacities to sub-national authorities. Councils for regional competitiveness, public-private bodies now operating at the department level, could help facilitate co-ordination among different departments in regions.
  3. Third, regional development agencies could be created, based on the observatories and the councils for regional competitiveness. The lack of an administrative authority at the regional level (i.e. the absence of an elected regional government) could help protect these institutions from the attempts of local elites to gain political control of regionally allocated public funds.
  4. Fourth, starting with "Prosperity for All", Colombia could consider for the first time assessing the long-term impact of quadrennial development plans. So far, this has been limited to a formal discussion in the Congress on the financial execution of the plan. This represents a loss of key information. A system for evaluating the long-term impact of planning, linked to the policy cycle, could improve the performance of the system on a continuous basis. Evaluation would be even more important in a regionalised planning system, with an increased number of policy measures and learning opportunities for policy makers. Regional observatories could also help evaluate the long-term impact of plans.

Industrial diversification is a government priority.

Colombia's industrial policy is partly a reaction to the increase of the REER, which has particularly hit manufacturing and agro-industry. Colombia's manufacturing activities are concentrated in traditional manufacturing sectors, such as textiles, or in sectors with low value added and low innovation capacity, such as car parts. Competition is based on price rather than value added. Agro-industry also faces structural problems, such as the lack of property rights (limiting the propensity to invest and innovate), poor transport infrastructure and dependence on public subsidies (particularly for coffee producers). Free-trade agreements have changed relative prices in the economy, affecting

long-established rents and the competiveness of the tradable, non-extractive sectors. Colombia's industrial policy has evolved on two different tracks: one focused on sectors, the other on framework conditions. In the late 1990s, the government decided to promote a small group of sectors, ranging from cut flowers to car parts, as national champions: 20 such sectors now receive intensive support. These industries have been associated with departments, resulting in a regionalisation of industrial policy. Meanwhile, the DNP and the presidency have developed a more holistic approach to industrial diversification. This includes supporting innovation capacity, formalising labour, building human capital, providing infrastructure and services to businesses and workers, and other enabling conditions. The National System for Competitiveness and Innovation has set up a network of regional councils for competitiveness in most departments, involving private stakeholders who provide guidance and feedback to policy makers.

However, a key challenge is represented by the fact that regionalisation of policy intervention is limited. The new intermediate institutions, like the regional councils in Colombia's institutional framework, offer fora where the local business community can help set policy. However, they are more effective in departments whose economy is already diversified. Regional policies have focused on industries rather than enabling conditions and public goods. Policy interventions tend not to reflect the presence of a spatial agglomeration of firms active along a common supply chain, but a given public authority's intent to support a sector within its jurisdiction. The overall policy framework suffers from duplication of effort and lack of a shared vision. The sectorial approach still absorbs a considerable amount of funds, despite its evident shortcomings, while the holistic approach gives only limited autonomy to regional constituencies and involves many pilot projects. All this fragments public resources. Lack of co-ordination between the strategies is proving costly and may not be viable in the medium and long term.

Key recommendations to promote manufacturing supply chains in Colombia

A review of all the current policies supporting industrial diversification is needed to simplify the process. Identifying responsibilities and encouraging horizontal and vertical co-ordination among public authorities would be helpful. The government should reinforce the current strategy to connect industrial diversification with territories. Regional stakeholders are a valuable source of information about investment opportunities. National authorities may consider:

- Emphasising enabling conditions at the regional level to facilitate innovation at the firm level. The aim should be to offer business a sheltered environment for experiment and innovation. The public sector should not directly provide capital to firms that claim to be innovative, but offer an integrated and tailored basket of public goods, infrastructure and services.
- Promoting better governance mechanisms, so local communities can help the public sector identify needs and investment opportunities. Resource-rich economies, like Colombia's, should improve the quality of governance, and focus less on directly diversifying exports or managing production. Colombia would be best served by building a diversified portfolio of assets, including natural resources, built capital and economic institutions. This is likely to raise productivity, offsetting the negative impact of the appreciation of the real exchange rate.
- Improved urban and regional connectivity may entail readjustment. Colombia has a well-developed urban system, but its cities tend to be relatively isolated. Urban poles have been severed from the rural areas affected by social unrest. The government's current efforts to connect urban agglomerations may prove difficult for some cities. As urban functions concentrate, some cities may lose functions. Measures to reduce the costs of this adjustment should be anticipated.

Colombia has reformed the way it handles the royalties derived from the exploitation of its natural resources to promote regional equity. A system in which royalties benefited

resource-rich departments has been replaced by one in which the allocation of royalties is distributed more evenly. Multi-level governance is central in the new system. The General System of Royalties (*Sistema General de Regalías*, SGR) provides sub-national governments with scope and funds. However, due to the lack of capacities, many sub-national entities, especially in remote and small communities, are not able to take full advantage of it. Moreover, the SGR is a project-based system, not a programme-based system that implements medium-term, viable and sustainable development strategies. In other words, the system supports a myriad of small-scale investment projects, but only a few large-scale investments involving several departments at once.

Key recommendations to enhance the impact of the reform of royalty payments on regional development

The medium-term success of development strategies in Colombia would require a number of structural reforms, including:

- Governance and scale. The current situation allows for confusion about the level of intervention. It is crucial to acknowledge the importance of the territorial viability of the unit of intervention. Most projects are developed at the municipal level, and few serve a group of departments or a region. Large-scale projects would require the development of specific institutions for development and planning at the regional scale.
- Programming. The current project-based system needs to be replaced by medium-term programming, developing a vision for each territory and integrating development planning over a determined period. Co-ordination at the regional, departmental and municipal levels, and of individual programmes with the National Development Plan, would be needed.
- Participation channels. To secure the support of the local population, adequate participation channels for local stakeholders, in particular business, need to be developed. Stakeholders should be gathered at local fora where information and energy can support decision making.
- Technical support. Regional, and, as needed, departmental development observatories could serve as advisory bodies for planning, implementation and monitoring for the regional and departmental councils. These should work with the National Planning Department and the National Administrative Department of Statistics.
- Fiscal autonomy. Greater fiscal autonomy at the sub-national level may be needed to ensure that local development processes are truly local.
- Innovation linked to business development, especially in the resource-based regions. The Science, Technology and Innovation (STI) Fund is underperforming. One solution could be to broaden its scope and support enabling conditions for innovation, and also to facilitate its connection with business. The fund could also be used to improve innovation and productivity in extractive activities in resource-rich territories. This could improve their productivity, increasing royalty payments and resulting in more funds for regional development in all regions.

The *Contrato* Plan is an instrument for improving the public sector's capacity to act in regions. Contracts were introduced in 2012 by the Organic Law governing the Territorial Organisation (known in Colombia as the LOOT: *Ley Orgánica de Ordenamiento Territorial*) and by the National Development Plan. In total, seven *Contrato* plans are expected to lay out an investment of USD 6.7 billion, for an overall population of 6 million. Most contracts focus on improving road connectivity, poverty reduction or support for regional competitiveness. Better service delivery is also a priority.

However, there are several challenges facing the effectiveness of the contracts. For instance, Colombia does not have a fully-fledged regional development policy. The contracts promote regional partnerships and local capacity, but are no more than project-based tools for implementation. They may also be vulnerable to the disruption of opportunistic behaviour or collusion. As actors search for solutions to overcome obstacles, consensus-based co-ordination of initiatives becomes necessary. Joint definition of pacts or agreements, or at any rate of shared reference norms, helps establish common parameters and set limits and constraints. While the *Contrato* Plan is probably an effective way to support regional development in areas with sufficient institutional capital to participate, the government should recognise the need to design regional strategies for economic growth in territories where institutional capital is lacking.

Key recommendations to improve negotiated territorial development

- Mainstream technical assistance within all seven *Contrato* plans to raise local expertise.
- Promote mutual support and exchange of good practices among sub-national authorities.
- Facilitate monitoring and evaluation of contracts' outcomes and impacts.

Colombia's urban development policy is a broad strategy that encompasses several key activities. First, the government (through the DNP, and in co-operation with the National Administrative Department of Statistics, or DANE) has identified functional urban regions. For the first time, local statistics are being organised within a spatial framework. Secondly, the government plans to connect the major urban poles. The *Misión de Ciudades* is an ambitious attempt to put in place a cross-cutting national policy framework for cities. It places particular emphasis on the need to improve the connections of Colombian urban poles both with one another and with the outside world.

However, national authorities should also consider that enhanced connectivity will have significant – and unintended – consequences on the distribution of wealth. The major cities do not trade much with one another and have relatively similar production structures. Due to their relative isolation, some cities concentrate more functions than a city of their size might in a typical urban hierarchy. Bottlenecks in access to external markets also constitute a form of protection for local producers. Improved connectivity will probably result in greater urban specialisation. That will generate both winners and losers in the short run, and may raise political challenges, as the immediate benefits are likely to be most apparent in the largest cities.

Key recommendations to promote inclusive urban development

This adjustment is probably both unavoidable and beneficial, but the question is how to limit the costs of the transition to a different kind of urban hierarchy. Rural development is particularly important in Colombia, since less-populated, peripheral areas suffered most in the period of social unrest. Decades of top-down sectorial policies, together with the risks of association and local clienteles during the conflict, have left many peripheral low-density areas without active stakeholders and institutions of civil society. In this sense, the robustness and stability of the national economy hinges on the performance of rural regions. As a result, Colombia has developed a rural development policy, the *Misión Rural*, addressing five aspects of rural development: *i*) rural areas' contribution to national development; *ii*) social gaps between urban and rural communities; *iii*) delivery of public services in rural areas; *iv*) agricultural competitiveness and environmental sustainability; *v*) governance systems that underpin rural development.

The current rural development policy has introduced a territorial approach. It is based on direct support to farming and promoting framework conditions in rural communities. The Ministry of Agriculture has implemented a territorial approach to rural development to provide rural households with access to basic services, including healthcare, road connectivity and education. The ministry is actively working to improve the issue of property rights, one of the key challenges to rural development. The DNP's Integrated Programme of Rural Development with Territorial Approach (PDRIET) aims to provide rural households in selected rural communities with access to a large basket of public services. The PDRIET, despite its relatively small scale, is providing key information about basic needs in rural areas and possible policy solutions. The rural development policy connects with other important policy agendas, like the reform of royalties, which could give rural communities a chance to bridge the infrastructure gap holding back their development.

Despite the current efforts, rural communities are still facing several key challenges. The lack of a territorial classification that recognises the different characteristics of rural areas across the country is an obstacle for Colombia's rural development policy. Remote rural communities suffer from difficulties in service delivery, but no national strategy exists to deal with this problem. Furthermore, the government considers rural development a social policy, not a way to promote economic development in all regions. Colombia's overall development strategy still exhibits an urban bias. Urban-rural linkages are weak, leading to a low spillover effect, and a two-tier economy with many rural households left behind.

Key recommendations to promote rural development across the country

The future of rural Colombia will determine the country's development trajectory, and can help reduce national poverty rates, unemployment rates and boost urban development. Rural development policy could benefit from the following recommendations:

- Improve the current taxonomy defining the human geography into urban and rural areas.
- Fine-tune policy interventions to the territorial context, engaging rural communities.
- Consider capitalising on the diffused specialisation of agriculture at the department level.
- Improve linkages between cities and rural areas.

The recommendations provided by the OECD offer a new approach to regional development, which also requires a radical change of Colombia's multi-level governance framework. Colombia suffers from a significant infrastructure gap, after decades of low and often inefficient public investment uncompensated for by private sector projects. Public expenditure, as a percentage of GDP, is low by comparison with OECD countries, as a result of centralisation and the lack of trust between the central level and department and municipal governments. The national fiscal framework tends to patronise sub-national levels and focuses on fiscal "discipline" rather than fiscal co-ordination.

However, the current fashion in which the General System of Transfers (*Sistema General de Participaciones*, SGP) functions limits the capacity of the fiscal framework to produce a basket of public goods, such as healthcare, education and water, to match regional needs. Sub-national governments depend on transfers from the centre to deliver services. Funds are earmarked for departments and municipalities according to a formula based on poverty rates and demographic size. The lack of territorial data makes it difficult to take account of Colombia's rich diversity, and the amount of funds allocated through transfers has remained virtually unchanged since 2005. Given the large internal migration flows, it is possible that local needs have changed. Some local governments are likely to have improved service delivery, but the sectorial allocation of transfers, set by the central level, cannot be modified.

The reform of royalty payments may complicate the SGP in the medium term. To protect financial sustainability at the local level, sub-national governments can only use additional revenues generated by royalty payments to finance capital investment. However, most capital investments (roads, schools, hospitals, etc.) generate recurrent expenditures, which will put pressure on funds from the SGP in the medium and long term.

Tax revenues at the sub-national level are low. The fiscal inertia of many sub-national governments is a consequence of the existing tax regulation, which does not allow municipalities and departments to create taxes. In addition, territorial governments do not have incentives to assume the political cost of raising taxes, if the extra funds collected are used to fund a basket of goods and services selected by the central government. In many cases, local taxes are not related to the quality and accessibility of services. This compromises accountability and transparency.

Key recommendations for a fiscal framework that delivers regional development

- Implement a reform of the General System of Transfers (SGP) to improve autonomy, flexibility, responsibility and solidarity among sub-national governments. National authorities may consider reducing earmarked transfers, simplifying the way the SGP allocation criteria are determined, and introducing new equalisation mechanisms, as well as co-ordination mechanisms between the SGP and the General System of Royalties. The SGP will have to shoulder a dramatic increase in current expenditure as a consequence of the capital investments built with royalties.
- Implement a tax reform to increase tax collection at the sub-national level. The portfolio of taxes levied by departments and municipalities should also be streamlined, and replaced by taxes shared between the central and sub-national governments. The cadastral and land registry should be updated to improve the performance of the municipal property tax, and clear incentives established to enhance tax collection at sub-national level. Sub-national government could be given more leeway to manage tariffs and fees associated with local public service provision.

Key recommendations for a fiscal framework that delivers regional development *(cont.)*

- Promote a fiscal framework conducive to public investment. Co-ordination across levels of government could be reinforced and multi-annual budgeting/planning framework adopted at the sub-national level. Adopting a "golden rule" in the sub-national fiscal discipline framework could help boost public investment. Meanwhile, sub-national government in general should be associated with the governance of public finance.

All levels of government are actively fighting corruption, and good practices at the local level inspired the recent national strategy. Corruption is more common at the level of sub-national government, where laxer controls and lack of institutional capacity often lead to irregularities. Many local communities chose not to wait for the central government, and have developed their own tools and institutions to fight corruption. This pioneering work inspired the recent anti-corruption strategy at the central level.

Colombia is filling the gap that separates citizens from government. Once a centralised presidential democracy based on a corporatist system of governance, Colombia is developing a more inclusive institutional framework. Citizen engagement will increase due to recent key reforms and policies. The reform of the General System of Royalties, which requires the local community to define a development strategy to access funding, needs to engage the active participation of local stakeholders, including citizens and business. If the DNP's next National Development Plan adopts a territorial approach, interaction with local communities will be key for pooling information and tailoring policy to regional needs and opportunities.

Nonetheless, transparency and citizen participation are constrained by several factors. For example, the approach to ethics is compliance-based, and involves a large number of rules and prescriptions. At the sub-national level, these regulations and the fear of contravening the law hampers the performance of the public sector, jeopardising the efficiency of the public administration and slowing down decision making. Excessive control and regulations burden public procurement, complicating investment linked to the reform of royalty payments. Meanwhile, local governments' limited autonomy on fiscal and policy matters reduces the scope for citizen participation and restricts local debate on how local revenues should be invested.

Key recommendations to promote integrity and transparency

- Shift from a compliance-based to an integrity-based ethics management in the public sector.
- Consider introducing a self-assessment tool to analyse the weaknesses of the institutional framework from a sub-national perspective.
- Enhance co-ordination among oversight bodies at sub-national level.
- Clarify the roles and responsibilities of oversight bodies at territorial level and effectively use the existing map of risk in public administration.
- Strengthen and develop the National Secretariat of Transparency's work at sub-national scale.

Key recommendations for stimulating citizen engagement

- Match devolution of power to sub-national levels, with tools to enhance citizen participation.
- Focus actions to enhance citizen participation on policies that they care about.
- Identify local best practices for engaging communities.

Chapter 1

Territorial statistics and information systems*

This chapter illustrates regional trends in Colombia, and assesses the national territorial information system. The chapter is organised into five main sections. After a brief introductory section, the second section provides an overview of the current system of territorial statistics in Colombia. The third section identifies the prevailing territorial definitions and places them in the context of the OECD's regional taxonomy. The fourth section reviews the existing territorial statistics, with the aim of providing baseline information and highlighting the analytical potential of several existing databases; this section also provides a preliminary assessment of key socio-economic trends in Colombian territories. Finally, the last section outlines possible measures that could strengthen Colombia's territorial information system.

* This chapter was produced in co-operation with Alessandro Alasia, Unit Head of Special Projects, Centre for Special Business Projects, Statistics Canada.

Key findings and recommendations

Key findings

- Many of the current statistics used by policy makers are projections, which do not necessarily provide an accurate measure of reality. The last Census of Population for Colombia was produced in 2005, and the last Census of Agriculture in the 1970s. The need to consolidate the current information systems for territorial indicators is particularly pressing given the emphasis that has been placed on territorial policies by the national government.
- Colombia's territorial classification distinguishes urban territory from *resto rural* (residual rural areas). Under this schema, about 75% of the population is considered urban. The failure to capture the true diversity of rural conditions may make it difficult to deliver services in sparsely populated areas. Since 2010, several attempts have been made to rectify this. However, if groups of municipalities were used as building blocks to develop a TL3 classification (based on commuting zones), they could be used to apply the OECD regional typology. It is likely that many of the TL3 regions of Colombia would qualify as "predominantly rural".
- Scarcity of data on regional and local trends. The statistics available are inadequate to inform policy making for the National Department of Planning and to help evaluate policy at the local level. The central level assesses the implementation of policy, focusing on investment flows at department and municipal level. These flows, however, do not reveal much about regional economies' capacity to absorb the investments and turn them into productive activity.

Key recommendations

- Colombia's statistical system, while generally solid and well established, could be further strengthened. The Census, cornerstone of the statistical information system in OECD countries, should be conducted at regular intervals, every ten or possibly even every five years. This is particularly important for territorial indicators, as the Census is the only data source that covers enough of the population to generate reliable estimates of demographic, social and economic indicators at a small geographic scale.
- It would be beneficial to conduct a thorough review of the existing definitions of rural and urban used in policy development and programme delivery. This would make it possible to identify a selected number of definitions and clarify their strengths and most appropriate uses and enhance the coherence of the geographic concepts being used for statistical and policy purposes.
- Efforts to increase the volume of territorial statistics should be paralleled by dissemination and knowledge mobilisation initiatives. The goal should be to make potential users aware of existing databases. This should also be accompanied by initiatives to mobilise existing and potentially under-utilised holdings of administrative data. A system for evaluating the long-term impact of planning, linked to the political cycle, could continuously improve the performance of the system. Evaluation would be even more important in a regionalised planning system, with an increased number of policy measures and learning opportunities for policy makers. Regional observatories could also help evaluate the long-term impact of plans.

Introduction

This chapter reviews the territorial information system and territorial statistics of Colombia, assesses their main challenges, and provides recommendations for potential improvements of the existing system and territorial indicators. The chapter is based primarily on information collected through the OECD Questionnaire for National Territorial Reviews, including the datasheets provided with the questionnaire. Additional information was provided by the documents and presentations delivered during the study mission (22-27 July 2013), as well as the data and information provided by Colombian authorities during follow-ups to the field mission.

The need to develop and maintain solid information systems at the sub-national level is well established across OECD countries. In the case of Colombia, the need to consolidate the current information systems for territorial indicators has been made even more relevant by the emphasis that has been placed on territorial policies by the national government (for instance DNP, 2011). The quadrennial National Development Plan includes a Territorial Development Strategy that sets out a national framework for territorial policies for the period 2012-15 (DNP, 2011). The next National Development Plan is expected to be developed in 2014 and will cover the period from 2014 to 2018.

The assessment and management of the quality of information along the supply chain plays a central role in the system. Several national statistical agencies have set up comprehensive frameworks to improve the quality of their information management. To facilitate the discussion and decision-making process for improving and managing the current system, this chapter uses a set of criteria that have been used to assess and manage the quality of information. These are illustrated in Box 1.1.

The system of territorial statistics in Colombia: An overview

By comparison with other national statistical systems, Colombia's territorial statistics system is well developed. Key demographic, social and economic indicators are generally available and easily accessible at the department level, and in several cases, at the municipal level as well. The accessibility of this information is facilitated by notable examples of web-based mapping systems for data dissemination (see Box 1.2).

The Colombian National Administrative Department of Statistics (*Departamento Administrativo Nacional de Estadística*, or DANE), is at the centre of the national statistical system.[1] As indicated in its code of good practice (DANE, 2011a), the department is the co-ordinating body of the National Statistical System, which establishes the guidelines, plans and programmes for statistical activity and plays a key role in the production and co-ordination of national statistics. This department is also the key supplier of territorial indicators for Colombia.

Box 1.1. **Statistics Canada's approach to information quality management**

Statistics Canada (2002) defines data quality in terms of "fitness for use". The essence of this policy is that users must be provided with the information necessary to judge its fitness for their intended use. To put this definition to work, the agency has identified six dimensions of information quality: relevance, accuracy, timeliness, accessibility, interpretability and coherence (Statistics Canada, 2002). These are also acknowledged by the Colombian National Administrative Department of Statistics (DANE) in its National Code of Good Practices for Official Statistics (DANE, 2011a).

Of these criteria, relevance is a variable and subjective factor inherent in the policy process. Likewise, accuracy is exclusively technical and can be characterised in terms of error in statistical estimates. The assessment of these two dimensions can be expressed in a dialogue among national actors and/or data-producing agencies. However, the other four dimensions do have relevance for this review. Timeliness can be seen as having several facets, quite apart from influencing relevance. It primarily refers to the delay between the reference point to which the information pertains and the date on which the information becomes available (Statistics Canada, 2002). More broadly, it can also reflect the lapse of time between the reference point of the most recent information and the time at which that information is being used.

Accessibility refers to the ease with which the information can be obtained (Statistics Canada, 2002). As a concept, this includes the ease with which the existence of information can be identified, the suitability of the form or medium through which the information can be accessed, and the possible cost of the information.

Interpretability reflects the need for, and availability of, supplementary information and metadata in order to interpret and utilise the primary information adequately. This supplementary information generally covers concepts, variables, classifications and methodologies (Statistics Canada, 2002).

Finally, the dimension of coherence expresses the degree to which the information the system supplies can be successfully collated with other information within a broad analytic framework and over time (Statistics Canada, 2002). The use of standard concepts, classifications, target populations and methodologies promotes coherence.

Source: Statistics Canada (2013), *Overview of the Census*, Catalogue no. 98-302-XIE, Statistics Canada, Ottawa, Ontario.

The territorial (geographical) dimension is not at present a cross-cutting dimension of DANE's statistical dissemination model, as suggested by the organisation of the website of the agency (www.dane.gov.co). Statistics are searchable in different fields (for instance, labour market, education, agriculture, etc.), one of these being territorial (regional) statistics. By contrast, a dissemination model in which geography played a more central role would offer a geographic filter on each of the subject matter domains for which statistics are gathered.[2]

Territorial statistics are a relevant component of DANE's statistical output. The agency's website provides direct access to various products with a focus on territorial statistics (*información georreferenciada*). The Geoportal (www.dane.gov.co/geoportal), one of these products, is an online mapping system that permits users to visualise and download territorial data (mainly data from the Census of Population 2005 at the municipal or departmental level).

The *Atlas estadístico* is an online publication that provides detailed demographic, social and economic profiles of Colombian regions (mainly municipalities and departments or major urban areas), using data from the Census of Population and other sources. These two territorial statistical products highlight the fact that, as with most

OECD member countries, a major source of territorial statistics in Colombia is the Census of Population (the last Census conducted in Colombia was in 2005).

Another product that also has a regional focus, but which is updated annually, is a series of bulletins on the current regional economic situation of the departments (*Informes de Coyuntura Económica Regional*). These publications are available on DANE's website and provide an in-depth economic profile and analysis of the most recent trends in each department. Many of the statistics presented are only for the main metropolitan area of the department (for instance, labour market and prices). Although in most cases the data sources are not presented in detail, there is clearly an extensive use of administrative data.[3]

In addition to these products, DANE is involved in another major data dissemination initiative in collaboration with other national and international co-operation agencies: the Geographic Information System for the National Planning and Territorial Structure (*Sistema de Información Geográfica para la Planeación y el Ordenamiento y del Territorial Nacional*, or SIGOT; see Box 1.2). SIGOT is a territorial database that was developed in line with the policies of the Colombian Infrastructure of Spatial Data (*Infraestructura Colombiana de Datos Espaciales*, or ICDE).

Currently, SIGOT appears to be one of the richest sources of territorial data that is freely accessible online (approximately 200 indicators at the municipal or department level, many of which are presented as time series). The indicators are easily accessible and can be mapped online; each indicator can also be downloaded in various formats, such as spreadsheets or PDF files. In addition, the metadata associated with the indicator is generally available and detailed through an online metadata management system.

Box 1.2. **SIGOT, an online territorial database**

The Geographic Information System for the National Planning and Territorial Structure (SIGOT), constitutes a network of institutions, technological resources and data whose goal is to facilitate access and use of geo-information. It aims to encourage efficient and timely decision making by authorities at national, regional and local levels, and to promote good governance for sustainable development.

The SIGOT project, initiated in 2005, is a practical application of the policies of the Colombian Infrastructure of Spatial Data (ICDE), in terms of standards, metadata and web portals.

The pilot application of SIGOT allows free online access to: *i)* information on almost 200 topics of interest for land-use planning, which allows users to generate 500 maps with national coverage using available time series data; *ii)* various statistical indicators organised into five categories: environmental, economic, social, cultural and institutional; *iii)* default maps that allow users to quickly view some of the most popular themes, with a total of 1 367 maps; and *iv)* metadata for each of the default maps and thematic layers.

Source: Excerpted from http://sigotn.igac.gov.co.

In addition to DANE, several other government departments are involved in the collection and processing of administrative data and/or production of estimates of a variety of socio-economic indicators at different geographic levels.[4] Interestingly, some of the databases are generated by survey collection methods (for instance, a survey conducted by SINERGIA, the unit of the National Planning Department (DNP) responsible for monitoring and evaluating the policy measures related to the National

Plan). In most cases, it appears that the department holding the data is also the key user of the same data holdings**.** These largely administrative databases could potentially be integrated with Census and other survey data into comprehensive territorial data infrastructures.

In some cases, the information is disseminated through subject-specific online data systems.[5] One such example is the information system for the agricultural sector (*Sistema de Información del Sector Agropecuario*), maintained by the Ministry of Agriculture and Rural Development.[6] Within this system, the Municipal System of Agricultural Evaluation (*Evaluaciones Agropecuarias Municipales*) generates annual estimates of agricultural and livestock supplies by collecting information from regional and local offices of the ministry. The estimates are produced for 1 123 municipalities and are then aggregated by department and at the national level.

In the absence of a regular agricultural census, this is the only up-to-date system of agricultural statistics at the local level. More recently, an online National Agricultural Information and Communication Network (AGRONET) was set up with the intention to connect small producers, although the network is aimed primarily at policy makers. AGRONET's content extends well beyond the dissemination of territorial statistics, but the system does feature an online mapping system for the visualisation and extraction of agricultural statistics at the municipal and departmental level (www.agronet.gov.co).

Colombian territorial statistics suffer from a lack of coherence and co-ordination. Although the variety of production and dissemination systems for national and territorial statistics adds an element of richness to the national information system, field meeting discussions suggest that this might raise some doubt over the coherency of statistical estimates, given possible discrepancies between the estimates generated by various departments for the same economic indicator.

Various initiatives show some promise of integrating different geo-referenced databases and increasing the coherence of territorial statistics. Like most OECD member countries, Colombia appears to be developing Infrastructure of Spatial Data (ICDE). An attempt to create a greater integration of its territorial and other spatial databases within DANE is provided by the *Bodega de datos espaciales* (DANE, 2011b; Alvarado Torres, 2011). This trend should promote increasingly integrated and coherent systems with standard geographies that are freely accessible online, in line with the trend in most OECD member countries.

OECD countries in recent years have seen a major shift toward spatially based data dissemination systems hosted or supported by national and sub-national governments. Examples include the UK Open Data Map-based Search (http://data.gov.uk/data/map-based-search), US Open Data (www.data.gov) and the GeoGratis Search in Canada (www.geogratis.gc.ca). One common feature of these systems is the option of obtaining a list of the information available for any specific area or region of interest through the use of an interactive map. Typically, this information would include both Census and non-Census data.

The bulk of the demand for territorial statistics appears to be related to the policy and planning needs of the national government, in particular the DNP, which is in charge of elaborating the four-year National Development Plan, and the 33 departments.[7] The growing emphasis on the territorial dimension of the national planning exercise will inevitably result in an increased demand for geo-referenced data, which will need to be comparable over time and space.

The development of a coherent system of geospatial data infrastructures will improve the accessibility and interpretability of territorial statistics, and serve a broader set of users. However, emerging demand is also likely to favour specific indicators that can be integrated into the policy process, as well as a stronger focus on the timeliness of the territorial statistics. These growing demands will probably create a need for enhanced analytical content, which in turn may increase demand for specific information products that provide not only raw data but also products that provide an analytical interpretation of the data, i.e. frameworks in which datasets and indicators from heterogeneous sources can be integrated and presented with some form of analytical interpretation.

Territorial structure of Colombia

The OECD regional classification is based on two main territorial levels. Territorial Level 2 (TL2) consists of macro-regions within each OECD country. Territorial Level 3 (TL3) consists of micro-regions. Each member county has identified the statistical or administrative geography that provides the best fit for this territorial classification. In the case of Canada, the TL2 corresponds to the provinces and territories and the TL3 corresponds to the Census divisions.[8]

The prevailing territorial structure used for statistical purposes in Colombia is summed up in the *Codificación de la División Politico-Administrativa de Colombia* (DIVIPOLA; DANE, 2013). Colombia is divided into 32 departments and a capital district, Bogotá, for a total of 33 territorial units that are generally presented together in the departmental statistics. Each department is divided into municipalities: the 1 122 territorial units are coded as municipalities (DANE, 2013).[9] Departments and municipalities are the main territorial units for which most of the demographic, social and economic statistics are available.[10]

In addition to these two territorial levels, the DIVIPOLA 2013 also includes 9 206 population centres (*centro poblado*), the relatively urbanised part of a municipality, as well as 6 metropolitan areas (*área metropolitana*), which are the groupings of municipalities that include and surround Colombia's 6 main urban agglomerations.[11] It should be noted that these six metropolitan areas are legislated territorial jurisdictions (cf. *Áreas Metropolitanas en Colombia, Ley 1625 de 2013*).

In addition to these departments and municipalities, DANE and the other agencies that contribute to the national statistical system collect data at several other territorial levels, which include the five districts classification, Afro-Colombian and aboriginal communities.[12] Another example is the classification of municipalities into Levels 1 to 6, based on their population size and income level (DNP, 2013a).

In terms of aligning the Colombian territorial structures with the OECD territorial classifications, the departments appear to be the most appropriate representation of the TL2 regions. By contrast, Colombian municipalities appear to be too small to represent TL3 regions in cross-country comparisons. This is also seen elsewhere, as TL3 is represented by geographic units such as the counties in United States, the Census divisions in Canada and *provincia* in Italy and Spain; in each of these cases, the administrative unit representing the TL3 level is composed of several municipalities grouped together.

An aggregation of Colombian municipalities according to some criteria of proximity, similarity and economic integration is probably the most appropriate approach for achieving a territorial unit comparable to the prevailing definitions of TL3 regions. Work

undertaken by the DNP appears particularly promising (DNP, 2013) and could provide the starting point for the identification of TL3 level units in Colombia.

Working with municipal level data, and through consultation with departments, the DNP's analysis yielded a total of 191 sub-regions with an average of 135 000 inhabitants (excluding the 6 major metropolitan areas) and 6 municipalities each. Of these sub-regions, 182 were identified as predominantly rural, leaving only 9 as predominantly urban. The aggregation of municipalities took into account existing regional development plans, historical factors, sub-national systems of governance and environmental conditions, as well as input provided in regional workshops.

Definitions of rural and urban areas

Regions of OECD member countries have been classified into predominantly urban, intermediate and predominantly rural regions (OECD, 2010a). This classification has been a cornerstone of OECD territorial analysis across its member countries, since analysis of regional socio-economic performance across countries is more meaningful when the comparison is made between regions of the same type. The OECD territorial typology is implemented for TL3 regions.

It is widely acknowledged that, even within a country, no unique definition of rural-urban concepts can fit all purposes. As a consequence, no unique and internationally recognised definition of the concepts of rural and urban exists. Nevertheless, in OECD countries, "urban" is usually defined by agglomeration size and density measures, while "rural" is usually defined by a lack of agglomeration (and density) and/or distance to density.

In Colombia, several definitions of "rural" and "urban" have been developed and used by various departments and organisations (see, for instance, Rojas and Rivera, 2011; PNUD/UNDP, 2011). This should not represent a problem for territorial indicators; on the contrary, it can represent a benefit for users, decision makers and analysts alike. However, some challenges that have been noted include the lack of consistent and coherent use of definitions, and in some cases, a lack of clarity in the terminology.

For statistical purposes, the prevailing definition of "urban" and "rural" used by DANE corresponds to the concepts of *cabecera* and *resto*. According to the 2005 Census, the population of Colombia was 42 888 592, of which 74.4% (or 31 890 892) were located in urban areas (*cabecera*) and 25.6% (or 10 997 700) were located in rural areas (*resto*). A detailed analysis of the spatial distribution of the Colombian population between urban and rural areas (i.e. *cabecera* and *resto*) is provided by *Atlas Estadístico, Tomo I: Demográfico* (DANE online).

With respect to the definition of urban or metropolitan areas, it should be noted that Colombia has six metropolitan areas established by national legislation. Alfonso Roa (2011) notes the lack of coherence in the use of the spatial "urban" concepts in various DANE survey and statistical programmes, such as territorial statistics on inflation (*Indice de Precios al Consumidor 2008 – IPC-08*), employment (*Gran Encuesta Integrada de Hogares*) and manufacturing (*Encuesta Anual Manufacturera*). These three major statistical initiatives each use different concepts and definitions of the term metropolitan. More information on an emerging concept of metropolitan areas (*Sistema de Ciudades*) and its potential for a territorial typology of Colombia is reported in the next section.

With respect to the definition of rural areas, various attempts have been made to develop an index of rurality that provides a better understanding of the diversity of rural

conditions across the country (see, for instance, Rojas and Rivera, 2011). González et al. (2011) and PNUD/UNDP (2011) argue that the approach DANE uses of presenting territorial statistics using the dichotomous categories of urban (*cabecera*) and rural (*resto*) masks the substantial variations within "rural" conditions across Colombia. The *National Human Development Report of Colombia* (PNUD/UNDP, 2011) proposes an Index of Rurality (*Índice de ruralidad*), a continuous measure implemented at the municipal level based on municipal data. According to this index, 75.5% of municipalities would be classified as "rural". This would leave 31.6% of the population as rural, in contrast to the 25.6% under the definitions used by the 2005 Census.[13]

The most relevant point suggested by these attempts to develop a more refined measure of rurality is that the diversity of rural conditions is not adequately captured by the tendency to refer to the areas outside the urban core as a homogeneous "rural" space. This issue has been recognised and addressed in various national statistical systems by presenting territorial statistics under some classification of rurality or, alternatively, degree of metropolitan influence. For example, Canadian Census of Population results are presented as groups of municipalities (Census subdivisions), according to whether they are a component of a large metropolitan area (Census metropolitan area), a smaller metropolitan area (Census agglomeration) or a "Metropolitan influenced zone" (MIZ). The MIZ is a concept that geographically differentiates the area of Canada outside metropolitan areas; each municipality outside a metropolitan area is assigned to one of the five MIZ zones. As a result, all of Canada's land mass is classified into a typology that tends to reflect an urban-to-rural continuum.[14]

Any effort to strengthen the coherence of a territorial classification should take into account three general purposes for which any definition of "rural-urban" is used. First, a definition for statistical purposes; typically, the definition used for Census purposes or other major statistical undertakings. Second, a definition for policy analysis purposes; these definitions are the most challenging, because the most appropriate definition for any given policy varies substantially depending on the scope of the policy. It might be advisable in this case to have a set of definitions, which might include statistical definitions. A definition for policy purposes could focus on the concept of the "functional area". Typically, these are delineated for labour market analysis purposes, using commuting-flow data. Finally, a definition for purposes of international comparisons could implement a classification of Colombia's territorial units using the methodology outlined in the OECD territorial typology (OECD, 2010a).

If the Colombian municipalities were selected as building blocks for the development of a TL3 classification, as was suggested in the previous section, they might also be used for the implementation of the OECD regional typology. The first step in the OECD territorial typology is that of classifying "local units" (administrative entities at a geographical level lower than TL3) as rural if their population density is below 150 inhabitants/km² (OECD, 2010a). In a second step, the local units are aggregated into TL3 regions and classified as "predominantly urban", "intermediate" and "predominantly rural", using the percentage of population living in rural local units. Figure 1.1 shows the population density of 1 118 municipalities for which data is available (DANE, Geoportal). Of these, 970 have a population density below 150 inhabitants/km². This suggests that, depending on the nature of the grouping of municipalities, a substantial part of the TL3 regions of Colombia could fall into the "predominantly rural" type.

Box 1.3. **Different "rural definitions": An example from Canada**

A review of the definitions of "rural" used in the Canadian context was conducted by Du Plessis et al. (2002). In the Canadian context, three main definitions of rural have been used in analysis and policy development, and the paper argues that the definition used for analysis should be governed by the topic addressed. The delineation of the Census results in a classification of small geographic units into population centres (formerly urban areas) and rural areas. A so-called "Rural and Small Town" (RST) definition is delineated by assigning municipalities as RST. The OECD definition classifies regions as predominantly urban, intermediate or predominantly rural regions (TL3 geographies for Canada; i.e. Census divisions).

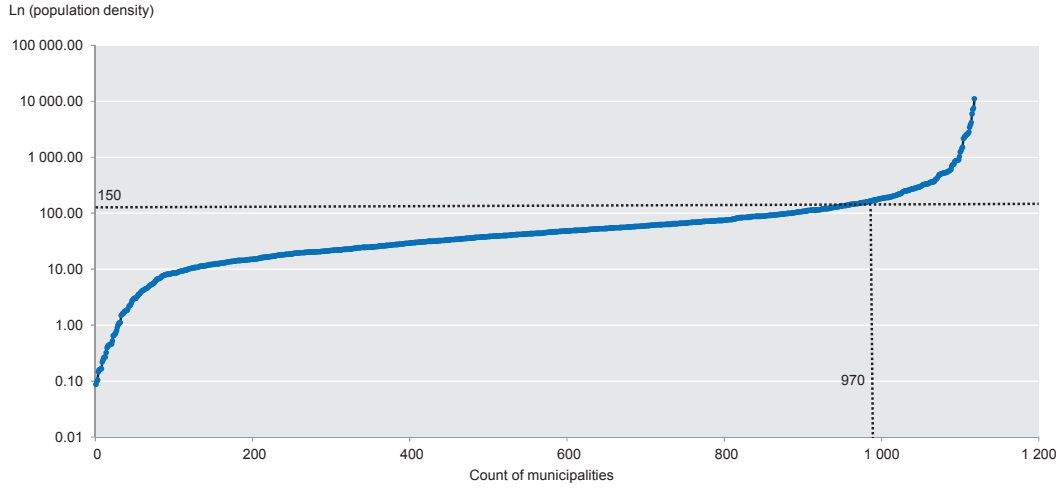
A rural definition based on small building blocks (i.e. each geographic unit that is designated "rural") should be used for the analysis of issues requiring a local solution. Examples might include day care services or quality of local well water (although these issues can be managed at different scales in different situations).

A rural definition under which incorporated towns and municipalities are delineated as urban or rural should be used for the analysis of issues that are the responsibility of towns and municipalities. Suggested examples might be the provision of roads and libraries (again, these issues can be managed at different scales in different situations).

A rural definition in which regions (i.e. groups of communities, towns or municipalities) are classified as urban or rural should be used for the analysis of regional issues. Economic development and labour market issues (e.g. training programmes) are seen as regional because individuals can commute from one community to another. Groups of communities would be expected to work together for mutual economic development and to improve their shared workforce.

Source: Adapted from Du Plessis et al. (2002), "Definitions of 'rural'", *Agriculture and Rural Working Paper Series*, No. 61, Statistics Canada, Catalogue no. 21-601-MIE, Ottawa, Ontario, available at: www5.statcan.gc.ca/bsolc/olc-cel/olc-cel?lang=eng&catno=21-601-M2002061.

Figure 1.1. **Rural Colombia: Population density by municipality, 2005**



Source: Own research based on DANE, *Geoportal, Densidad de Población, según municipio*, 2005.

Functional areas in Colombia

One of the major shifts in regional policy thinking within OECD countries has been the shift of focus from administrative regions to functional regions (OECD, 2012b). Metropolitan areas have received considerable policy attention, due to their central role in

regional development. Territorial performance can be better assessed by using functional units of analysis (usually, local labour market areas) or economic regions; their use is highly encouraged within OECD countries. Several OECD countries have standard geographies that align with the concept of the functional region. These are geographic definitions that are consistently used in official statistical programmes as well as in policy delivery. One example is the concept of Census metropolitan areas and Census agglomerations used in Canada.

The OECD has developed a new methodology to delineate comparable functional metropolitan areas across OECD member countries (OECD, 2012b). The creation of a framework of functional areas for OECD member countries based on a set of common or similar criteria is a crucial initial step towards producing comparative statistics for national urban systems. The conceptual framework used by the OECD is based on two main principles: *i)* the use of a defined core area as the starting point of the delineation of functional areas; and *ii)* the use of commuting data as a proxy measurement of the relationship between defined core areas and peripheral or hinterland areas.

In the case of Colombia, as noted in the previous section, six metropolitan areas have been defined by the national legislation. Although there is no official definition of functional areas, some examples of so-called "functional areas" are being used in policy development and programme delivery.

One analysis of particular relevance for the identification of functional metropolitan areas is represented by the *Misión de Ciudades* (DNP, 2012). This analysis uses travel-to-work statistics and applies a methodology that appears to have several points in common with the prevailing methodologies for defining functional metropolitan areas developed by the OECD. This analysis is the result of a major research policy undertaking focusing attention on the performance of metropolitan areas and their contribution to national growth.[15]

The methodology used by the *Sistema de Ciudades* is outlined in DNP (2012). The key input data for the identification of the agglomerations are the commuting flows between municipalities based on place of residence and place of work information from the 2005Census of Population; hence, the building blocks are municipalities. The central nodes, to which other municipalities are aggregated, are the largest municipalities. Smaller municipalities are thus aggregated to the largest one in each cluster. The results of the analysis of *Sistema de Ciudades* are reported in Table 1.1. A total of 151 metropolitan areas are identified, classified into 6 types. The largest 18 metropolitan areas (*aglomeraciones urbanas*) include 113 municipalities and account for 23.7 million of the 29.7 million people who live in metropolitan areas.

The definition of this type of region can be important for the delivery of policy at the regional level. The central government needs a functional region concept that is meaningful for the delivery of policy, particularly for regional development planning. Finally, although the focus of functional regions has so far been on metro-centric regions, consideration has also been given to functional regions that are predominantly rural in nature (Box 1.4). This type of approach might be relevant for Colombia, particularly given the geographic extent of its predominantly rural areas.

Table 1.1. **Metropolitan areas and urban centres in Colombia (*Sistema de Ciudades*)**

	Municipalities	Urban population, 2010 (million)
Urban centres *(Aglomeraciones urbanas)* (18)	113	23.7
Main regional cities *(Centros regionales principales)*	4	1.6
Intermediate regional cities *(Centros regionales intermedios)*	11	2.6
Main sub-regional cities *(Centros subregionales mayors)*	15	1.4
Department capital *(Capitales de departamento)*	6	0.4
Cities *(Ciudades)*	2	0.2
Total	151	29.7

Source: DNP (2012), "Algunos aspectos del análisis del sistema de ciudades colombiano", Bogotá, December (Questionnaire Annex 24).

Measuring and monitoring territorial performance: What is regional Colombia?

This section provides information on demographic, social and economic trends in Colombia and highlights the analytical potential of several existing databases with a territorial breakdown, for the purposes of international comparability. The intent is not to present a comprehensive demographic, social and economic profile of the regions of Colombia; that is provided by the *Atlas Estadístico de Colombia*, an online publication of DANE with extensive coverage and mapping of demographic, social and economic indicators for departments and municipalities.[16]

The type of indicators needed for policy development, implementation, monitoring and planning can vary largely depending on the specific context, the scope of the policy and the time period. There is no standard approach to choosing territorial indicators to measure and monitor performance. Based on the OECD experience, for international comparative purposes the use of relatively simple and readily available indicators is preferable to the use of more complex indices. As suggested by the OECD, it is generally preferable to use single indicators, as opposed to composite indices resulting from multivariate analysis or a combination (e.g. weighting) of single indicators.

Moreover, some multivariate analysis on territorial structure and performance has already been undertaken by the DNP (see DNP, 2013). The analytical unit of the DNP developed an Endogenous Development Index (IENDOG), using municipal-level data that include 3 main factors and a total of 13 specific indicators from the Census and other administrative sources.[17] The intent of this section is not to replicate work either completed or currently being undertaken by government departments in Colombia. Rather, the purpose is to provide some highlights of territorial patterns using indicators that are particularly suitable for the purposes of international comparability.

Demographics and settlements patterns

Demographic indicators such as population counts, density and changes are some of the most relevant indicators of territorial performance, with demographic and settlement patterns being the distinguishing feature of the typology of regions (OECD, 2010a). Rural regions share one important characteristic: lower population density. This reduces the opportunities and potential for positive externalities among firms and workers, while increasing the costs of physical infrastructure and service provision. By contrast, considerable research has shown that agglomeration economies generally provide benefits to firms and workers (Alasia, 2005). It is thus not surprising that demographic growth, or

increasing density, is usually seen as a key indicator of positive territorial performance or territorial dynamics.

Box 1.4. **Functional regions in predominantly rural territories: The Canadian example**

Typically, the analysis of spatial labour areas has focused on the connectivity between smaller geographic units through labour force commuting flows. In the Canadian context, this type of analysis has considered metropolitan areas and major agglomerations as the primary destination of commuting for non-metropolitan residents. The best-known example is the Metropolitan Influenced Zone (MIZ) classification system, which emphasises the connectivity between core metropolitan areas and their surrounding areas. However, this classification pays less attention to the connectivity among smaller geographic areas outside the labour market areas of Census metropolitan areas (CMAs) and Census agglomerations (CAs).

To address this issue, an exploratory analysis was undertaken to assess the possibility of identifying self-contained labour areas (SLA) across Canada, as well as in predominantly rural areas (Munro et al., 2011). An SLA was defined as a group of two or more municipalities (Census subdivisions), where at least 75% of the workers both live and work in the area. The guiding concept of this analysis is the evidence that rural-to-rural commuting is substantial. Previous analysis had shown that, for residents of areas outside a CMA or a CA, the commuting exchange with other non-CMA/CA areas was as significant as the commuting toward a CMA/CA area. In other words, for Canadian residents of rural areas and small towns, the labour markets represented by small towns and rural settlements are as important as the labour markets of larger metropolitan centres.

The methodological approach used for this analysis concentrated on the multi-directional nature of commuting flows and accounted for the strength of commuting relationships between municipalities (Census subdivisions), regardless of their settlement structure. The data used to create SLAs were the commuting flows data (journey-to-work) generated by the 2006 Census of Population. Although journey-to-work data are available at many different levels of geography, the Census subdivision (CSD) geography combines both national coverage at the smallest possible geographic scale and a relatively close match with actual administrative units (the municipality).

The analysis built on existing literature on the delineation of labour market areas. A clustering procedure used an algorithm that emphasised the reciprocal importance of commuting flows to measure the strength of the linkage between any two Census subdivisions. This procedure focused on the reciprocal importance of commuting linkage by repeatedly selecting for the CSD or CSD group with the lowest degree of self-containment, regardless of their classification into types of settlements.

The results of this analysis generated a proposed delineation of 349 self-contained labour areas across Canada. On average, these SLAs are 96% self-contained, which is significantly higher than the minimum required level (75%). The average SLA has a resident workforce of 36 000 workers and a resident population of 89 000 inhabitants and is composed of 11 CSDs. However, the population size across the 349 SLAs varies considerably. Three SLAs have a population of 2 million or more and comprise 40% of Canada's population; these are centred on the metropolitan areas of Montreal, Toronto and Vancouver. At the opposite end of the spectrum, the analysis resulted in 162 SLAs with a population of less than 10 000, representing about 2% of Canada's population.

In between these two groups, the results showed a range of SLA types with different sizes of agglomerations and settlement structures. Most importantly, the SLAs resulting from this analysis reveal some predominantly rural labour market areas, with relatively higher linkages within the SLA and relatively lower linkages across SLAs. Examining these SLAs in terms of the degree of rurality provided interesting results. In particular, between 29% and 39% of Canada's rural population, depending upon how rural is defined, resides in SLAs that are predominantly rural. In turn, this suggests that further investigation and assessment of the concept of functional areas in predominantly rural territories could lead to relevant findings for analysis and policy implementation.

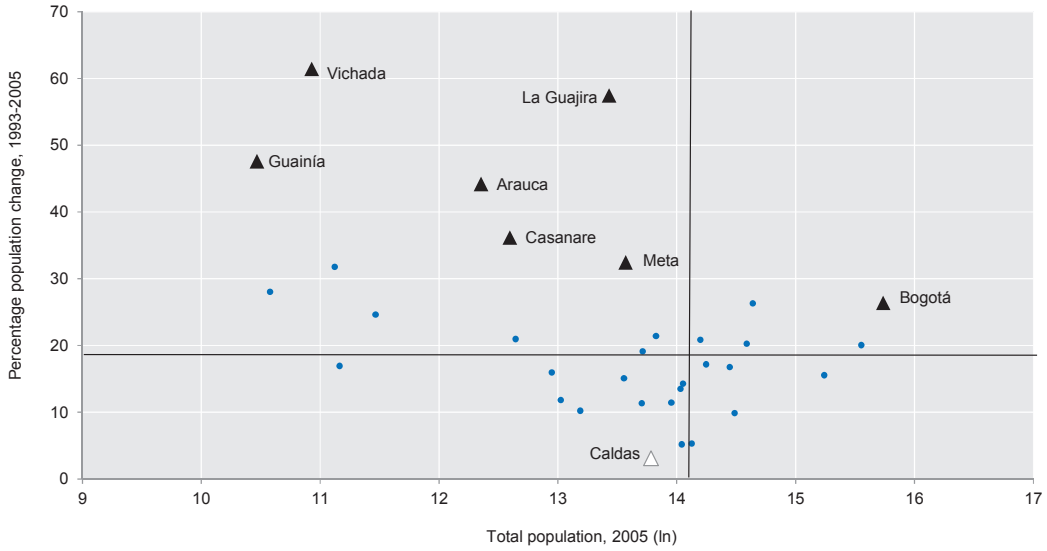
Source: Munro, A., A. Alasia and R. Bollman (2011), "Self-contained labour areas: A proposed delineation and classification by degree of rurality", *Statistics Canada Rural and Small Town Canada Analysis Bulletin No. 8*, Catalogue no. 21-006-X, Ottawa, Ontario, www.statcan.gc.ca/pub/21-006-x/21-006-x2008008-eng.htm.

In Colombia, demographic estimates at the sub-national level that result from actual data collection are only available for the years 1993 and 2005. For these two years, the source of the estimates is data drawn from the Census. For other, more recent, years, the demographic counts that are available are population projections. Given the relevance of demographic statistics in monitoring territorial performance, it is clear that the fact that a Census is not conducted at regular intervals presents a major challenge for the consolidation and maintenance of any territorial information system.

Keeping this weakness in mind, the existing population projection for 2012 indicates that 54.2% of the total population, or approximately 46 582 000 individuals, are concentrated in 6 departments. These departments are: Bogotá (16.3% of the total population), Antioquia (13.4%), Valle del Cauca (9.6%), Cundinamarca (5.5%), Atlántico (5.1%) and Santander (4.4%).

However, these departments are not among the ones that recorded the highest population growth between 1993 and 2005. Figure 1.2 shows the relationship between population size in 2005 (in logarithmic form) and the percentage population growth between 1993 and 2005. Note that the relationship between population density and population change is virtually identical. The relationship between population size and population growth is not strong; some of the largest population changes at the departmental level were recorded for departments with a relatively small population, such as Vichada and Guainía.

Figure 1.2. **Population size (2005) and population growth (1993-2005) by department, Colombia**



Note: The reference years 1993 and 2005 were used because the estimates from these two years are actual measures from the censuses. Population data for other years are projections.

Source: Own research based on DANE.

DANE produces annual population estimates at the department and municipal level; maps of population density at the municipal and department level are readily accessible on the SIGOT website. In addition to basic demographic counts by gender and age cohorts, DANE maintains accounts of the total number of immigrants to Colombia, by country of origin and by level of education, as well as the number of emigrants from

Colombia by origin by level of education and by country of destination (DNP, 2013). The dataset on international emigration is available at the department and municipal level.

Domestic mobility estimates appear to be either outdated or generated from administrative sources, whose reliability was questioned by users interviewed during the field mission for this report. The *Atlas Estadístico de Colombia* provides detailed mapping of short-term and long-term mobility flows based on the 2005Census.[18] These estimates were considered to be largely outdated by several people interviewed during field work, due to the high domestic mobility flows perceived to have occurred in recent years.

Because of the size of these flows, the lack of recent information on internal mobility has been reported as a major challenge to the accuracy and timeliness of national demographic statistics. Up-to-date information is spotty regarding the *desplazados*, rural inhabitants expelled from their land by the armed conflict, who have moved to large urban centres. As a result, population projections based on past Census figures are often disputed. Some argue that no accurate figures exist for the total population of Bogotá or other key urban areas, because population projections do not take account of the large domestic mobility flows.

Human capital and poverty rates in regions

Educational attainment, the most commonly used measure of human capital at the territorial level, has been shown to have a strong positive correlation with territorial performance across OECD countries (OECD, 2012a). The share of low-skilled workers appears to have a greater (negative) impact on growth than the (positive) impact of the share of workers with a tertiary education (OECD, 2012a). Monitoring educational levels and educational attainment at the territorial level provides key insight into the potential economic performance of the region.

Educational attainment statistics at the municipal level are available on the Geoportal (DANE) and SIGOT. Education-related expenditures were provided by the National Planning Department (DNP, 2013). Statistics on poverty are also produced by DANE. Estimates of the incidence of poverty (i.e. the percentage of the population living below the poverty thresholds set by DANE) are produced for 23 departments as well as the capital district of Bogotá.[19] In addition, estimates of urban poverty levels in Colombia and time series of poverty indicators are also available.

Figure 1.3 shows that departmental performance in reducing poverty levels from 2002 to 2012 varied widely. Some departments managed to reduce the incidence of poverty at a greater rate than the average national decline (-17 percentage points), while others reported an increase (Cauca and Chocó, specifically).

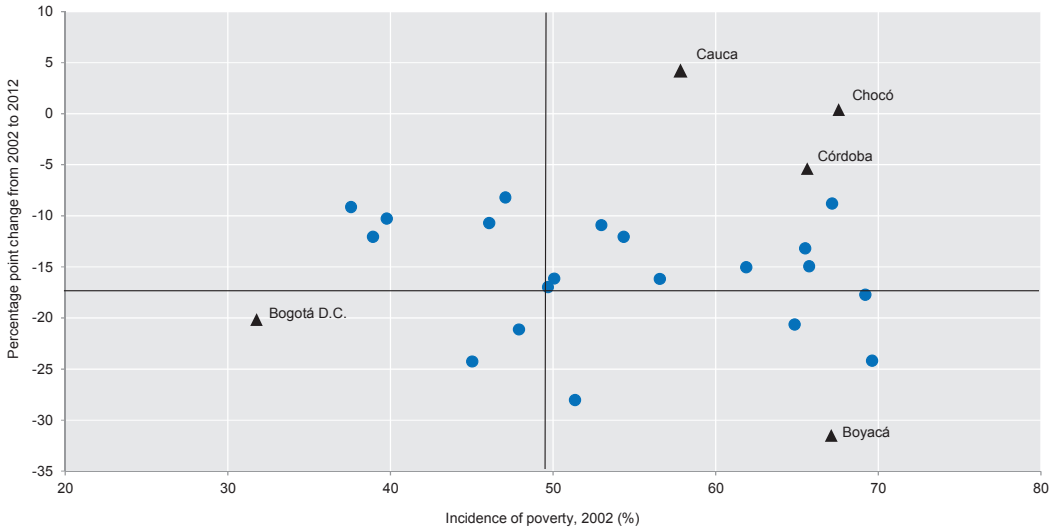
In 2012, 17 of the 24 departments for which the statistics are produced reported an incidence of poverty that was above the national average of 32.7%. The remaining seven departments with a relatively contained incidence of poverty are Antioquia (26.8%), Bogotá D.C. (11.6%), Cundinamarca (23.3%), Meta (29.5%), Risaralda (28.4%), Santander (20.8%) and Valle del Cauca (26.9%).

Growth and the process of agglomeration

Economic activity in Colombia is highly concentrated. In 2011, nearly 60% of the national GDP was generated by five departments: Bogotá D.C. (24.4%), Antioquia (13.1%), Valle del Cauca (9.4%), Santander (7.5%) and Meta (5.5%) (data

provided in the questionnaire). The ten departments that contributed least to the gross domestic product generated only 2.6% of the total production (Vaupés, Guainía, Vichada, Amazonas, Guaviare, San Andrés, Caquetá, Chocó, Putumayo and Sucre).

Figure 1.3. **Incidence of poverty (2002) and change between 2002 and 2012, 23 departments and Bogotá D.C.**



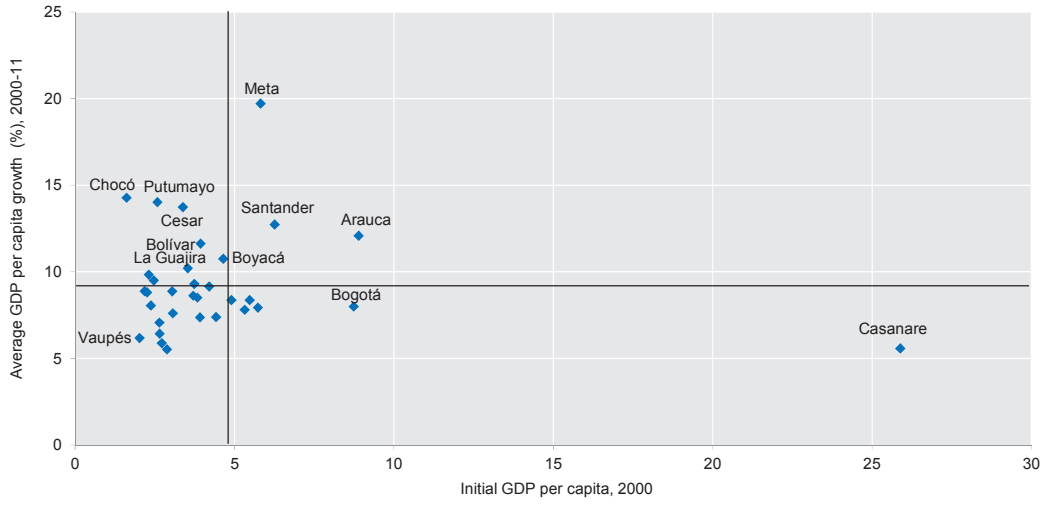
Note: Data expanded from population projections, using as a base results of the 2005 Census. Information on the poverty of each person is analysed and the percentage of those below the poverty threshold is calculated.

Source: DANE, Encuesta Continua de Hogares (2002-2006) and Gran Encuesta Integrada de Hogares (2008-12).

One of the key questions for regional policy is how the initial conditions of a region affect its economic performance over time (OECD, 2012a). Figure 1.4 shows the GDP per capita growth trends across the 33 departments of Colombia between 2000 and 2011, in terms of their condition at the beginning of the period (2000). The figure shows a large dispersion of performance for similar levels of GDP per capita at the beginning of the period. The departments with the highest average annual GDP per capita growth have a resource-driven economy (Cesar, Chocó, Meta and Putumayo).

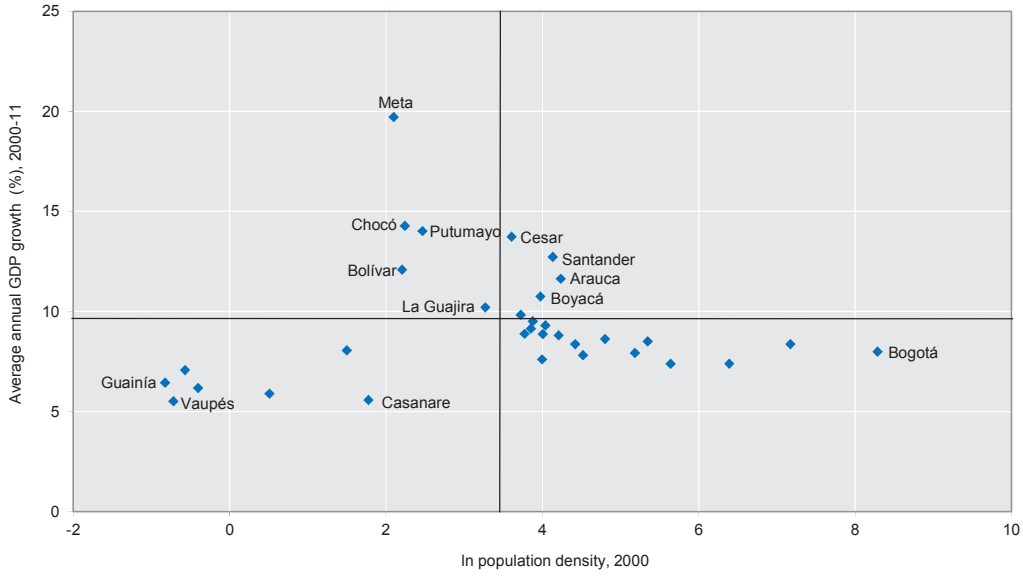
A slight correlation can be observed between the population density of a department at the beginning of the period considered and the average annual GDP growth over the following decade. This means that the main driver of rapid GDP growth does not appear to be agglomeration (and urbanisation), but rather the presence of a resource-based economy (Figures 1.5 and 1.6). Chocó, Meta and Putumayo, for instance, are not among the departments with the highest population density in 2000. However, their rates of average annual growth per capita between 2000 and 2011 were among the highest recorded among all departments in Colombia. Similarly, Bogotá had the highest population density in 2000, but its average GDP growth was comparable to that of some departments with the lowest population densities. The current policy focus on urban development, while important, could have less impact than expected on national development overall.

Figure 1.4. **Growth trends across departments, Colombia, 2000-11**



Source: Own research based on DANE.

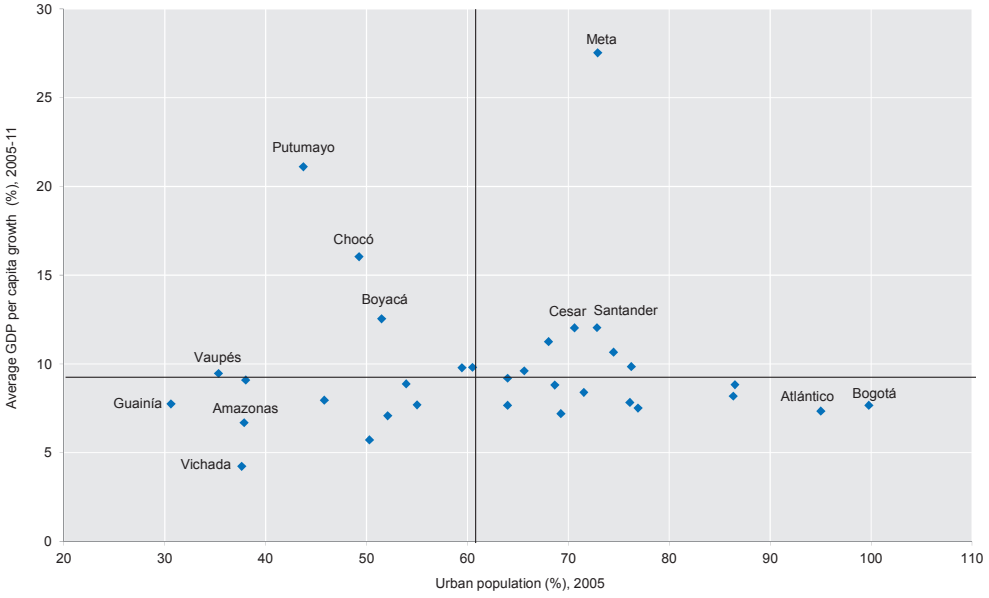
Figure 1.5. **Population density (2000) and annual average growth rate (2000-11), by department, Colombia**



Source: Own research based on DANE.

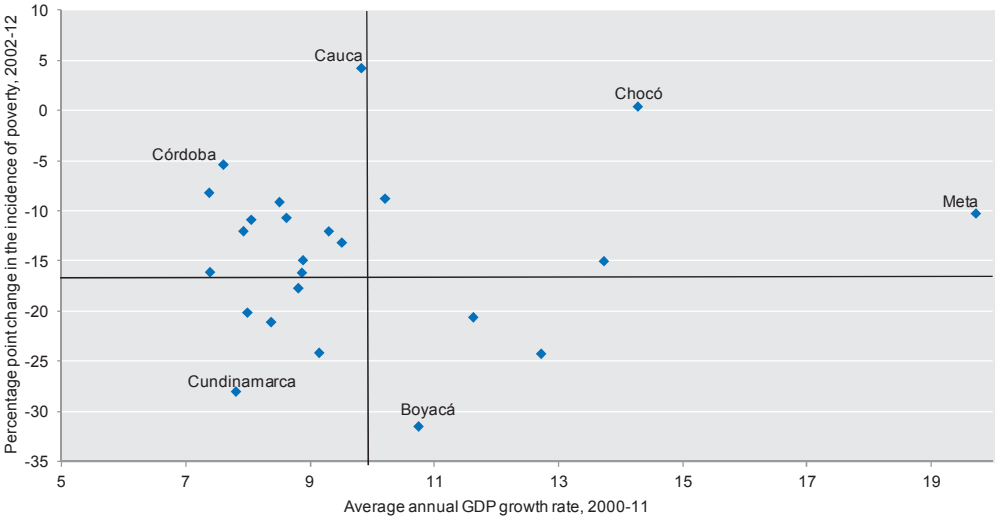
Economic growth trends and poverty changes at the department level suggest that the highest rate of reducing poverty is not necessarily associated with rapid economic growth (Figure 1.7). Indeed, departments with very similar performances in terms of GDP growth, average annual growth between 2000 and 2011, reported largely different results in terms of the changing incidence of poverty between 2002 and 2012. This data provides justification for the recent reform of the General System of Royalties. Despite the investment capacity generated by the activity of extractive industries in their territories, poor departments have not so far been able to promote sustainable economic development.[20]

Figure 1.6. **Urbanisation (2005) and average GDP per capita growth (2005-11), by department, Colombia**



Source: Own research based on DANE.

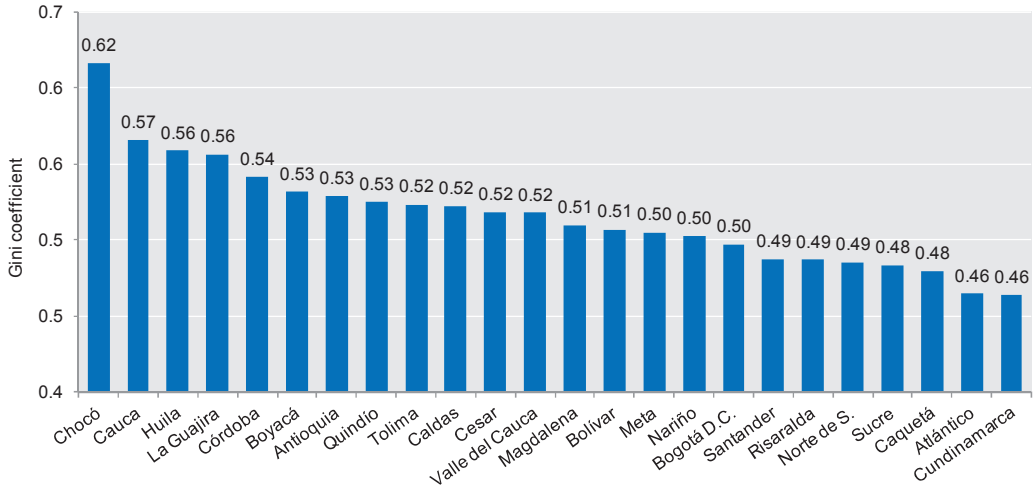
Figure 1.7. **GDP growth and poverty change, 23 departments and Bogotá D.C., Colombia**



Source: Own research based on DANE.

The diversity in distributional effects of economic growth at the departmental level is reflected in the economic disparities that exist within each department. The Gini coefficient is one of the most common measures used to assess inequality, in this case income inequality. Figure 1.8 shows the Gini coefficient for 23 departments and Bogotá D.C. in 2012. The highest values of the coefficient, or the highest income inequalities, were recorded for the departments of Chocó, Cauca and Huila. By contrast, Cundinamarca, Atlantico and Caqueta reported the lowest Gini values (lowest levels of income inequality).

Figure 1.8. **Gini coefficient, 23 departments and Bogotá D.C.**



Note: A Gini coefficient of 0 indicates perfect equality (everyone has exactly the same income); a Gini coefficient of 1 indicates maximal inequality (only one person has all the income). Data expanded from population projections, using as a base results of the 2005 Census.

Source: Own research based on DANE, Encuesta Continua de Hogares (2002-2006) y Gran Encuesta Integrada de Hogares (2008-2012).

Industrial mix and location of firms

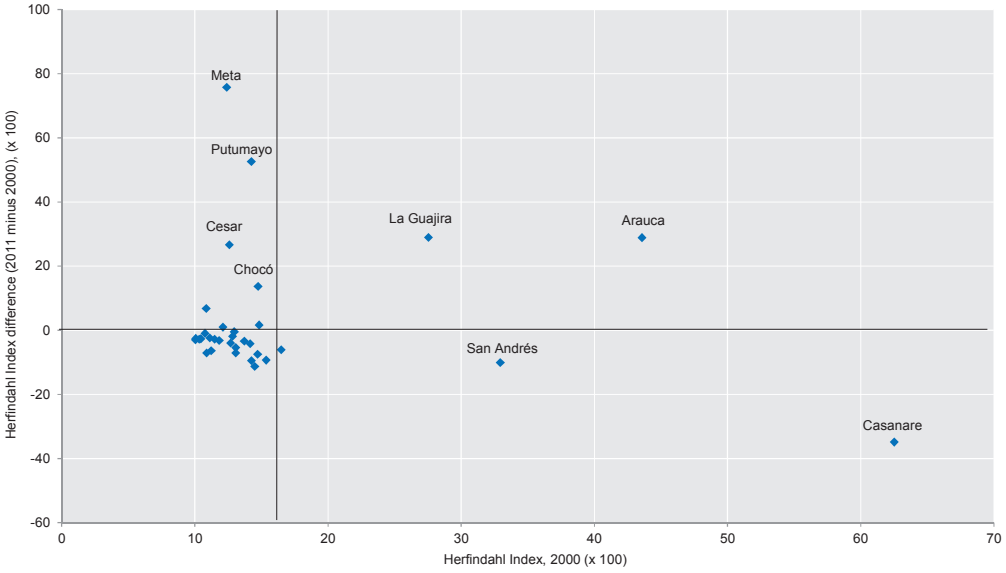
One of the features of a territorial development plan is the support of key sectors within each department. The central government is engaged in a dialogue with departments that is expected to lead to the identification of strategic economic sectors in each department. Departments are then expected to build on their economic strengths and specialisation within those strategic sectors. However, information on industrial clustering and spatial distributions of the value chain is lacking. The main information on the current industrial base of each department comes from departmental GDP estimates by sector of economic activity.[21] For the purpose of this analysis, the 80 economic activities were aggregated into 15 major industry sectors. These sectors were used to compute Herfindahl indices (Hi)[22] and location quotients (LQ)[23] for each department. The trends in industrial specialisation for each department were assessed by comparing the Herfindahl Index in 2000 with the change in this index between 2000 and 2011 (Figure 1.9).

Most departments have experienced some diversification of the regional economy, as indicated by the fact that the difference between the Hi at the beginning and at the end of the period was negative. For one group of departments, however, the Hi indicates a substantial increase in the level of economic specialisation. This shows that a larger share of the departmental GDP is now generated by a single industry and that, not surprisingly, those departments were typically the ones with strong growth in their extractive industries.

Location quotients are computed for each of the provincial sectors (15), in each of the 32 departments and for each year from 2000 to 2011. Here, the results are presented for the year 2010, with a focus on mining, agriculture and manufacturing, the key tradable sectors (extractive and non-extractive).[24] Mining activities are highly concentrated in a few departments, as indicated by the location quotient (Figure 1.10). In departments like

Arauca, Casanare, La Guajira and Meta, economic activities associated with mining had a share that was seven times or more the share of that industry found in the national economy. Most of the departments have a location quotient well below the unit value, meaning that the share of economic activities related to mining in the department is only a fraction of the national activity in mining. No department had a location quotient within the range of 0.7-1.3, which would imply a regional share of the mining sector similar to the share of the sector in the national economy.

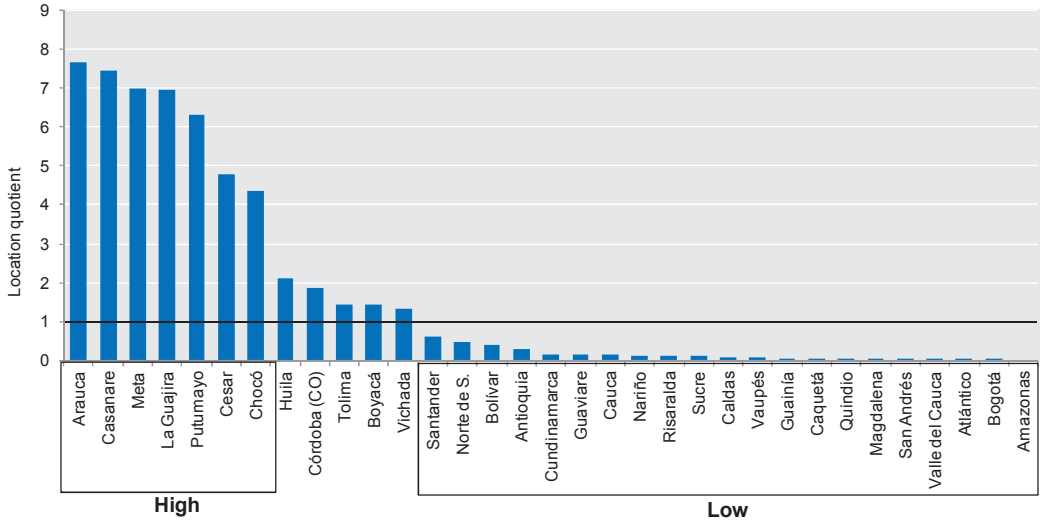
Figure 1.9. **Specialisation trends across departments, Colombia, 2000-11**



Note: For the purpose of this figure, the index values of 2000 and 2011 are computed as a three-year average (for 2000, 2001 and 2002 and 2009, 2010 and 2011).

Source: Own research based on DANE, *Dirección de Síntesis y Cuentas Nacionales, Cuentas Nacionales Departamentales de Colombia, PIB a precios corrientes por departamentos Base 2005*.

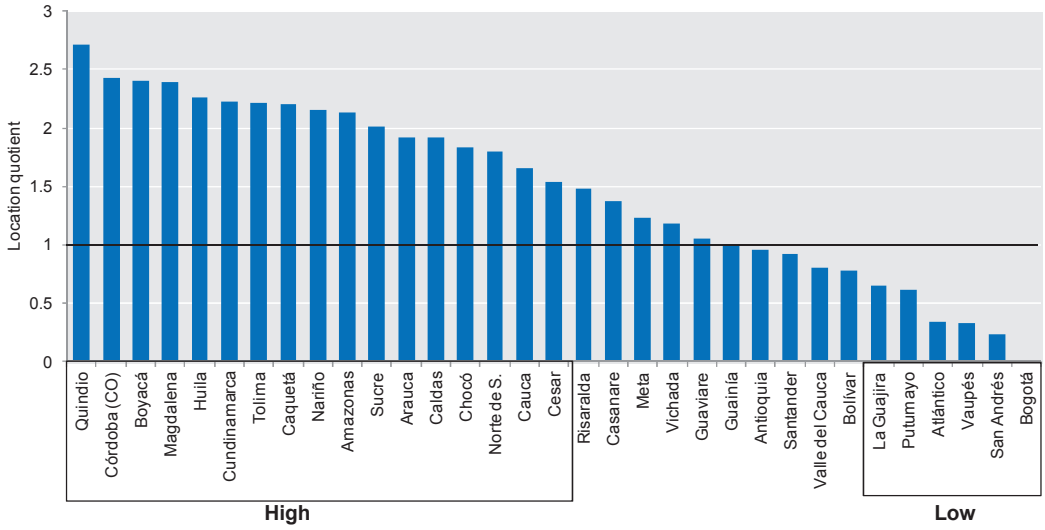
Figure 1.10. **Location quotient for the mining sector by department, Colombia, 2010**



Source: Own research based on DANE, *Dirección de Síntesis y Cuentas Nacionales, Cuentas Nacionales Departamentales de Colombia, PIB a precios corrientes por departamentos Base 2005*.

Data suggests that the agricultural sector could become one of the engines of a distributed growth process across departments, rather than one more likely to affect only a few departments (Figure 1.11). Substantial emphasis has been placed recently on the development of Colombia's agriculture sector. Agriculture, forestry and fishing, as an aggregate, represent a sector that had a strong presence in most departments (LQ above 1.3), except for the four departments that represent over 50% of the national GDP and a few other departments. The challenges in the development of the agricultural sector are substantial, and the central government is committed to improving the productivity of the sector. The upcoming Census of Agriculture, expected to be implemented in 2014, will provide a substantial statistical update on the sector's structure and characteristics, as well as detailed territorial statistics.

Figure 1.11. **Location quotient for the agriculture, forestry and fishing sectors by department, Colombia, 2010**



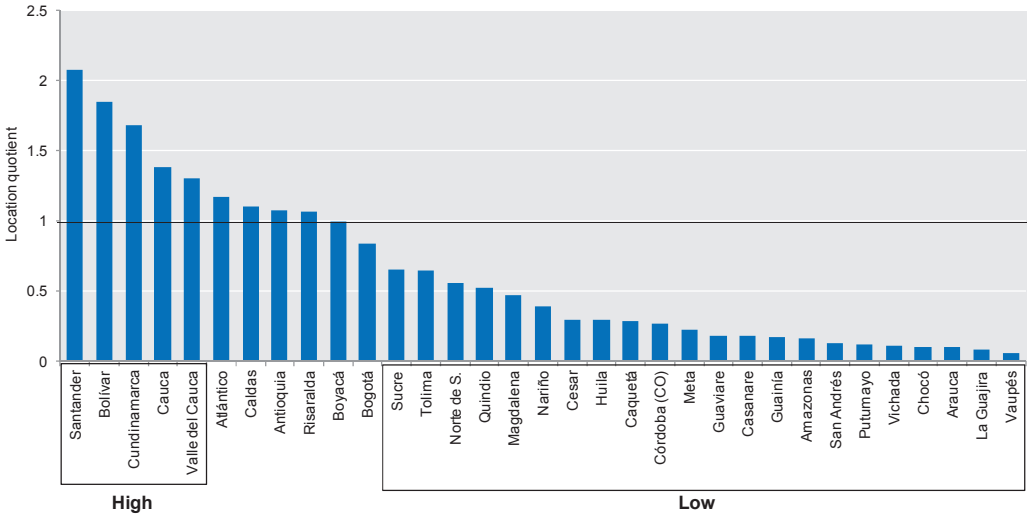
Source: Own research based on DANE, *Dirección de Síntesis y Cuentas Nacionales, Cuentas Nacionales Departamentales de Colombia, PIB a precios corrientes por departamentos Base 2005.*

The location quotients for the manufacturing sector indicate that only a few departments have relatively high specialisations in manufacturing. These are some of the largest and the fastest-growing departments, in terms of their share of national GDP (Figure 1.12). In addition, it should be noted that agriculture and manufacturing are both relatively important for Cauca and Cundinamarca (LQ > 1.3). For these two departments, this might suggest the existence of potential and specific synergies among their two sectors, which have been identified as priority sectors by national policies. A more detailed analysis of sub-sectors should be undertaken to assess potentials and linkages across value chains. The link between agriculture and manufacturing is a feature of economies at an early stage of industrialisation. It depends on the capacity of farmers to accumulate capital and to invest it in the creation of firms in secondary activities. These firms are generally small or micro enterprises.[25]

The analysis of the location quotients provides several additional insights into the industrial structure across departments. For instance, the presence of financial and insurance activities (code 51), real estate activities (code 52) and professional, scientific and technical services (code 53) is concentrated in very few departments (basically

Bogotá and departments with major metropolitan areas). In addition, the Hi and LQ combined highlight the nature of specialisation-diversification for the various regional economies. For instance, as suggested by the Hi, Antioquia has one of the most diversified departmental economies and is also the second-largest department in terms of GDP. Most LQ values of this department are close to the unit value (i.e. the regional share is similar to the national share for each sector), with a few notable exceptions, such as mining, since there is no mining in Antioquia.

Figure 1.12. **Location quotient for the manufacturing sector by department, Colombia, 2010**



Source: Own research based on DANE, *Dirección de Síntesis y Cuentas Nacionales, Cuentas Nacionales Departamentales de Colombia, PIB a precios corrientes por departamentos Base 2005*.

A more detailed analysis of manufacturing and competitiveness measures of the manufacturing sector could be derived from two databases that feature a territorial breakdown. The first is a database of exports and imports by departments, products and months for 2000-13. The second is the national business register (*Directorio Estadístico de Empresas*), which includes information on the location of businesses across the country for both enterprises and establishments.[26] The register is updated on a continuous basis through the use of administrative sources, surveys and direct follow-up with businesses. The microdata from this register were not accessed for the purpose of this territorial review. However, depending on the quality and actual coverage of the current register, substantial potential remains for generating business demographic indicators at the territorial level from this source.

Other key indicators of economic and social performance

SIGOT and Geoportal provide access to a multitude of additional indicators that can be used to assess and monitor territorial performance or specific programmes. SIGOT includes some data on local fiscal structure and capacity, which appears to be a major area of concern for territorial governance. Compared to other OECD countries, sub-national authorities in Colombia raise a very limited amount of resources and are considerably dependent on the central government. The central government is attempting to reverse this trend, by asking local authorities to increase their financial independence and collect local taxes; however, local fiscal capacity varies widely. Although in most

cases local governments do not generate their investment money through local taxes, municipalities such as Barranquilla were able to multiply their tax revenue by a factor of four in less than five years.

Another domain of major interest for national territorial policy development and for international comparability is access to key services and infrastructure. Data on transport and communications infrastructure are available from various administrative sources and can be accessed through SIGOT. This also includes data on external and internal accessibility to Colombia: main ports, airports, railway transport and roads. Road network data for the country was provided by the National Planning Department (DNP, 2013), along with definitions for the measurement of distance and accessibility to markets in Colombia. Data on communication technologies are available from a survey conducted by DANE (*Encuesta de Calidad de Vida*, 2012). This provides some basic indicators at the department level, such as the number of telephones per 1 000 inhabitants (DNP, 2013a).

Areas of potential data development

In general, the Colombian government needs to improve the link between (available) information and actionable knowledge (for policy makers). Unquestionably, several aspects of territorial statistics could be further developed. The comments and feedback of data users, as well as a review of existing databases, suggest that efforts to increase the volume of territorial statistics should be supplemented by dissemination and knowledge mobilisation initiatives. The goal should be to make potential users aware of existing databases. This should also be accompanied by initiatives to mobilise existing and potentially under-utilised holdings of administrative data.

The lack of accurate and timely demographic statistics emerged as an issue throughout the field mission interviews. As already noted, not having Censuses conducted at regular intervals is a major impediment to the validity of territorial statistics for small geographic units. For instance, while some information on mobility is available through SIGOT, the shortage of information on the true magnitude of population mobility in recent years was reported at several meetings. On several occasions, data gaps were also observed within thematic areas such as justice statistics and information on energy accounts, including renewable energy (DNP, 2013a).[27]

Conclusions

Strengthening the territorial statistics and information system of Colombia: Some options

Although Colombia's statistical system is generally solid and well established, a number of initiatives could enhance its information system, particularly with respect to the production, analysis, dissemination and interpretation of territorial statistics.

Consolidating baseline statistics

The Census is the cornerstone of a statistical information system in OECD countries. Censuses should be conducted at regular intervals, every ten or possibly even every five years. This is particularly important for territorial indicators, as the Census is the only data source that covers enough of the population to generate reliable estimates of demographic, social and economic indicators at a small geographic scale (Box 1.5).

In this respect, the current legal framework of Colombia negatively affects the quality of territorial statistics. For instance, no law regulates the Census cycle, and the Census of Population and the Census of Agriculture are currently not being conducted at regular intervals. The parliament would have to approve a specific law to provide Census activities with a budget. The last Census of Population for Colombia was produced in 2005, and the last Census of Agriculture in the 1970s. As a result, many of the current statistics used by policy makers are projections, which do not necessarily provide an accurate measure of reality.

This is a challenge for a country that has undergone extreme socio-economic changes over the last decade. For instance, the 2005 Census provides limited information on the *desplazados*, the displaced rural population who have caused a surge in poverty rates and informal housing. This vitiates the figures for the total population of Bogotá and other key urban areas. Another challenge is that parliament must approve the Census before it is published. This curtails DANE's independence and could compromise the quality of the final results.

Box 1.5. **Importance of the Census for national and territorial statistics, as seen from the Canadian context**

The Census of Population and the Census of Agriculture are the foundation of the national statistical systems of most OECD countries. Their relevance is widely stressed by national statistical agencies.

The Census is the primary source of reliable demographic data for specific groups such as one-parent families, seniors and language groups. The information is used in taking decisions, for neighbourhoods, communities, provinces and the country as a whole.

The Census is also the main source of data available in a standardised format for small areas. It provides nationally comparable data that can be cross-classified to show details. It is also the main body of comprehensive statistical data at the sub-provincial level on Canada's population (Statistics Canada, 2011).

Governments, businesses, associations and community organisations use Census information to plan services that benefit everyone who lives in Canada. These services include schools, day care, police services and fire protection.

For instance, in Canada, Statistics Canada is required by law to conduct a Census of Population and a Census of Agriculture every five years, in the years ending in 1 and 6 (see: Statistics Act, Subsection 19(1), Section 20, Subsection 21(1)).

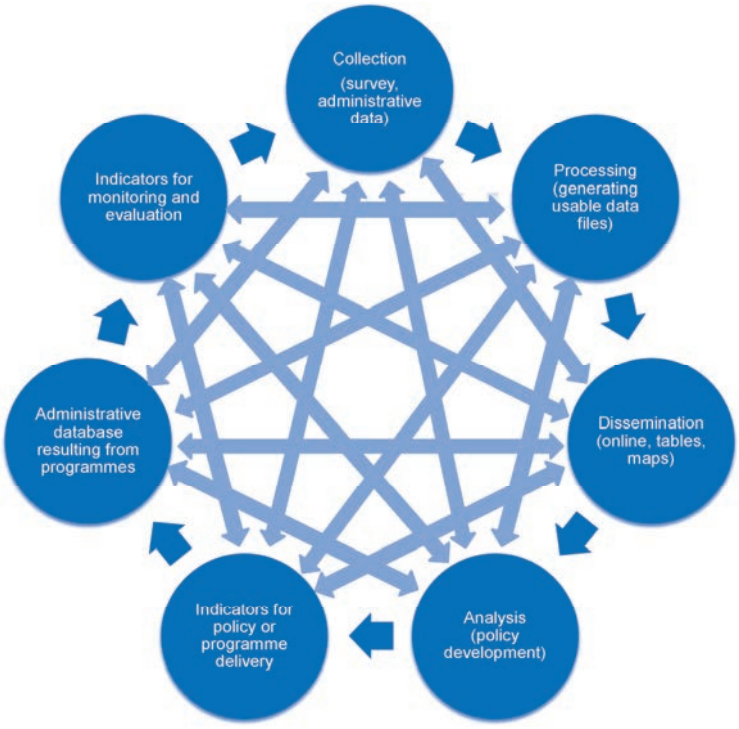
Source: Excerpt from: Statistics Canada (2011), "Chapter 1: Taking an agriculture census", Overview of the Census of Agriculture, Statistics Canada, Ottawa, Ontario, available at: www12.statcan.gc.ca/census-recensement/2011/ref/overview-apercu/ag1-eng.cfm (last accessed 3 November 2014).

Co-ordination along the information supply chain

Co-ordination of territorial information is a form of multi-level governance of data: i.e. a way of sharing decision-making authority, responsibility and implementation across different administrative and territorial levels of the information supply chain. Multi-level governance of statistics has a horizontal dimension across different ministries, as well as a vertical dimension between different tiers of government at the municipal, departmental and national level. This co-ordination can also occur at different phases of the information supply chain, such as data collection, processing, analysis and dissemination, and policy use and evaluation.

An informed regional policy cycle requires an integrated information system for territorial policies that can address the complexity of this value chain and its multi-level governance. OECD (2010a) outlines the key components of this system, building on the framework of an informed policy cycle. Initiatives intended to strengthen the territorial information system should look at the roles performed and the linkages between entities in the supply chain. One conceptualisation of this network of linkages is presented in Figure 1.13.

Figure 1.13. **Co-ordination across the territorial information system**



Typically, national statistical agencies play a key role in the information supply chain and its co-ordination. They are often at the centre of the collection, processing, analysis and dissemination of statistics. Territorial data in Colombia are produced and collected by different bodies and at different levels, which impinges on the co-ordination and coherency of the national statistics available. Although DANE is the main producer and broker of statistics, key administrative datasets with a territorial dimension are also produced by other entities as a result of their programme deliveries or management. These entities include the DNP, the Ministry of Agriculture and other national agencies in charge of specific policies such as food security and well-being. Important data on economic activities are also collected through the mining registry (*Registro Minero*). The fragmented nature of these administrative data holdings can result in duplication of data.

DANE could play a greater role in co-ordinating data collection and processing territorial statistics, including the management and processing of administrative data holdings. The effective use of administrative data files from heterogeneous sources poses several challenges and requires, for example:

- a substantial degree of collaboration and communication across agencies, which could require data-sharing agreements and legal frameworks for data transfers and linkages, confidentiality agreements and data-sharing protocols

- co-ordination of infrastructures and technologies such as software and data storage systems
- specific information management procedures for the storage and maintenance of master data files.

Another way to ensure a more effective use of administrative data holdings would be to strengthen the regulatory framework that provides agencies (ideally the national statistical agencies), with the mandate and authority to obtain administrative and survey data holdings from other departments. For instance, in the Canadian context, this is ensured by Section 13 of the Statistics Act.[28]

Enhancing co-ordination for territorial statistics might also require horizontal co-ordination across directorates with a territorial focus. One example might be to establish a relationship between the directorate that deals with urban policy and the one that deals with rural department policies.

Dissemination can occur through a variety of media. Today, online dissemination plays a central role in any data dissemination model. For territorial statistics, dissemination can be enhanced by a variety of online mapping systems. Colombia already has several online mapping systems and associated databases. Two are particularly comprehensive: SIGOT and Geoportal, which can be found on DANE's website. Building on these initiatives could be the best way to strengthen the country's territorial information system. However, introducing some form of co-ordination between these initiatives is likely to be beneficial for all of the stakeholders involved.

Dissemination should also include knowledge sharing and knowledge management among stakeholders. This can be implemented in a variety of ways, including relatively simple initiatives such as developing an online community of practices for territorial statistics and indicators across key departments and users, or establishing an annual workshop that enhances the visibility of and knowledge sharing about data/analysis/dissemination among territorial data stakeholders.

The analysis of territorial data is likely to play an increasing role in the information supply chain. The development of a unit dedicated to territorial research, with a cohesive group of analysts, will be vital for the success of the information supply chain. The DNP is expected to establish a "territorial observatory" within the department, which could become one of the key entities for territorial policy analysis.

Although this unit could be located in any department, the success of the system will be largely dependent on fostering extensive connections between the unit and both the collection and processing phase, as well as with the policy side. An analytical unit/capacity for analysis is critical for handling policy questions from the policy and programme department and the statistical entity.

A successful information supply chain thrives on well-defined mechanisms for feedback loops, both throughout the system and among each stage or function of the chain. For instance: feedback from every stage, from the analytical phase to processing, is of paramount importance to improve data quality. Likewise, policy needs and questions have to be able percolate through the system to direct collection efforts and analysis toward priority items. Promoting this type of feedback and linkages across all actors is likely to reduce the risks (and costs) of duplication in the collection, production and analysis of territorial data.

Geography as a key element of the data dissemination model

Statistical dissemination models are constantly evolving, and a multiplicity of forms present different advantages for meeting a country's statistical needs. However, in several national contexts, the geographic dimension is a key unifying element of the dissemination model adopted by statistical agencies.

Dissemination models that take geography as a key element use it as a filtering criterion for every topic for which statistics are disseminated (e.g. demographics, income, employment, education, etc.). This approach contrasts with the model in which "regional statistics" is one of the key subjects used in the dissemination framework. The development of systems through common geospatial data infrastructure is likely to result in growing standardisation of the geographical concepts within national statistical systems.

Colombia could benefit from conducting a thorough review of the existing definitions of rural and urban that are used in policy development, programme delivery and even in legislation or regulations. This would make it possible to identify a selected number of definitions and clarify their strengths and most appropriate uses, and would enhance the coherence of the geographic concepts used for statistical and policy purposes.

Strengthening analytical capacity to support territorial policy development, monitoring and evaluation

A trend likely to emerge as territorial policies are decentralised and local actors become more engaged in shaping their own economic and social policies is a demand for analysis of the territorial information. As the demand for access to plain data and statistics grows, so will demand for analysis of the data.

The central government clearly sees a need for a strategic plan to engage in capacity building and the empowerment of sub-national policy. The development of a strategic plan for capacity building could include a specific set of activities to strengthen analytical capacity for territorial development.

The national government is in the process of creating a "territorial observatory". Framing regional observatories within the DNP would create a powerful tool for territorial policy development. A co-ordinated network of regional observatories could function as a single observatory for territorial cohesion at the national level. Building the analytical capacity of the observatory might require a variety of capacity-building activities, which could include both formal training and education of staff, as well as on-the-job training through rotations and exchanges with other organisations involved in territorial data analysis.[29]

Timely territorial indicators

This is likely to become another critical area of development for territorial statistics in Colombia. Enhancing the timeliness of territorial data will have ramifications for various phases and aspects of the information chain. Timeliness is directly connected to the relevance of statistics. The implementation of Censuses at regular intervals would substantially improve the timeliness of relevant territorial indicators. Increasing the frequency of territorial statistics (e.g. collecting quarterly data on employment trends for major metropolitan areas), could also substantially improve the results. Examples of such timely statistics are available on the Geoportal (DANE).

Notes

1. DANE employs approximately 1 000 full-time staff.

2. As the world of data dissemination evolves, statistical agencies adapt their dissemination models to emerging needs. For instance, Statistics Canada is developing a new dissemination model (Statistics Canada, 2013a; 2013b). One of the key concepts behind the new model is improved navigation of web resources for the user. The application of consistent filters is in line with this concept, as it will make it easier to find information. One of the filters that will be applied is a geographic filter, to facilitate access to territorial information for any given statistical domain (Statistics Canada, 2013a).

3. In most cases, for the data generated by DANE, the source is simply reported as "*DANE*".

4. Field interviews revealed one example of an extensive administrative database of social statistics maintained at the municipal level, associated with the *Sistema de Identificación y Clasificación de Potenciales Beneficiarios para Programas Sociales, Sisbén*.

5. See, for instance, Agronet for agriculture statistics at the territorial level and its online mapping system available at: www.agronet.gov.co/agronetweb1/Agromapas.aspx.

6. PowerPoint presentation, field mission July 2013: *Sistema de Información del Sector Agropecuario, 2013. Dirección de Politícal Sectoral, MinAgricultura*.

7. For an example of the extent and detail of territorial indicators used in the planning process, see DANE (2007).

8. Census divisions represent counties, regional districts, regional municipalities and other types of sub-provincial legislated areas. For more details, see: www.statcan.gc.ca/pub/92-195-x/2011001/geo/cd-dr/cd-dr-eng.htm.

9. However, a few (approximately 20) do not have the status of municipality.

10. It should be noted that these territorial units are part of an international standard, specifically the "*Nomenclatura de las Unidades Territoriales Estadísticas de la Comunidad Andina*" (NUTE ANDINA), see: www.comunidadandina.org/normativa/dec/anexoDEC534.pdf.

11. DIVIPOLA 2013 reports the following metropolitan areas: Barranquilla, Bucaramanga, Cúcuta, Valle de Aburrá, Centro-Occidente, Valle del Cacique de Upar.

12. DIVIPOLA 2013, the districts (*distritos*) are: Barranquilla, *Distrito Especial, Industrial y Portuario*; Bogotá, *Distrito Capital*; Buenaventura, *Distrito Especial, Industrial y Portuario*; Cartagena de Indias, *Distrito Turístico, Histórico y Cultural*; Santa Marta, *Distrito Turístico, Cultural e Histórico*.

13. The territorial classification implemented by UNDP/PNUD is a simplified version of the OECD territorial classification.

14. Statistics Canada, Statistical Area Classification – Variant of SGC 2011, available at: www.statcan.gc.ca/subjects-sujets/standard-norme/sgc-cgt/2011/sgc-cgt-intro-eng.htm#a5-1.

15. It is often reported that the urban economic activities contributed to "over 50%" of the GDP growth of Colombia during the last four decades (World Bank, 2012).

16. Available at: http://sige.dane.gov.co/atlasestadistico (accessed 21 October 2013).

17. To give a sense of the variety and detail of territorial indicators available, here is a summary of the three factors and associated indicators (data were collected for the OECD in DNP, 2013). Factor 1: quality of life; specific indicator: income per capita (estimation from municipal tax collection; DDTS, 2008); percentage of rural population; percentage of urban population; adult literacy. Factor 2: population and financial density; specific indicators (source): population density; value of bank loans per capita; bank offices per square kilometre. Factor 3: growth; specific indicators (source): gross education enrolment: primary; gross education enrolment: secondary; municipal government investment per habitant; institutional capacity of the municipal government (*Índice de Desempeño Integral*); percentage of economically active population; percentage of people who speak English.

18. Source: http://sige.dane.gov.co/atlasestadistico.

19. The departments for which poverty statistics are not available are Amazonas, Arauca, Casanare, Guainía, Guaviare, Putumayo, San Andrés, Vaupés and Vichada.

20. For an analysis of the national reform of the General System of Royalties, see Chapter 5.

21. Source: DANE, Dirección de Síntesis y Cuentas Nacionales, Cuentas Nacionales Departamentales de Colombia, PIB with current prices for departments based on 2005 figures (2000-11).

22. The Herfindahl Index is one of the most commonly used measures of specialisation. For the purpose of this analysis, the index is computed as the sum of the squared GDP shares of each industrial sector in each department. Hence, the index varies from values closer to 0, when there is perfect diversification and the department has exactly the same share of GDP from each industry, to the value of 1, when there is perfect specialisation and one industry accounts for all departmental GDP.

23. The LQ provides a measure of the intensity, measured as a share of departmental GDP, of a given industry in a department relative to the intensity of the same industry at the national level. The LQ for each industry/department is computed as the ratio between the share of departmental GDP for a given industry and the share of GDP for the same industry at the national level.

24. Data for 2010 rather than 2011 were used because 2011 figures were described as preliminary estimates.

25. Colombia's policy framework to support small and micro firms is very limited, as the country is primarily focusing on attracting foreign direct investment to generate large manufacturing poles.

26. Source: www.dane.gov.co/index.php/informacion-georreferenciada/directorio-estadistico (accessed 20 October 2013).

27. Information on justice at the regional level could be particularly relevant in a country that struggles with law enforcement.

28. Access to records (Section 13): "A person having the custody or charge of any documents or records that are maintained in any department or in any municipal office, corporation, business or organisation, from which information sought in respect of the objects of this [a]ct can be obtained or that would aid in the completion or correction of that information, shall grant access thereto for those purposes to a person authorised by the Chief Statistician to obtain that information or aid in the completion or correction of that information."

29. See, for instance, the experience of Quebec with the network co-ordinated by *Solidarité Rural du Québec* (www.ruralite.qc.ca). *Solidarité Rural* functions as an independent (public) body co-ordinating the actions of regional development agents operating at the community level. Agents are part of a strategic framework supporting rural development that includes regional research centres and incubators of small and medium-sized enterprises (OECD, 2010b).

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Chapter 2

Integrating urban and rural development in Colombia

This chapter discusses both urban and rural development policies in Colombia. It suggests how Colombia could better link the currently disconnected urban and rural policy agendas to improve regional development outcomes. The chapter is divided into three main parts. The first part focuses on Colombia's urban development policy and, in particular, assesses the recent efforts to connect the main urban agglomerations. The second part discusses the national rural development policy, which although it focuses on agriculture, is also experimenting with a holistic approach to territorial development in low densely populated areas. Finally, the third part draws some general conclusions and sums up key recommendations.

Key findings and recommendations

Key findings

- Settlement patterns in Colombia involve an archipelago of urban regions surrounded by poorly connected rural areas. Colombia has an unusual polycentric urban system in the Latin American context, comparable to Brazil and to some extent, Mexico. It has five main urban agglomerations that serve as hubs for the surrounding region. Due to the lack of transport infrastructure, the functional area of each urban hub tends to be relatively small and isolated. Colombia's major cities have essentially become production and service centres, developing too many functions relative to their size. New cities have emerged in this structure (47 cities had a population larger than 100 000 in 2014), but the split between rural and urban is evident.
- Colombia has a significant infrastructure gap, particularly in transport. Despite increasing public investment, Colombia still has one of the biggest gaps in transport infrastructure in Latin America. Its network of roads and railways is low by Latin American standards given its per capita gross domestic product (GDP), and it lags well behind Asia and OECD countries in transport infrastructure. Most of its poor communities also suffer from isolation from the rest of the country. This may represent an important bottleneck for regional development.
- Social unrest has caused a rural diaspora to cities. Many rural areas have been dangerous places for several decades, sheltering guerrilla groups and the cultivation of illicit crops (opium poppies and coca). Rural residents forced off their land moved to cities, regardless of their ability to participate in the urban labour pool. No official data are available on the number of *desplazados* living in urban areas, but the flows have resulted in informal settlements and increased urban poverty.

Key recommendations

- The future of rural Colombia will determine the country's development trajectory, and can help reduce national poverty rates, unemployment rates and boost urban development. As it develops a new set of territorial statistics and classifications, the government could experiment with rural communities, allowing them to adjust policies to their needs and opportunities. To fine-tune its implementation, Colombia could study international experiences such as the European Union's LEADER programme, designed to promote social capital in declining rural communities between the 1990s and 2000s.
- Improved urban connectivity may entail readjustment. Colombia has a well-developed urban system, but its cities tend to be relatively isolated. Urban poles have been severed from the rural areas affected by social unrest. The government's current efforts to connect urban agglomerations may prove difficult for some cities. As urban functions concentrate, some cities may lose functions. Measures to reduce the costs of this adjustment should be anticipated.
- Assess the possibility of capitalising on the diffused specialisation of agriculture at the department level. While it has identified the agro-industry as a potential driver for national growth, Colombia's rural policy is still focusing on direct subsidies to farmers. Taking into account Colombia's diffused specialisation in farming activities, *Misión Rural* could assess the characteristic of agro-industry in different regions and identify opportunities for investment and growth. Linkages with manufacturing activities could be considered.

Introduction

In Colombia, both urban and rural areas have an important economic role to play. The country has a relatively large number of urban hubs and medium-sized cities compared with other Latin American countries. The main urban hubs, such as Bogotá and Medellín, have improved their international visibility and provide services for a large functional region, and also for the country as a whole (universities, international airports, research centres, amenities, etc.). Medium-sized cities also provide services to their surroundings, including rural areas where agriculture and extractive activities are located. This means that some of the key drivers for Colombia's economy are located in sparsely populated areas.

The national government has developed two ambitious policy agendas for urban and rural areas that intended to operate in parallel. Through its urban development agenda – called *Misión de Ciudades* – the government aims to link the urban hubs and secondary cities in an integrated transport network. This should facilitate internal trade and provide the manufacturing activities in the centre of the country (in the region of Bogotá, for instance) with access to Atlantic and Pacific ports. As for rural development, national policy interventions can be divided into two different categories. On the one hand, the government has started providing subsidies to all farmers, including smallholders, whereas subsidies were previously restricted to cash crops and large-scale farming. In addition, the policy aims to provide farmers with the skills to support innovation and productivity. The government is also assessing the possibility of adopting a more holistic approach – *Misión para la Transformación del Campo*, or *Misión del Campo*, hereafter – whose main goals are to facilitate access to basic services for rural residents and promote skills in rural communities.

These two strands of policy – urban and rural – reflect dramatic and positive change in the way Colombia supports territorial development. The national approach, in both cases, focuses on geography and aims to tailor policy interventions to local needs. However, certain challenges remain. For instance, improving cities' links with metropolitan areas could result in unintended agglomerations that cause factors of production to leave secondary cities for urban hubs. This could upset the current equilibrium and put pressure on services in large cities. It is also important that the policy does not consider the *resto rural* as an empty space, and that it takes into account the impact major transport infrastructure may have on rural communities and landscapes. As for rural development policy, the transition toward a "modern" and holistic approach to rural development is complicated by the need to deal with agrarian protests. It is important to demonstrate to rural dwellers that an integrated territorial approach can be more effective than subsidies in improving their overall quality of life. Concluding the peace process could help realise the potential of Colombia's rural areas, and it is important that the government continue to set a post-conflict policy framework to capitalise on this historic opportunity.

Colombia's industrial mix has become more complex in recent years, and territorial networks linking both rural and urban territories have emerged. Policies are needed to enhance urban-rural linkages, to allow rural inhabitants to access urban services without migrating into the cities. This would also increase urban citizens' access to rural amenities and the delivery of such essentials as food, energy and water, which are generally produced in rural areas. This chapter will focus on the need to link both rural and urban policy agendas. This chapter does not include the statistical analysis for rural

and urban regions (and related national classifications), as this has already been discussed in the previous chapter.

Urban development and policies

Colombia is highly urbanised, with a polycentric urban system

Colombia is, and has long been, a highly urbanised country, particularly compared to other countries with similar levels of per capita income. According to the official data, 77% of the population lived in urban areas in 2012, up from a level of around 60% in the early 1970s and only 30% in the late 1930s. To some extent, this very high rate of urbanisation may be a statistical artefact, reflecting the methods used to measure urbanisation in Colombia (Box 2.1), but there is little doubt that, by any measure, Colombia is heavily urbanised. The authorities project further increases in the urbanisation rate, to 83% in 2035 and 86% in 2050. To some extent, Colombian urbanisation was accelerated by the security situation. The armed conflict and illegal activities the country experienced from the early 1960s meant that, until relatively recently, a great deal of the countryside was unsafe. Large numbers of people moved (or were forced to move) into cities more for reasons of security than economic opportunity. As will be explained later, this has had implications for the relationship between urbanisation and development.

In contrast to most Latin American countries, Colombia has a polycentric urban system. Only Brazil and, to a limited extent, Mexico share this characteristic, and even Mexico has a much higher level of urban concentration than Colombia. Among the larger Latin American countries,[1] only Brazil has a lower urban primacy index. Colombia has five main cities: Bogotá, Bucaramanga, Cali, Medellín and the Atlantic urban system that includes Barranquilla, Cartagena and Santa Marta. Each of these cities serves as an urban hub for its surrounding region. Some smaller centres (spokes) are connected to the main hubs; these are, in many cases, capitals of departments, where service provision and administrative functions have helped solidify their position (in 2014, 47 cities had a population of at least 100 000). Thus, while there has been some increase in urban primacy, Bogotá is by no means the only city whose importance has been increasing.

That being said, there are concerns about the concentration of the strongest cities in the Andes and on the Caribbean coast. Cali-Buenaventura apart, the Pacific region has not seen much development. This represents both a challenge and an opportunity, as the world's economic centre of gravity shifts ever more rapidly to the Pacific. The country also has a fair number of intermediate and small cities that have experienced economic and demographic stagnation: this is primarily true of cities in regions that have not benefited from the mining boom and, in some cases, of places close to the five largest urban areas, which have suffered from increasing concentration in the biggest cities. Cities in the south and in the coffee-growing region, as well as Barrancabermeja and Sogamoso, have not flourished. By contrast, cities like Riohacha, Valledupar, Villavicencio and Yopal, in mining regions, and Apartadó and Turbo, linked to successful agribusiness, have experienced substantial growth. Nonetheless, excluding mining activities, the level of economic concentration in the urban system rises substantially: around 75% of non-mineral GDP is generated in the departments where Bogotá, Cali and Medellín are located (World Bank, 2010).

Box 2.1. What does "urbanisation" mean in Colombia?

Urbanisation is most often defined as the process whereby the number of people living in cities (urban areas) increases relative to the number of people living in rural areas. This definition, of course, begs a number of questions, particularly the definitions of urban and rural areas. Above all, cities are distinguished from rural places in terms of their higher population density and consequently, the degree to which human, as opposed to natural, geography defines their character. However, definitions vary across the world, because the densities typical of both rural and urban areas vary so widely. The OECD definition of "functional urban areas" (FUAs) has been devised precisely in order to serve as a standard method and thereby to ensure comparability across countries, and yet it nevertheless uses different density and size thresholds for different groups of OECD countries.[1] While this introduces an element of difference in a framework that is in all other respects common to all, such variation is inevitable given the very different patterns of urban and rural settlement across countries.[2]

In addition, factors such as the nature of the built environment and the share of the population engaged in "urban" (i.e. non-agricultural) activities come into play. Many European countries, for example, define urbanised areas on the basis of land use, employing satellite imagery instead of Census blocks to determine the boundaries of the urban area. In developing and middle-income countries, in addition to land use and density requirements, an indicator concerning the share of the population engaged in "urban" economic activities (i.e. not agriculture and/or fishing) is often included. Such differences complicate the task of discussing urbanisation processes in a comparative context.

In the case of Colombia, urbanisation rates are to some extent influenced by its reliance on the *cabecera-resto* approach in defining urban areas. People living within the limits of settlements that are the seats of Colombian municipalities (*cabeceras municipales*) are defined as *ipso facto* "urban". Since this definition ignores the agricultural and rural character of many *cabeceras*, the official data are likely to yield a higher urbanisation rate than would be derived using the definitions typical of most OECD countries. This factor should be borne in mind when assessing data at the scale and speed of urbanisation taking place in Colombia. While there is no doubt that an extraordinary urban transformation has taken place – both economic and geophysical data make this clear – it is not always possible to be precise about the extent of Colombia's urbanisation at any given time or about comparisons to other countries. However, it is clear that, by almost any standard, the country is heavily urbanised. In 2010, 58.5% of the population lived in the 18 major urban agglomerations (approximately 23 million people) or the 38 other major urban centres (cities with over 100 000 inhabitants, capitals of departments and cities with regional or sub-regional functions accounted for 5.1 million people).

With respect to the definition of functional urban areas – that is, to defining urban agglomerations in terms of settlement and activity rather than administrative boundaries – Colombia has designated 6 metropolitan areas in national legislation, while 18 large "urban agglomerations", with a total population of 23.7 million in 2010, are identified in some of the recent analytical work done for the government's *Misión de Ciudades*. This is a promising step, as the *Misión* definitions are based on settlement and commuting patterns, comparable to the methods used for OECD FUAs. However, Alfonso Roa (2011) observes that different territorial statistics use different definitions of metropolitan areas, so that, for example, data on inflation, manufacturing and employment are not fully aligned. Over time, the authorities will need to apply standardised, consistent definitions across the system of territorial indicators.

Notes: 1. See OECD (2012). For most countries, the threshold density is 1 500 inhabitants per square kilometre, but a level of 1 000 inhabitants/km² is used for Canada and the United States. Moreover, the minimum size of these dense urban cores is set at 100 000 for Japan, Korea and Mexico but at only 50 000 elsewhere. 2. It would, in particular, exclude the low-density areas of some cities in North America and Oceania, where the built environment and structure of economic activity are undeniably urban, but population densities are low.

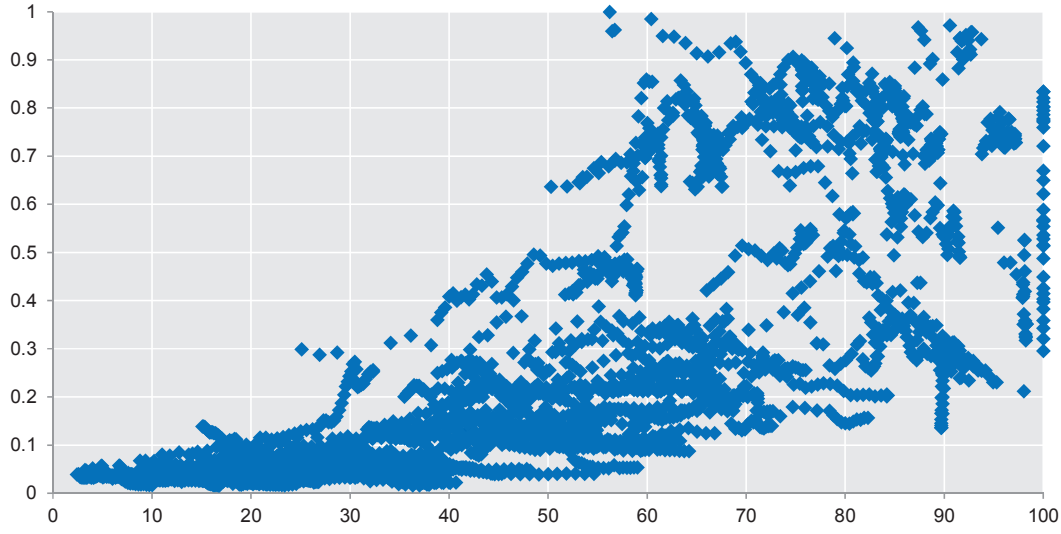
Due to the lack of transport infrastructure and, until recently, the security situation, the functional area of each urban hub has tended to be relatively small and isolated from the others. Each FUA has developed like an island surrounded by sparsely populated rural areas. Major cities became production and service centres for their surrounding areas, meaning that they have developed far too many functions relative to their size. Such functions could be more efficiently carried out by other cities if the urban network were more integrated. Although new cities have emerged within this structure (47 cities now

have more than 100 000 inhabitants), the split between rural and urban is evident, as is the lack of integrated urban networks.

This pattern of urbanisation has had implications for the relationship between urbanisation and development in Colombia. This link is well established (see Henderson, 2010), but it is not linear (Figure 2.1). While virtually all high-income countries have fairly high levels of urbanisation, not all urbanised countries have achieved high levels of income. Unfortunately, Latin American countries are prominent among those that urbanised faster than they developed (the People's Republic of China, for example, represents a contrasting case, with urbanisation levels still relatively low given its per capita income). Colombia's economy is still heavily reliant on the primary sector: while services now account for the largest part of GDP (54% in 2011), manufacturing generates just 13% and primary-sector products still account for most exports. The major change in the export basket over the last 40 years has been a shift from agricultural products to energy. Whereas agriculture constituted over half the export basket in the 1970s, it accounts for less than 10% today; by contrast, the share of energy has risen from less than 5% to more than 50% of total exports over the same period. This implies, among other things, that the sources of growth in Colombia remain largely exogenous. This is also true for Colombia's cities, whose fortunes still depend to a great extent on the presence (or absence) of a flourishing primary sector in the region. In short, the drivers of growth are far less urban than the structure of employment and activity would suggest.

Figure 2.1. **Urbanisation and convergence in the world**

Annual values for 92 countries for 1970-2005 – Relative to US GDP per capita



Source: World Bank (2013), World Development Indicators, http://data.worldbank.org/data-catalog/world-development-indicators.

In part, this probably reflects the degree to which urbanisation in Colombia was driven by non-economic push factors, but it also reflects the way in which urbanisation has been managed. To generate agglomeration economies (Box 2.2), cities require more than population density: it is the density of transactions and economic activity that counts (OECD, 2014). This, in turn, means organising cities in order to make it easier, faster and cheaper for agents to interact and exchange with one another. One of the outstanding features of Colombian cities hitherto, however, has been the contrast between high

population densities – Bogotá, Medellín and Bucaramanga are among the 50 densest cities in the world – and their relatively low densities of economic activity and employment (World Bank, 2012). To say this is not to deny either the considerable benefits that urbanisation has delivered in terms of well-being (see below) or Colombia's recent history of good growth and sound macroeconomic management. However, much remains to be done to turn Colombia's cities into the engines of endogenous growth they have the potential to become. Better co-ordination of land-use and transport planning at the local, and above all at the regional levels, for example, could contribute to both lower congestion and higher economic densities.

Box 2.2. **Agglomeration economies**

Economic activity is not naturally dispersed; rather it tends to concentrate in some places rather than others, mainly owing to the benefits associated with economies of agglomeration. People want to live where firms – and therefore job opportunities – are concentrated, and firms want to locate where demand – and therefore population – is large. Agglomeration economies occur when firms enjoy increasing returns to scale (IRS) in a particular place. Some of these IRS effects are internal to the firm, while others are externalities. Often, these external effects are reciprocal, at least to some degree – that is, agents are not compensated for the benefits they generate for their neighbours, but neither do they have to compensate others when they themselves benefit from positive externalities. The reciprocal effects are one of the main reasons why clusters form and flourish.

IRS could arise in a place because of the presence of natural advantages (i.e. natural resources, location, etc.), monopolistic protection, political factors (e.g. the decision to create a capital city or administrative centre) or some other reason. The presence of IRS also induces other firms to locate there, as people come in search of higher wages, a wider range of job opportunities and better/more varied amenities and consumption opportunities. Part of the advantage of large cities thus stems from their appeal for high-productivity firms and for individuals with high levels of human capital; in other words, a selection effect is at work. However, there is clear evidence that this selection process is magnified by agglomeration dynamics: other things being equal, individuals and firms become more productive in denser places. This reflects the opportunities that cities afford for sharing assets, improving matches on the labour market and knowledge diffusion. The result of these combined selection effects and agglomeration dynamics is that cities tend to be more productive, on average, than non-urban places (the major exceptions tend to be resource-rich rural regions). They have higher incomes and higher GDP per capita. Three main mechanisms work to produce agglomeration economies:

1. Mechanisms that deal with the sharing of:
   - Indivisible facilities such as local public goods or facilities that serve several individuals or firms. Some examples, other than public goods, are facilities such as laboratories, universities and other large goods that do not belong to a particular agent but where some exclusion is implicit in providing them.
   - The gains from the wider range of input suppliers that can be sustained by a larger final goods industry. In other words, the presence of increasing returns to scale, along with forward and backward linkages, allow firms to purchase intermediate inputs at lower costs. While the literature has tended to focus on the variety of inputs available, a variety of potential suppliers is also good for firms, in that it is likely to lead to lower prices (more competition) and less risk of disruption if an upstream firm is distressed (redundancy in markets). The latter issue is particularly relevant in low-density places, where long supply chains and a lack of such redundancy can render firms vulnerable – and may in some cases prompt greater vertical integration than would be efficient in a denser place.

Box 2.2. **Agglomeration economies** (*cont.*)

- The gains from the narrower specialisation that can be sustained with higher production levels. Several firms specialise in producing complementary products, reducing overall production costs.
- Risks. This refers to the idea that an industry gains from having a constant market for skills. If there are market shocks, firms can adjust to changes in demand if they have access to a deep and broad labour market that allows them to expand or contract their demand for labour.

2. Matching mechanisms by which:
   - Agglomeration improves the expected quality of matches between firms and workers, so both are better able to find a good match for their needs.
   - An increase in the number of agents in the labour market also improves the probability of matching.
   - Delays are alleviated. Contractual problems arising from renegotiation among buyers and suppliers can potentially result in one of the parties losing out to the other party in a renegotiation. However, if the agglomeration is extensive enough, agents can find an alternative partner.
3. Learning mechanisms based on the generation, diffusion and accumulation of knowledge. This refers not only to the learning of technologies, but also the acquisition of skills.

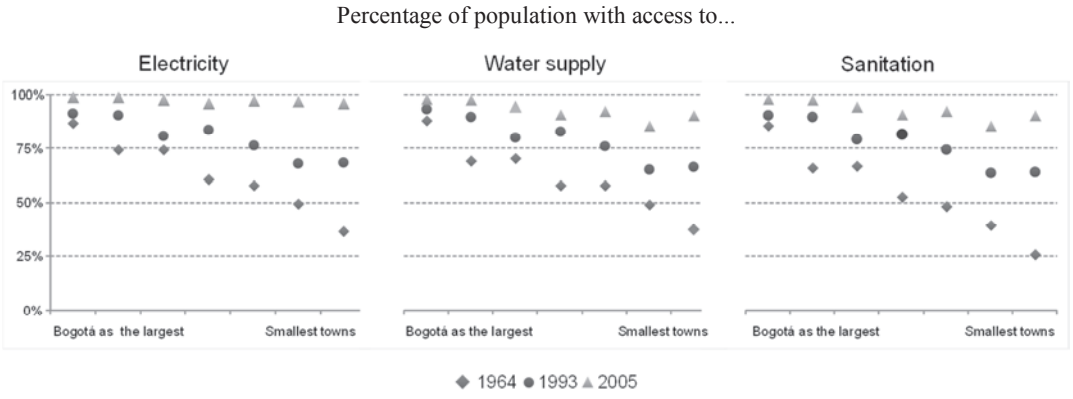
OECD metropolitan regions benefit from agglomeration effects and thus tend to display higher levels of productivity, higher rates of employment and higher levels of GDP per capita than other regions. These benefits, however, are limited by congestion costs, diseconomies of scale and oversupply of labour, among other potential negative elements, and many metro regions have in recent decades tended to underperform national economies.

Sources: Duranton, G. and D. Puga (2004), "Micro-foundations of urban agglomeration economies", *Handbook of Regional and Urban Economics*, Vol. 4, No. 4, February; OECD (2009), *OECD Economic Outlook*, Vol. 2008/2, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_outlook-v2008-sup2-en.

Despite these limitations, Colombian urbanisation has been pro-poor and generally beneficial for well-being. A host of indicators bear this out:

- The Multidimensional Poverty Rate (MPR) in urban Colombia fell to 20.6% in 2012, from over 50% just 15 years earlier, and was far below the rural rate of 48.3% or the national level of 27%. While poverty in rural areas has also fallen sharply, the rural MPR in 2012 was 2.3 times the urban rate, as compared to a ratio of 1.7 in 1997. There has been similar progress with respect to monetary measures of poverty – the poverty rate and the extreme poverty rate in Colombian cities fell to 28.4 and 6.6% in 2012, respectively, from 45.5 and 12.2% a decade earlier.
- Strikingly, the MPR is lower than the monetary poverty rate, a fact that to some extent reflects Colombia's success in improving access to services in urban areas. The striking progress here has been bringing more equal access to such essential services as electricity, water supply and sanitation. There has been a dramatic reduction over the last half-century in the degree to which access to such amenities is linked to city size – in the case of electricity, the relationship has all but disappeared, and tremendous progress has also been made with respect to the others (Figure 2.2).

Figure 2.2. **City size and access to electricity, water supply and sanitation**



Source: World Bank (2012), *Colombia Urbanization Review: Amplifying the Gains from the Urban Transition*, The World Bank, Washington, DC, preliminary document, final version available at: http://dx.doi.org/10.1596/978-0-8213-9522-6.

These improvements in social indicators, though impressive, are far from uniform. Both poverty and extreme poverty are far lower, and have fallen faster, in the 13 largest metropolitan areas than they have in other cities.[2] The poverty rate in the large metros fell from 36.3% in 2002 to 18.9% a decade later, while the corresponding figures for extreme poverty were 7.6% and 3.3%. In other cities, poverty and extreme poverty fell from 59.2% and 19.2%, respectively, to 42.2% and 11.4% over the same period – impressive progress on all fronts but still decidedly uneven, especially given that the inequalities in access to education and services reflected in the MPR are likely to reinforce, rather than mitigate, the differences between the big 13 and the others.

More serious still are the challenges Colombia faces with respect to education. Access to primary education is nearly universal in Colombian cities, but access to high schools is not (World Bank, 2012). This is largely comparable to the deficits seen in, for example, Brazil, and less than those in some other middle-income Latin American countries (e.g. Mexico). However, the deficits are nevertheless substantial, especially when compared with high-growth, urbanised economies like Korea's. Quality, moreover, may be even more of a problem than quantity, as Colombia's relatively poor performance on such international benchmarks as the Programme for International Student Assessment (PISA) rankings attest. To be sure, this is not strictly an "urban" problem, but it is undoubtedly critical to the successful development of Colombian cities, in terms of both equity and efficiency. In a cross-country analysis of the sources of agglomeration economies, OECD (2014a) finds human capital to be of increasing importance in realising the potential economic benefits of urbanisation. Colombia has made laudable efforts to improve both access and quality, not least by improving the information infrastructure of the school system so as to better identify and support struggling students and schools, but much remains to be done.

Colombia exhibits one of the largest gaps in transport infrastructure in Latin America (Nieto-Parra et al., 2013). Compared to other countries the region with similar levels of per capita GDP, its infrastructure density is low, and it lags well behind the quantity and quality of transport infrastructure found in many Asian and OECD countries. This infrastructure gap is in no small measure a product not only of the country's difficult topography but also of its violent past: the security situation both lowered the demand for inter-urban transport networks and increased the cost of infrastructure provision. This, in

turn, has had important distributional consequences, not the least of which is that most of the country's poorer communities tend to suffer from geographic isolation in relation to the rest of the country. This may generate a lock-in dynamic in which instead of catching up, less affluent regions just fall further behind in relative terms. Fortunately, this is changing: the most recent data available (for 2012) suggest that freight costs fell by about 17% nationwide over the period 2009-12 and that the transport costs between locations outside the five biggest conurbations fell faster, thus reducing, albeit modestly, their relative isolation. Improving inter-city connectivity remains a key priority for the government (see below).

The urban development policy is a broad strategy that encompasses several key activities

The government has in recent years become increasingly active in trying to put in place an integrated, cross-cutting approach to urban development. First, the government (specifically, the National Planning Department of Colombia, or DNP, in co-operation with the National Administrative Department of Statistics – DANE) has been working on the identification of functional urban regions. For the first time, the government is organising local statistics in a spatial framework. Secondly, the government has ambitious plans to connect the major urban poles, thereby overcoming the historical isolation of cities that characterises Colombia. Thirdly, thanks to the Organic Law governing the Territorial Organisation in Colombia (known in Colombia as the LOOT: *Ley Orgánica de Ordenamiento Territorial*), there are new governance arrangements that can facilitate this endeavour, including metropolitan areas and the *Contrato* plans. Alongside these efforts, there are the DNP's *Misión de Ciudades* and *Misión del Campo*, which are remarkable in two respects. First, the evidence base is impressive – it draws on a wide range of literature and on 17 studies commissioned by the DNP investigating various dimensions of urban policy, as well as on recent World Bank studies of urbanisation and related issues in Colombia (World Bank, 2010; 2012). Secondly, it is transversal, addressing the urban dimensions of such diverse issues as demographics, productivity, cost of living and quality of life, infrastructure, institutions and planning, rural-urban linkages and finance. Thirdly, it reflects a determination to integrate urban and regional policies, two policy domains that obviously are very closely linked and that nevertheless tend to be disconnected from one another in many OECD countries.

Enhanced connectivity is a major objective of urban policy

The *Misión de Ciudades* places particular attention on the need to improve the connection of Colombian cities both to one another and to the outside world. This reflects Colombia's particular historic conjuncture. Connectivity among its urban centres has always been difficult, due to the size and topography of the country, which raises the cost of overland transport infrastructure. This is particularly true of connections among inland cities and between inland cities and the coast. In the more recent past, as noted above, the internal security situation reinforced the isolation of Colombia's cities. The pacification of the country has dramatically increased movement among cities, but infrastructure investment has not kept up. The road network is saturated on most international trade corridors as well as most lines of access to the main cities. The emphasis on upgrading and expanding connective infrastructure thus makes sense and is likely to improve national economic performance and competitiveness. It is likely to be one of the more promising uses of the country's resource rents.

In addition to infrastructure investment, enhanced connectivity is likely to involve regulatory reform. Given the existing challenges for internal and external connectivity in Colombia, it is important to ensure that transport costs are not inflated by regulations that reduce efficiency and impede competition. Transport sectors have traditionally been heavily regulated in many countries, including Colombia, and they are often largely exempt from the provisions of standard competition legislation. While many OECD countries have liberalised domestic transport sectors in recent decades, international transport is still subject to extensive regulation, much of which serves to undermine competition, particularly in road, rail, maritime and air freight. Cartels and lack of cabotage rights are common (Clark et al., 2004).

In the case of Colombia, World Bank (2012) observes that a number of institutional and regulatory changes could help open up the transport sector. Some key elements of the regulatory framework are missing, and substantial fiscal, technical and human resources will be needed to complete it and make it effective. This particularly applies to regimes for ensuring equitable access to port and rail infrastructures. The OECD's own indicators of product-market regulation confirm this impression: while Colombia has more liberal regulatory regimes with respect to communications and energy than most OECD member countries, the regulation of road and rail transport in 2013 was more restrictive in Colombia than in all but four OECD countries. It was also less open than in such Latin American peers as Brazil, Mexico and Peru; only Argentina's was somewhat more restrictive. This result is all the more striking because it rests entirely on the regulation of road and rail – the two sectors that matter most for trade – whereas in many countries, it is domestic air travel that is the focus of much anti-competitive regulation.

Better inter-urban connectivity is likely to lead to greater concentration and specialisation

Enhanced connectivity will have significant distributional implications, and policy makers need to be prepared to address them. The relative isolation of cities in the late 20th century had a number of economic consequences that may be wholly or partly undone as a result of greater integration among them.

- The major Colombian cities do not trade much with one another and also have relatively similar production structures (mid-sized cities show greater specialisation). This is a natural consequence of the unusually high degree of autarky imposed by topography and the security situation.
- It is likely that such relative isolation means that some cities probably concentrate more functions than cities of their size might be expected to have in a more "normal" urban hierarchy.
- Bottlenecks in access to external markets constitute a form of protection for local producers: easier access to the rest of the world will favour more competitive tradable firms and sectors, while adding to the pressure on others.

There is international evidence, such as from post-reunification Germany (Box 2.3), demonstrating that improved connectivity will probably result in both greater urban specialisation and the increasing concentration of certain functions in specific places. That will generate both winners and losers, at least in the short run, even if it improves overall national performance. It may also raise political challenges, as the immediate benefits are likely to be most apparent in the largest cities – above all, Bogotá. The urban hierarchy is likely to become more concentrated in terms of both population and employment. Colombia's polycentric urban system is long-established and is not about to

morph into a monocentric one, but some increase in urban concentration is probable and can be expected to generate resistance. Moreover, this is a process that may be replicated at various territorial scales, especially if connectivity within and around the major cities also improves, resulting in greater concentration of settlement and activity within individual regions, as well as across the country as a whole.

Box 2.3. **Urban agglomeration and urban hierarchies in post-reunification Germany**

As a consequence of German reunification, some cities along the former border experienced a disproportionate loss of market access relative to other West German cities. The reason is that West German cities close to the new border lost nearby trading partners with which they had interacted at low transport costs prior to partition. In contrast, the effect on West German cities farther from the border was muted, because they were more remote from the trading partners lost, and therefore already faced higher transport costs prior to division.

German reunification is a good example of the impact of (re)connecting territories due to a series of factors that have eased econometric analysis. First, by contrast with cross-country studies, there is no obvious variation in institutional quality that could explain the differential performance of the cities, as they are part of the same country. Second, no straightforward explanations emerge for the findings on urban performance in terms of changes in natural endowments, such as climate conditions or disease. Third, the change in market access after German partition was much greater than is typically observed in other contexts, and it is possible to observe its effects over a substantial period. Fourth, demarcating the border between East and West Germany was based on military considerations, so it was not likely to be correlated with the cities' pre-war characteristics. Taken together, these factors make it possible to empirically disentangle the effects of market access from other determinants of comparative economic development.

The conclusion is that sudden modification of a given equilibrium due to a generalised increase of market access may cause some cities to suffer a reduction of their overall competitiveness. For instance, a city that has benefited from a good relationship with trading partners due to lower transport costs can suffer from a reduction in its competitiveness if other cities with equal (or smaller) transport costs emerge in the national system.

Source: Redding, S.J. and D.M. Sturm (2008), "The cost of remoteness: Evidence from German division and reunification", *American Economic Review,* Vol. 98, No. 5, pp. 1 766-1 797.

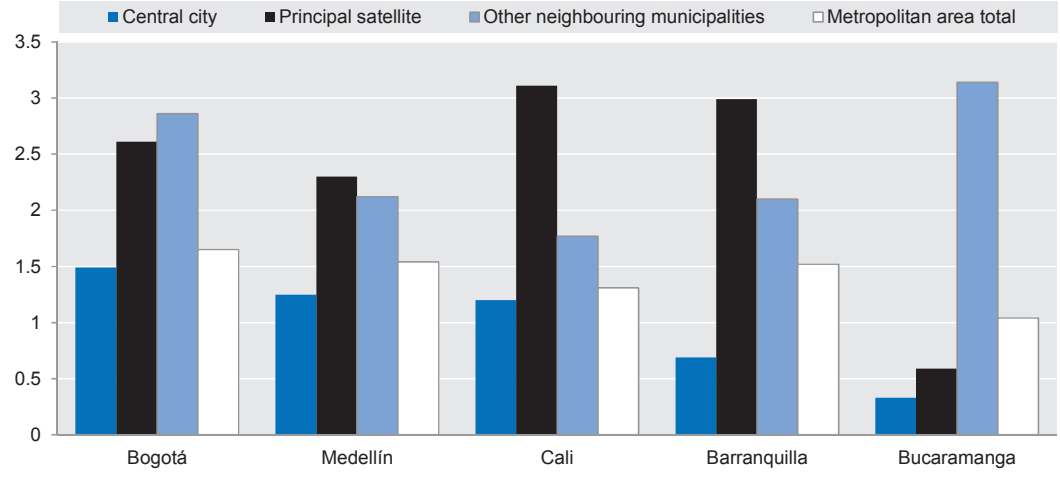
This adjustment is probably both unavoidable and beneficial. The question, then, is how to limit the costs of the transition to a different kind of urban hierarchy in Colombia. Previous OECD work suggests that the costs of this restructuring will be lower if factor mobility is assured and labour and product markets are fairly flexible. That does not mean, though, that regions and cities are mere passive observers in the process: analyses of regional economic performance also suggest that the effects of new physical infrastructure can be significantly affected by the presence or absence of complementary measures to increase human capital or to promote innovation and entrepreneurship. It will be important, therefore, that the knitting together of Colombia's network of cities be accompanied by national, regional and local policies that help mobilise the potential of cities across the country to adapt successfully.

Colombia is moving to improve governance at the metropolitan scale

Like many countries within and outside the OECD, Colombia is increasingly trying to address the challenges of metropolitan co-ordination that arise when previously separate cities "grow together". In recent years, the urban population has grown faster in the municipalities surrounding major cities like Barranquilla, Bogotá, Bucaramanga, Cali and

Medellín than it has in the cities themselves – in some cases far faster (Figure 2.3). The overflow of Colombia's larger cities into neighbouring municipalities creates particular difficulties with respect to service delivery, financing and urban planning, especially in a context characterised by very strong traditions of municipal autonomy. Colombian policy makers' keen interest in – and the difficulty of tackling – metropolitan challenges are shared across the OECD area, as reflected in the wide spectrum of metropolitan governance models currently in place in OECD countries and in the large number of metro governance reforms launched since the end of the 1990s (Box 2.4). These reforms reflect increasing recognition that larger cities and their spheres of influence (metropolitan areas) are in need of greater co-operation on a metropolitan-wide basis. Their importance for national economic performance is one rationale. The increasing attention to the environment and well-being is a further motivation. Financing systems at the local level often provide disincentives for metropolitan-wide engagement, so national reforms are often used to provide better incentives.

Figure 2.3. **Growth rates in major Colombian metropolitan areas, 2005-10**



Source: Own elaborations based on data from DANE.

While some governments have chosen to retrofit administrative boundaries around the renewed urban shapes (e.g. via municipal mergers), most have eschewed this approach. Many are encouraging municipalities to build partnerships within a more or less institutionalised framework. Each type of metropolitan governance arrangement is likely to carry its own set of strengths and challenges, and the OECD has undertaken a new survey of metropolitan governance in metropolitan areas to allow in-depth exploration of these issues (Ahrend, Gamper and Schumann, 2014a). To date, the survey has brought together data on 263 of the 275 functional urban areas in OECD countries with a population of more than 500 000, covering well over 90% of the population of large OECD metros. While the survey reveals a wide range of governance solutions adopted in different places, ranging from limited inter-municipal agreements to the creation of supra-municipal authorities and even outright mergers, it also suggests a relationship between metro size and the strength of governance solutions: larger, more fragmented metropolitan areas tend to require stronger co-ordination institutions.

Box 2.4. **Metropolitan governance reforms in OECD countries**

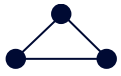
Since the 2008 crisis, there has been an acceleration of metropolitan reforms across OECD countries. The objective is to find the right scale, i.e. the most consistent and relevant scale for metropolitan strategic competences. The intent is a search for efficiency of public action and also optimisation of public spending.

- In the framework of the local government reform "New Municipality 2017", the metropolitan area of Helsinki, Finland, is expected to be granted special status, a scenario that has been in play for several years now.
- Eight regional, city and district councils in New Zealand were amalgamated to form the Auckland Council in 2010. A Unitary Plan was established for the new entity, which lays out development policies and replaces the previous seven district plans.
- In France, a Law on the Modernisation of Territorial Public Action and on Affirmation of Metropolitan Cities (MAPAM) was adopted in December 2013, creating new governance structures for Paris Île-de-France, Grand Lyon and the Aix-Marseille-Provence metropolis (the largest metropolitan areas). For 11 other metropolitan areas of more 400 000 inhabitants (metropolises of "common law"), competences will be reinforced in the areas of economic development, housing, environment, roads and social action, after an agreement is reached with the *département* in which they are located. Paris, Lyon and Aix-Marseille-Provence each have an *ad hoc* status depending on their particular characteristics and needs. This represents an innovation in French legislation. Their authority as metropolitan areas will be substantially reinforced, as well as their tax integration and equalisation mechanisms.
- In the United Kingdom, the "City Deals" programme allocates new competences and specific funding to the biggest cities, on the condition that they consolidate their governance structures.
- In Italy, legislation adopted in April 2014 lays the groundwork for the elimination of the provincial level of government in ten Italian provinces and their replacement by new *Città metropolitane* (metropolitan cities) organised around the country's main cities – Turin, Milan, Venice, Genoa, Bologna, Florence, Rome, Naples, Bari and Reggio Calabria.
- In Australia, various Australian states have launched metropolitan reforms. In June 2011, the state of Western Australia commissioned a group of experts (the Metropolitan Local Government Review Panel) to conduct an evaluation of the Perth metropolitan governance. The report, released in 2012-13, has developed 30 recommendations that were the subject of a public consultation in the summer of 2013. A committee (the Metropolitan Reform Implementation Committee) is now in charge of implementing this reform of metropolitan governance.
- Similar reforms were introduced in Ireland, with the establishment of the Dublin Regional Authority governed by an elected mayor and having responsibilities for a wide range of public services, such as water, waste, transport, housing, regional development and also in Greece, where metropolitan regions were established in the areas of Attica and Thessaloniki to deliver such policies as transport and communications, environmental protection and spatial planning.
- In Denmark, the local government reform of 2007 has granted special status to Greater Copenhagen.
- In Turkey, the status of metropolitan municipalities has been attributed to 30 large urban areas (16 in the 1980s and 14 new ones after the March 2014 local government elections).
- In Korea, Seoul and the six metropolitan areas of more than 1 million inhabitants are accorded, as "metropolitan cities", the same status as that of the larger and more populous provinces.
- In Portugal, the central government in 1991 established the status of "metropolitan areas" for Lisbon and Porto, a status reformed in 2003 and 2008.

Source: OECD (2014a), *OECD Regional Outlook 2014: Regions and Cities: Where Policies and People Meet*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264201415-en.

OECD experience shows four main types of metropolitan governance arrangement (Table 2.1). Considerable diversity exists among (and sometimes even within) these categories in terms of legal status, composition, power, budget and staff – with varying impacts on policy design and implementation. For example, less than 20% of OECD metropolitan areas have a governance body that can impose laws or regulations. On the whole, though, the "lightest" metropolitan governance arrangements tend to prevail over the most "stringent". Unsurprisingly, size is a factor: the larger the population of a metropolitan area, the more stringent its choice of metropolitan governance arrangement tends to be.

Table 2.1. **Four broad categories of metropolitan governance bodies in OECD metropolitan areas (from the lightest to the most stringent in institutional terms)**

a) Informal/soft co-ordination. Often found in instances of polycentric urban development, lightly institutionalised platforms for information sharing and consultation are relatively easy both to implement and to undo. They typically lack enforcement tools, and their relationship with citizens and other levels of government tends to remain minimal.	
b) Inter-municipal authorities. When established for a single purpose, such authorities aim at sharing costs and responsibilities across member municipalities – sometimes with the participation of other levels of government and sectorial organisations. Multi-purpose authorities embrace a defined range of key policies for urban development, such as land use, transport and infrastructure.	
c) Supra-municipal authorities. An additional layer above municipalities can be introduced either by creating a directly elected metropolitan government or with the upper governments setting down a non-elected metropolitan structure. The extent of municipal involvement and financial capacity often determine the effectiveness of a supra-municipal authority.	
d) Special status "metropolitan cities". Cities that exceed a legally defined population threshold can be upgraded to a special status as "metropolitan cities", which puts them on the same footing as the level of government just above them and gives them broader competencies (e.g. Germany's city-state *Länder*).	

Source: OECD (2014a), *OECD Regional Outlook 2014: Regions and Cities: Where Policies and People Meet*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264201415-en.

Recent OECD empirical work based on the survey results suggests that governance arrangements do affect economic and environmental performance and quality of life. First, it provides evidence that municipal fragmentation reduces economic efficiency and undermines the growth of metropolitan areas. OECD estimates indicate that a doubling of the number of municipalities per 100 000 inhabitants is associated with a decrease in productivity of around 6%. In many cases, the fragmentation of governance may undercut the economic benefits of agglomeration. The effects of fragmentation, however, can be substantially mitigated through adequate governance arrangements. More precisely, the existence of a central metropolitan governance body is estimated to reduce the negative productivity effect of municipal fragmentation by roughly half (Ahrend et al., 2014b). OECD work based on the Metropolitan Governance Survey has found other empirical regularities. Metropolitan areas without a co-ordinating governance body have larger increases in sprawl, even though they seem to be less attractive, as indicated by lower population growth than in metropolitan areas with such bodies. Similarly, in metropolitan areas without a co-ordination body for transport, such as a transport authority, citizens are much less satisfied with the public transport system; these metropolitan areas also have significantly higher levels of air pollution (Ahrend, Gamper and Schuman, 2014).[3] The survey also suggests that the areas where co-operation across municipal boundaries is most urgently needed include environmental challenges (particularly management of

waterways and water resources), transport and land-use planning, and economic development. These are all areas that rank high among the issues of co-ordination facing Colombian cities.

The national government will have to play an important role in fostering metropolitan co-ordination

"Metropolitanisation" processes are still at a fairly early stage in Colombia. Although the institution of metropolitan areas has been in place since the 1970s, it was the 2011 Organic Law governing the Territorial Organisation in Colombia (LOOT) that provided the legislative basis for implementing metropolitan areas, in the form of voluntary associations of municipalities formed to regulate issues that cross municipal boundaries. The law authorises metro-scale development plans (*planes de desarrollo*) and spatial planning (*planes de ordenamiento*) covering economic development as well as social and environmental issues. However, because metropolitan areas are not considered territorial entities under the law, they are largely reliant on transfers for funding and do not have the power to define land-use planning norms that are binding on municipalities within the metropolitan area. One of the challenges for the central government is thus to strengthen the framework for metropolitan co-ordination, encouraging and supporting more effective engagement. International experience suggests that this will require national action. This is not so much because co-operation can or should be imposed in a top-down manner, but because a degree of leadership (and often resources) from above is often required to surmount the barriers to co-operation across jurisdictional boundaries, even when those involved recognise the need for co-ordination:

- Even if all the municipalities in a large urban area or region stand to gain from co-operation, none may have the capacity and incentive to take on the costs of gathering the necessary information, mobilising others, etc. In some cases, municipalities may lack the capacity needed to engage in co-operation. A lack of strategic planning capabilities at the local level has impeded inter-municipal collaboration in such diverse settings as Canada and Slovenia.
- Big differences in capacity and resources across jurisdictions may aggravate the problem by undermining trust or weakening incentives to collaborate. Differences in size, wealth and priorities can make it difficult for neighbouring municipalities to agree, particularly where very large cities are engaged with much smaller municipalities. The former are likely to question how much they need their smaller neighbours, and may be wary of carrying their burdens, whereas smaller municipalities often doubt their ability to uphold their interests in such an unequal partnership. Co-operation can also be difficult where significant differences in income levels between adjacent jurisdictions exist, because the wealthier jurisdiction will often fear subsidising its poorer neighbour.
- Inter-jurisdictional competition is another obstacle to fostering horizontal collaboration at the local level in many places. Competition between municipalities often tends to trump collaboration incentives, as municipalities compete to obtain funding from higher levels of government. Where indivisible assets like schools and hospitals are concerned, collaboration can be harder still. Municipalities may be reluctant to participate in scaling up major infrastructure projects if this would mean locating key facilities (and jobs) in other jurisdictions. Potential economies of scale notwithstanding, individual local authorities may prefer less-efficient local provision. That is why it is often easier to co-operate in

fields like public transport or waste disposal than on new infrastructure projects or the provision of other key facilities.

- Regulatory impediments may exist. For example, the statutory obligations imposed on municipalities may make it impossible for them to contract out certain functions to neighbouring municipalities or joint bodies, even where this is more efficient. National legislation may also raise the costs associated with organising joint undertakings among municipalities.

Rural development and policies

Many of Colombia's key policy challenges are rural

Rural development policy is likely to shape the future of Colombia. Despite the importance of the urban dimension, it is in rural areas that Colombia faces its most important policy challenges. The armed conflict, which started in the 1960s and seems to be close to a definitive conclusion, as well as the agrarian protests of 2012-13, are just two examples illustrating that the economic and social stability of the country is closely bound up with the ability to deliver growth and development in rural areas.[4] In this sense, the robustness and stability of the national economy hinges upon the performance of rural regions.

In general, a disjuncture persists between the contribution of rural assets to national growth (energy commodities, for instance) and the living standards of the rural population. Socio-economic indicators for rural households are significantly lower, with some remote rural communities remaining particularly vulnerable in terms of poverty rates and inadequate infrastructure. Furthermore, rural regions remain largely isolated and disconnected from urban areas, and their local institutions are generally weaker than in the rest of the country. This limits their capacity to determine a local development strategy and take advantage of national policies offering additional investment capacity (as under the reform of royalty payments). All these factors have generated a two-tier economy in Colombia, with a large disparity in development opportunities between rural and urban areas.

Characteristics and trends in Colombian rural regions

As in many developing economies, rural regions in Colombia display different stages of development. Rural regions that are part of the national economy have strong links with urban areas and with international markets. The roles and functions of urban and rural regions tend to vary and evolve through the stages of development. More developed economies tend to become more integrated and experience stronger urban and rural linkages (OECD, 2014):

1. At the earliest stages of development, rural activities in agriculture and natural resources are dominant. The vast majority of population and economic activity is rural, with urban places serving as market and supply points and with a few coastal centres serving as export and import terminals. Over time, the national economy evolves to include more urbanisation that is based initially on first-stage processing of rural products and the local production of inputs for resource-based industries. The increase in domestic value added allows further expansion, diversification and urbanisation of the economy. Urban and rural economies become tightly coupled and effectively form a single supply chain.

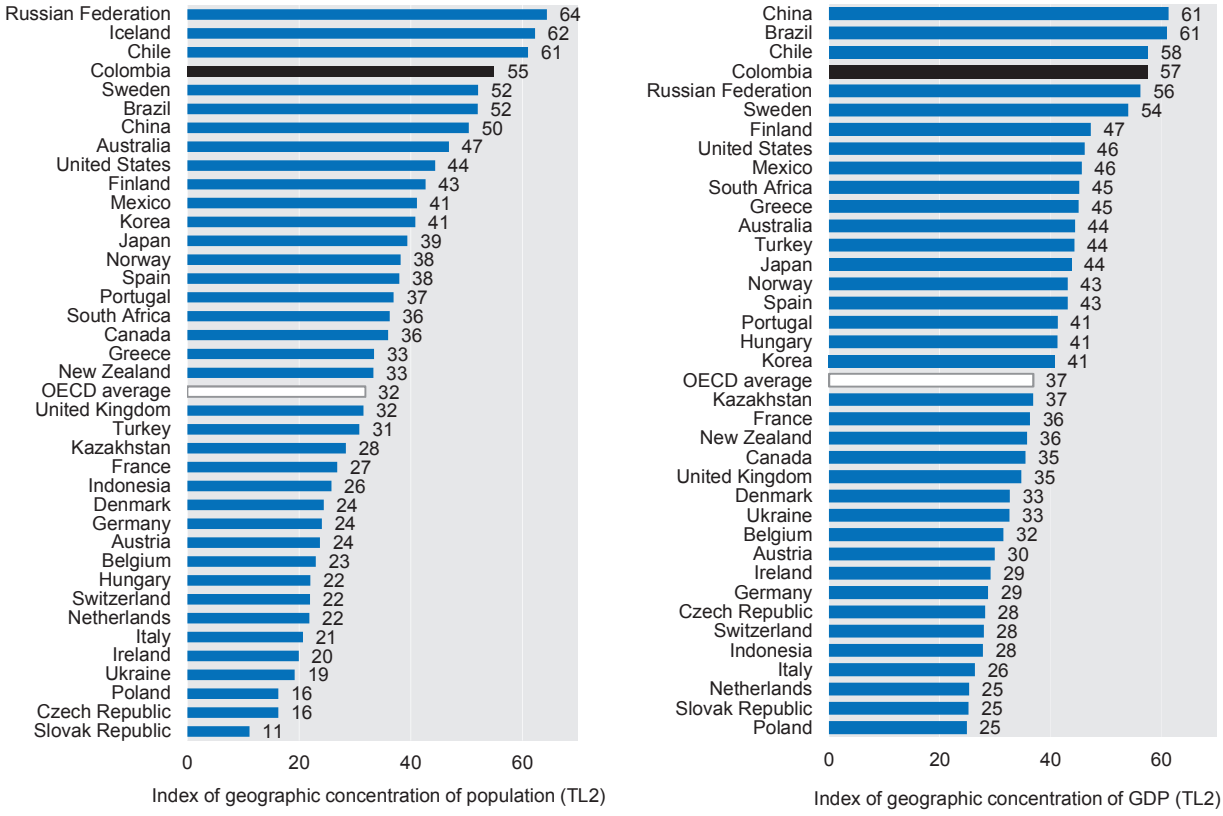
2. As urban economies continue to grow in size, they begin to disengage from the rural economy and develop an internal market, complementing rural activities. As the national economy shifts from rural-led growth to urban-led growth, population begins to concentrate in cities, especially larger cities where manufacturing and the service sectors provide increasing income and employment. The share of rural production in GDP and employment begins to fall rapidly, even though the volume and value of resource-based activity continues to expand, and its share in exports remains strong. As development advances, the process of urbanisation introduces activities less dependent on rural production, which results in diversification and increased stability. Urban and rural economies become more complementary activities.
3. At a subsequent stage of development, rural regions become more diversified. Through greater concentration of production and people in urban areas, production costs increase accordingly. This induces some firms to seek lower cost locations in rural regions. The outflow of firms from urban areas provides diversification benefits in rural regions and reduces congestion costs in urban regions by retaining people in rural regions and thereby reducing urban housing costs. In addition, firms that may have become uncompetitive in a higher-cost urban environment can continue to earn positive profits in a rural location.
4. At the most advanced stages of development, a considerable share of the urban economy depends upon a direct connection to rural activities. In advanced stages, the bulk of the population and economic activity occur in the most urbanised regions. However, these regions are tightly coupled to rural regions by transport and communication networks.

Colombia, under this schema, is transitioning between stages 2 and 3. Its urban economy is decoupled from the rural economy, and its rural regions are not very diversified. The armed conflict, despite its low intensity (Restrepo et al., 2004), severed the relatively safe urban poles from the rural areas, which were characterised by social unrest and a lack of basic public institutions, in many cases for decades. This has stalled Colombia's ability to evolve through the stages discussed above. As a result, it has not been able to fully capitalise on its relatively high level of urbanisation, because its territories are not properly networked. Its urban and rural linkages are also shaped by specific geographic and sub-national characteristics. Regional data show that, despite the high and spatially concentrated inequalities manifested in a large regional concentration of GDP, the situation has been improving. This may offer Colombia the possibility of promoting inclusive growth, given the following regional trends.

Colombia has a very high level of concentration in settlement patterns and economic activity. Concentration levels in Colombia are twice as high as in OECD member countries (Figure 2.4) on average, both in human settlements and in economic activity. Of non-OECD countries, only Brazil, Chile and China have higher levels of economic concentration and only Chile, Iceland and the Russian Federation are more concentrated in settlement patterns.

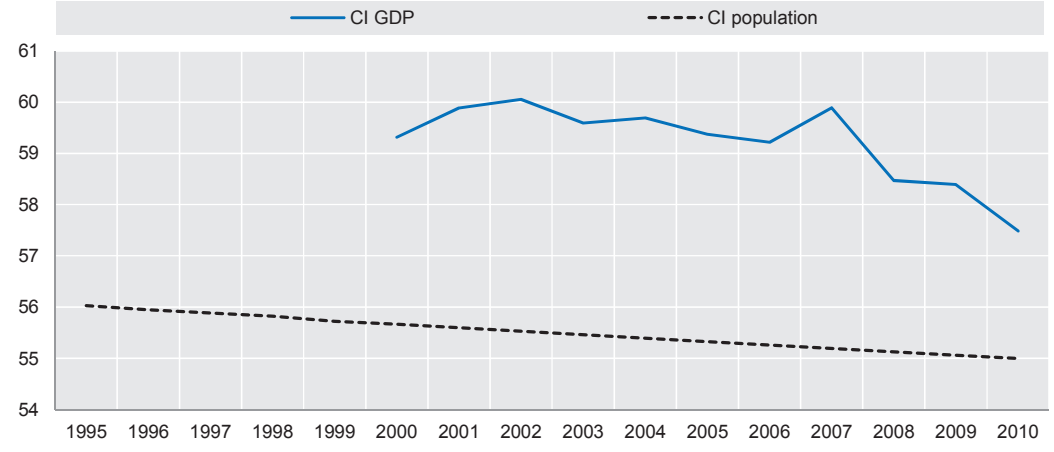
However, and contrary to the trend in OECD member and non-member countries, concentration among TL2 regions has been decreasing (Figure 2.6). Over the period 1999-2010, only Australia and Brazil experienced a greater decline in economic concentration than Colombia. When compared to other developing economies with similarly high levels of inequality – for example, Brazil, China and the Russian Federation – the trend in Colombia also runs counter to that observed in China and the Russian Federation and resembles the trend in Brazil.

Figure 2.4. **Demographic and economic concentration among TL2 regions, 2010**



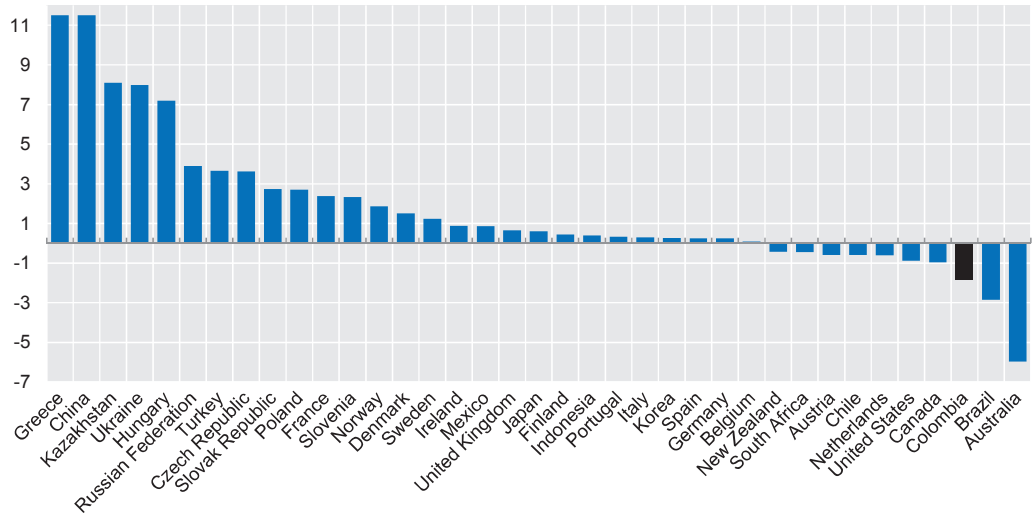
Source: OECD (2013a), "Large regions, TL2", *OECD Regional Statistics* (database), http://dx.doi.org/10.1787/region-tl2-data-en.

Figure 2.5. **Demographic and economic concentration among Colombian TL2 regions, 1995-2010**



Source: OECD (2013a), "Large regions, TL2", *OECD Regional Statistics* (database), http://dx.doi.org/10.1787/region-tl2-data-en.

Figure 2.6. **Economic concentration among TL2 regions, 1998-2010**



Source: OECD (2013a), "Large regions, TL2", *OECD Regional Statistics* (database), http://dx.doi.org/10.1787/region-tl2-data-en.

Inequality in GDP per capita among regions in Colombia is relatively high. With a Gini coefficient of 0.31, inequality in GDP per capita amongst Colombia's 33 *departamentos* exceeds the average level of inequality amongst TL2 in OECD countries (0.20) in 2010. It should be noted, however, that this level of inequality is lower than in three OECD member countries, Mexico (0.35), Chile (0.36) and the Slovak Republic (0.37), and lower than in four non-member countries in the process of development, China (0.61), the Russian Federation (0.46), Kazakhstan (0.41) and India (0.37).

However, inequality in Colombia in GDP per capita has been decreasing in recent years. Although in OECD member countries, inequality has been decreasing, a number of developing countries, including Brazil, China, the Russian Federation and South Africa, have also experienced a decrease in inequality among regions (Figure 2.7).

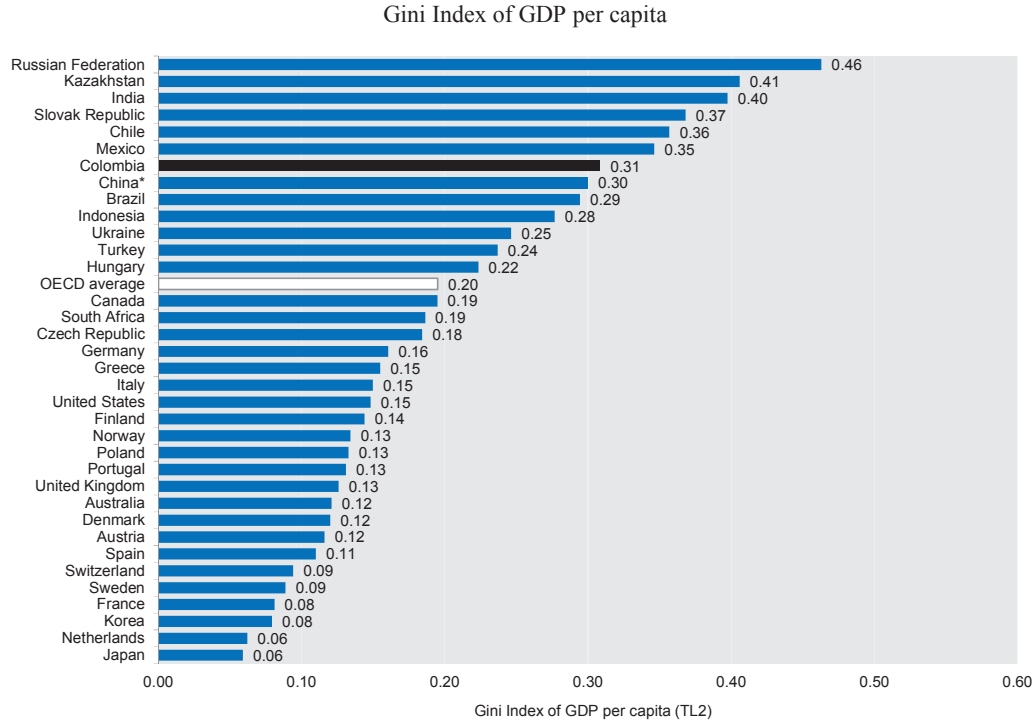
In sum, sub-national trends reveal that despite its polycentric urban structure, Colombia exhibits high levels of economic and demographic concentration and high levels of inter-regional inequality. This runs counter to the pattern seen in many OECD member countries, where polycentric urban structures are typically characterised by low levels of concentration and low levels of inequality, as in the case of the Netherlands (OECD, 2014). The divide in Colombia is mainly between the urban structure and the rest of the territory defined as rural. In other words, linkages between urban and rural regions, and also between rural regions, are weak.

Additional factors have contributed to the urban and rural divide, including the lack of transport infrastructure and the armed conflict that isolated rural from urban areas. The functional area of each urban hub thus tends to be relatively small and isolated. Each functional urban area has low linkages to the contiguous sparsely populated rural areas, which creates a bottleneck for competitiveness and for diversification efforts because it results in:

- a fragmented economy
- low spillover effects

- a two-tier economy with many rural households left behind
- migration from rural to urban areas of low-skilled workers looking for a job or for access to basic services that are not available (or difficult to access) in their communities.

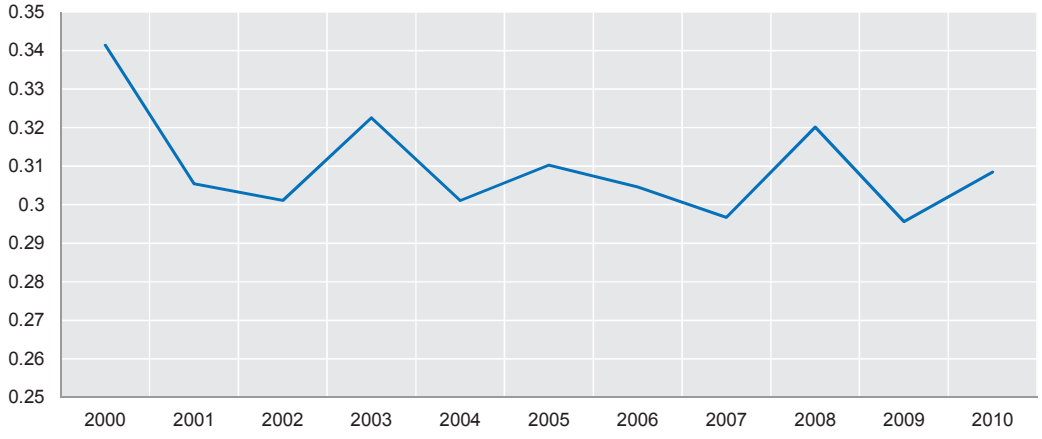
Figure 2.7. **Inequality in GDP per capita among TL2 regions, 2010**



Note: * The autonomous regions Hong Kong, Macau and Taipei were excluded.

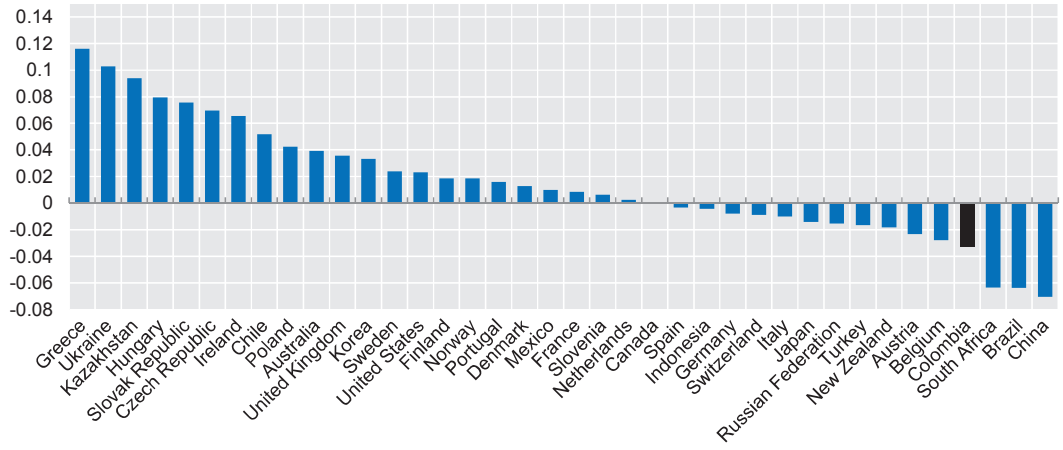
Source: OECD (2013a), "Large regions, TL2", OECD Regional Statistics (database), http://dx.doi.org/10.1787/region-tl2-data-en.

Figure 2.8. **Inequality in GDP per capita among Colombia's TL2 regions, 2000-10**



Source: OECD (2013a), "Large regions, TL2", OECD Regional Statistics (database), http://dx.doi.org/10.1787/region-tl2-data-en.

Figure 2.9. **Inequality in GDP per capita among TL2 regions, 2000-10**



Source: OECD (2013a), "Large regions, TL2", OECD Regional Statistics (database), http://dx.doi.org/10.1787/region-tl2-data-en.

Economic opportunities for rural and urban households in Colombia are uneven. More than 60% of rural households do not have access to productive activities. According to data from the Multidimensional Poverty Index (MPI),[5] although rural poverty has been alleviated in the last 16 years, decreasing from 86% of the population in 1997 to 48.3% in 2012, it continues to be much greater than urban poverty, at 20.6%. In addition to the low degree of urban and rural linkages, rural regions in Colombia are not diversified and continue to focus on traditional agricultural activities or primary activities.

According to Colombia's national rural definition, about a quarter of the population lives in rural areas, where agricultural activities remain the key activity. The 2005 Census reveals that 26% of the population (10 999 239 inhabitants) live in rural areas. This share is anticipated to drop to 24%, according to population forecasts for 2012. The agricultural sector contributed 6.2% of national GDP and employed 17.6% of the total workforce in 2012. Agricultural jobs totalled 2 491 812, the majority of which were concentrated in the production of permanent crops (coffee and cocoa, for instance) with 2 049 715, or 82.2% of agricultural jobs.

Although agriculture has historically been one of Colombia's chief productive sectors, its competitiveness has dropped in recent years, in particular after the crisis at the end of the 1990s. In effect, in the last decade, the sector grew by an average of 2%, compared to the national growth rate of 4.4%, and below the average growth of agriculture in Argentina (7.4%), Peru (5.6%) and Chile (4.2%).[6]

Agribusiness in Colombia is burdened by inefficient land allocation. According to UNDP/PNUD (2011), 52% of farm land is (formally or informally) owned by 1.15% of landowners. Extreme concentration of land ownership was one cause of the armed conflict. This unrest, in turn, set off a vicious cycle in which many smallholders, starting in the 1980s, were dispossessed of their land and forced to leave rural areas to move to urban centres. While land reform is called for, the government also needs to deal with three issues that are holding back rural Colombia's competitiveness: improving (functional) rural and urban linkages; diversifying the rural economy beyond primary activities and ensuring that economic activities in rural regions translate into higher standards of living. Improving rural policies in these three key domains can boost the

performance of rural regions but also that of urban regions, which suffer from strong migratory pressures from low-skilled workers.

Colombia's policy framework for supporting rural development

National authorities are well aware of the importance of supporting rural areas. By 2010, the National Development Plan "Prosperity for All" ("*Prosperidad para Todos*") had identified rural development as a key priority, and emphasised the potential for agriculture to regain its historical role as the driver of the economy. The national focus on rural development has intensified after the agrarian protests that started in 2013. Farmers blame the removal of trade barriers (in particular the free trade agreements with the United States and the European Union) for flooding the market with agricultural products at prices they are unable to match. They also argue that the increasing cost of such inputs as fuel and fertilisers has turned small-scale farming into a loss-making proposition. While this is not always supported by the evidence (due also to the lack of data on trends for 2012-13), farmers and inhabitants of rural areas justifiably perceive that national economic growth is not benefiting them. It is worth noting that the protests were organised not only by agricultural sectors, but along geographical and ethnic lines, including the aboriginal and Afro-Colombian population. Smallholders also played a key role in the agrarian protests. That small-scale farmers now enjoy increased political visibility should be considered a positive factor and may be linked to improved property rights, a key focus of the national government since 2010.

Land ownership and property rights remain a key issue in rural Colombia. In its modern history, and in particular since the 1960s, the country has made several attempts to reform the regime of land ownership, with mixed results (Albertus and Kaplan, 2012). As noted above, Colombia's land distribution remains among the most unequal in the world. Since the process to create an institutional framework promoting smallholdings is still under way, it is as yet too early to assess its impact.

Meanwhile, the government has instituted a multi-faceted strategy to support farming and rural development. The government has recognised how beneficial the peace process can be to the welfare of rural communities. Some of its interventions have focused on short-term needs, but others have attempted to establish a broader strategic framework that extends beyond primary activities and focuses on rural institutions (including property rights and land reallocation programmes), service delivery and industrial diversification. However, the need to deal with an emergency (at a delicate point in the political cycle, during presidential elections) may have hampered co-ordination among sectorial ministries.

The rural pact

In 2013, the government imposed a one-off (*una tantum*) tax on financial transactions to finance the national budget for agriculture and rural development. This generated a total budget of USD 2.3 billion for agriculture and rural development in 2014 (compared with USD 1.2 billion in 2012), which helped to finance the *Gran Pacto Nacional por el Agro y el Desarrollo Rural* or *Pacto Rural*, or Rural Pact.

The Rural Pact, managed by the Ministry of Agriculture and Rural Development and the Ministry of Labour, includes a series of measures to support agriculture and rural development. Under the agreement, subsidies to agriculture have been extended to small-scale farmers and to a longer list of crops than in the past, when subsidies were mostly focused on cash crops, like coffee.[7] To save time and streamline the governance of

this programme, the pact will only provide funds to existing (already approved) projects in rural areas.

The pact also focuses on empowering rural institutions and facilitating citizen participation. It has initiated a major national consultation, implemented in every municipality, to assess local needs and development opportunities. The information collected will be used for the next National Development Plan and will set the stage for a national rural policy with an enhanced territorial approach, appropriate for a country with major regional differences of topology, demography, society and economic specialisation. Under the pact, the Ministry of Labour will also create municipal and department councils for rural development (known as CMDR and CONSEA, by their Spanish acronyms). These should facilitate the interactions between business and the public sector at the regional and local levels and also help identify needs and investment opportunities that could be reflected in locally designed and implemented policies.

PDRIET and Misión del Campo

Other interventions to support rural development are delivered through the National Planning Department (DNP). The DNP is in charge of a series of pilot projects that adopt a territorial integrated approach to rural development (*Programa de Desarrollo Rural Integral con Enfoque Territorial*, or PDRIET). Their aim is to assess policy options to improve rural households' accessibility to public services. The DNP funds and directly co-operates with municipalities in their design and implementation. The DNP, in co-operation with the Ministry of Agriculture and Rural Development, is also in charge of another initiative to promote sustainable rural development: the *Misión del Campo.* This is a policy assessment that aims to provide long-term policy guidelines to the national rural development strategy. To do so, the *Misión* is assessing five main aspects related to rural development: *i*) rural areas' contribution to national development; *ii)* social gaps between urban and rural communities; *iii)* delivery of public goods and services in rural areas; *iv)* competitiveness and environmental sustainability of agriculture; *v)* governance systems underpinning rural development. The *Misión del Campo*, which was still under elaboration at the time of writing and had yet to be implemented, represents an important innovation in the approach to rural development. In particular, it may help the national policy framework focus on investment promotion and growth rather than on transfers, subsidies and social policies (Box 2.5).

Challenges to the current policy framework

The government has made a major effort to promote rural development. Substantial funds have been allocated for this and to support agricultural activities. Different sectorial ministries are involved, as well as the DNP, which is directly involved in finding solutions to improve service delivery in rural areas. It may not be easy, however, to maintain this degree of focus on rural development, given its demands on government resources.

A better understanding of rural dynamics, through improved regional indicators and better territorial classifications, may help fine-tune policy interventions (as already mentioned in the previous chapter) and reduce their cost. The government's decision to provide subsidies to more farmers, regardless of their geographical location, specialisation and the size of their holdings, was also a function of the limited information available on real local trends and needs. Similarly, the decision to extend consultation to 1 500 communities (to all municipalities and some smaller units) suggests that the current

rural classification is not helping to guide policy making. This is also true of the DNP's PDRIET piloting projects, which absorb considerable funds and human and institutional capital and are unlikely to be replicated in other rural areas.

Box 2.5. **Colombia's Rural Mission (*Misión del Campo*)**

The mission, led by the National Planning Department (DNP) in co-operation with the Ministry of Agriculture and Rural Development, will be in charge of elaborating the strategic guidelines for rural development policies in Colombia for the medium and long term. Its aim will be to advance modernisation in Colombia's agricultural sectors and rural-related activities, and improve the provision of services and quality of life in rural areas The forthcoming National Development Plan will follow the main recommendations of the Rural Mission, which will focus on five key areas:

1. The first thematic area focuses on the role of the rural in Colombia's development in the following domains:
   - a conceptual framework that serves as the basis for the design of public policy
   - diagnosing the challenges and problems of the Colombian countryside.
2. The second area concerns the reduction of social disparities through rural development in the following areas:
   - planning property and efficient use of land and water resources
   - social infrastructure and rural development programmes with a territorial focus
   - competitive and sustainable family farming.
3. The third area aims to improve the provision of public goods and services in rural areas through:
   - technical assistance and irrigation
   - innovation, science and technology.
4. The fourth area focuses on sustainable and competitive agricultural development through:
   - efficient use of market risks, optimising production costs for improving competitiveness
   - rural employment
   - commercialisation and distribution of products and incentivising investments in rural areas.
5. The fifth area aims to improve the quality and efficiency of institutional arrangements through:
   - efficient co-ordination between the government and the territory
   - allocation and execution of public budgets, multi-sectorial interventions
   - formulation and collection of information for the design and implementation of public policy.

In this complex situation, policy interventions that aim to promote institutions in rural areas (including the Rural Pact and Rural Mission) are a step in the right direction. It is surprising that the government, despite the large-scale protests, was able to implement policies likely to have an impact in the medium and long term. Some challenges may, however, emerge from over-institutionalisation in rural communities. For instance, it will be important to avoid competition between the municipal and departmental councils for rural development (CMDR and CONSEA) and other bodies that are already in place, including collegiate bodies (*Órganos Colegiados de Administración y Decisión*, OCADs), the regional council for competitiveness, the forthcoming regional observatories, and – most importantly – elected bodies. Finally, although the *Misión del Campo* is broad in scope, it focusses on closing the gaps and supporting the competitiveness of agricultural activity. Evidence in OECD countries has shown that typically, successful rural development strategies do not have a sectorial focus. Agriculture now represents only a small percentage of regional GDP and employment, and the most affluent rural communities are those that specialise in manufacturing and service activities.

Valuable policy guidelines for rural development in Colombia

This section discusses two important policy frameworks for OECD rural regions: the New Rural Paradigm and the rural-urban linkages framework. Both have interesting implications for Colombia.

The New Rural Paradigm

The New Rural Paradigm (NRP) was adopted by OECD member countries to promote development in rural regions. Globalisation, the dramatic reduction in farm employment and the emergence of important non-farm niche markets have generated a common understanding that rural policy will fall short if it is conceived of only as agricultural policy. Throughout OECD countries, rural areas are increasingly looked upon as a heterogeneous array of regions where one-size-fits-all policies can no longer capture the diversity of rural needs and opportunities (OECD, 2006). Innovative governance structures have been created in many OECD countries to strengthen co-ordination across sectors and across levels of government and between public and private actors; so have innovative policy instruments intended to identify and exploit the varied development potential of rural areas. The NRP's two main characteristics are: *i)* a focus on places, rather than sectors; and *ii)* a focus on investments rather than subsidies (Table 2.2). Its key features are:

1. an investment-oriented approach
2. a holistic focus on the entire rural economy and not just a few sectors
3. a bottom-up development strategy that reflects local priorities and an inclusive style that encourages the participation of all potential stakeholders, not just a small elite.

The NRP promotes a place-based approach, involving top-down and bottom-up development processes. Because it is an investment approach, it implicitly conceives of economic development as wealth or capital expansion. Rural regions' current and optimal mix of capital are likely to differ, and will also differ from those of urban regions. This suggests that benefits can result from introducing both urban and rural development approaches.

Table 2.2. **The New Rural Paradigm**

	Old approach	New approach
Objectives	Equalisation, farm income, farm competitiveness	Competitiveness of rural areas, optimising local assets, exploitation of unused resources
Key target sector	Agriculture	Various sectors of rural economies (e.g. rural sustainable tourism, manufacturing, information and communication technology, industry, natural amenities, etc.)
Main tools	Subsidies	Investments
Key actors	National governments, farmers	All levels of government (supra-national, national, regional and local), various local stakeholders (public, private, non-governmental organisations)

Source: OECD (2006), *The New Rural Paradigm: Policies and Governance*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264023918-en.

The aim of the NRP is a better alignment of policies aimed at incentivising rural regions to mobilise their assets and resources. The approach creates the potential for lagging rural regions to contribute more to national development. The strategy does not envision that in this process, rural regions will inevitably grow to become large, urbanised regions. In the regional hierarchy, both large urban and smaller rural regions have a part to play, and these roles are complementary. Instead, the intent is a process where rural regions develop in the sense of accumulating the types of capital appropriate for their particular role in the national economy.

The NRP recognises the wide variability in the needs and assets of rural regions, and the need for adaptability and flexibility. This makes it impossible for a central authority to manage the development process. While national governments have the important task of setting out broad goals and acceptable behaviour, it is important to provide a flexible approach at the regional level in finding ways to achieve these goals. National financial support can help or limit this process, depending on how it is provided. Offering flexibility in the use of the funds can greatly facilitate the development process. If funds are strictly earmarked for specific uses, the result in rural areas is typically activity that results in limited development. The region takes the money offered and implements the project, but the project provides few long-term benefits, so in effect, the money is wasted. The NRP's final section includes the acknowledgement that an integrated rural policy requires significant co-ordination among various national government ministries, regional and local governments and private firms.

Encouraging urban and rural linkages

The NRP could benefit from an approach currently adopted in many OECD member countries that focuses on rural and urban linkages and their potential complementarities. This framework requires a refined rural definition that recognises and measures different types of rural regions (see Box 2.6).

While it is clear that urban policy applies in urban areas and rural policy to rural areas, the intersecting fringes of urban and rural areas and mixed territories require a different approach. A first step needed in Colombia to take advantage of the potential synergies between urban and rural areas is to differentiate between different types of rural regions. Remote rural regions must be distinguished from rural regions with strong linkages to cities. This will require refining the current taxonomy, which demarcates the national territory into urban and rural regions. In Colombia's case, this is particularly

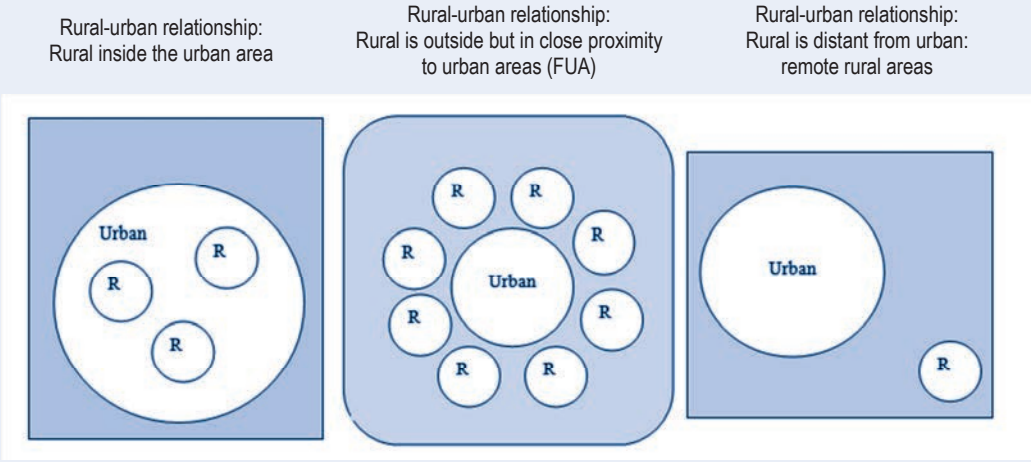
important given the paucity of linkages between urban and rural regions. Recognising and distinguishing these mixed spaces with high interactions can improve the co-ordination of urban and rural policies.

Box 2.6. **Different types of rural regions**

In broad terms, three types of rural regions have been identified in OECD member countries, each with different characteristics, challenges and policy needs. These categories include:

1. Rural regions within functional urban areas (FUAs) – these fall into the catchment area of the urban core, and their development is fully integrated into the metropolitan strategy. The main challenges they face are accessibility of services within the FUA, matching skills to the wide range of supply and managing land-use policy, given increasing pressures on the urban core.
2. Rural regions close to cities – the main challenges in these regions are improving two-way connectivity and accessibility between the cities and rural territory, building short supply chains that link urban and rural firms, balancing population growth with the preservation of quality of life and green spaces, and enhancing the provision of secondary goods and services.
3. Remote rural regions – in these regions, rural areas depend to a great extent on the primary activities of the area. Growth comes from building upon areas of absolute and comparative advantage, improving connectivity to export markets, matching skills to areas of comparative advantage and improving the provision of essential services (e.g. tourism).

Three types of rural regions in OECD countries



Source: OECD (2014b), *OECD Rural Policy Reviews: Chile*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264222892-en.

The Rural-Urban Partnership (RURBAN) work of the OECD (OECD, 2013b) starts from the recognition that urban and rural are different, but that there are important connections between them. No matter what the size of the region, there are many links, in the form of labour market flows, business interactions, delivery of public services, transport and utility connections, and co-ordination of government decisions. Where these links are well managed, both urban and rural territories perform better economically and

enjoy a higher quality of life. An important part of this process is having appropriate definitions that recognise the areas with high inter-relations.

Box 2.7. **Urban and rural linkages vary among types of regions**

The OECD has recently completed a study of the types of relations that exist between rural and urban areas, where they come together at the peri-urban fringe. The review looks at a variety of interactions including labour flows, housing choices, public service linkages, environmental service linkages and government co-operation. Because the nature of these linkages varies widely by size and type of urban agglomeration, three broad situations were examined. The first involves a large city that dominates a surrounding hinterland. The second is a less-populated intermediate region, typically involving a system of cities that collectively form a polycentric urban core. The third is a region of even less population density, where there are no cities of significant size and most urban places are tightly connected to a surrounding rural economy.

Highly urbanised regions typically have large internal commuting flows. These can often be from rural suburbs with lower cost housing into the urban core for work, but in some cases in both directions. In some cities, like London, higher income individuals may live in peri-urban areas and commute into the core, while lower income individuals live in relatively cheap urban housing and work in lower paying sectors that locate within the region but outside the core. Rural residents clearly benefit from access to business and public services in the urban core and from the greater variety of retail establishments. On the other hand, urban residents value the green space and other environmental amenities available in nearby rural areas. Crucially, both urban and rural parts of the region perform better if there is relatively strong collaboration between local governments.

In intermediate regions, the balance of contributions to the local economy from urban and rural territories is less unequal. Without a single dominant urban centre, a degree of specialisation often develops among urban and nearby rural areas. Some places will become manufacturing centres, others may provide higher education or healthcare, and others may host major retail centres. The result can be an agglomeration that provides a high quality of life for all. However, this is the ideal outcome. In other intermediate regions, little co-operation exists and places seek to be self-sufficient. In such situations, duplication and inefficiencies can mean that both rural and urban regions are worse off.

Most rural regions have only small urban centres, providing a limited variety of goods and services. A major role of these urban places is to act as market towns for the surrounding rural economy. If the industries based in the rural territory are successful, the urban area is also successful, but without a strong rural economy, little economic activity takes place in the urban areas. Such regions are typically specialised in natural resource extraction and first-stage processing. The towns can provide housing both for workers who leave for a rural location to work on a farm or in a mine, and can be the site of processing activities such as fruit and vegetable packing plants or ore-refining facilities.

In OECD countries, the majority of the rural population lives in relatively close proximity to urban centres, but the RURBAN study demonstrates that while they live near a city and are influenced by it, their lifestyle and economic role differs from those of city residents. Rural and urban areas have complementary functions, but the nature of these functions varies with the size of the urban region.

Source: OECD (2013b), *Rural-Urban Partnerships: An Integrated Approach to Economic Development*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264204812-en.

Conclusions

Colombia's government is actively promoting urban and rural development. Better territorial indicators and a regional taxonomy that identifies FUAs and different types of rural regions could both help fine-tune policy for this purpose. The OECD, in co-operation with Statistics Canada, has already provided national authorities with recommendations in this respect.

In the area of urban development, the aim of the national policy is to connect large urban agglomerations and cities. This should promote factor mobility and overall productivity, and also improve national and international trade. While this is a step in the right direction, it is worth considering the unintended impacts it might have on urban hierarchy and local specialisation. In agglomeration economies, economic activities concentrate in core areas, affecting economic development in the periphery of the system. To prevent adverse effects on smaller cities, urban development policy should promote human capital, innovation and entrepreneurship. Meanwhile, governance co-ordination tools among municipalities could aid collaboration and territorial integration in FUAs.

Rural development policy is more fragmented, and less straightforward in terms of policy goals, than urban development. The agrarian protests that started in 2013 put pressure on the government to offer more farmers direct subsidies, a policy that is extremely costly and that is unlikely to be sustainable in the near future. A broader policy framework for rural development is now being formulated, but due to the long-standing urban bias in Colombia (Lipton, 1977), institutions and capacities at the local level must be created. To this end, the government is creating councils for competitiveness in rural municipalities and departments, and setting up a broad national consultation to solicit citizens' input on their needs and ideas for rural development. A policy assessment, the *Misión del Campo*, is due to present the foundation for the national approach to rural development in the next National Development Plan. Although Colombia's overall approach to rural development has dramatically progressed since 2010 (i.e. with the National Development Plan "Prosperity for All"), the country has to deal with a large institutional gap in rural areas that presents challenges for policy delivery. While pilot projects under the PDRIET could be a solution, they are intensive in human and financial resources and cannot be generalised throughout the country. In this context, the government should communicate its current efforts and challenges to rural residents more effectively and look for new rural constituencies that can engage in a policy dialogue, to reduce the current focus on agriculture in rural development policy.

As the country develops, its economy will become more capital intensive and more diversified, even in rural areas. A rural policy built on the economic potential of rural activities is likely to show more promise than the current focus on transfers and agriculture.

One other issue is that the urban and rural policy agendas are being dealt with on different tracks, with little co-ordination. Many rural communities are close to cities or large urban agglomerations. It would be worth considering whether to provide these regions with better transport infrastructure, to give rural dwellers access to urban services, without being forced to move into the cities. Conversely, this could give urban residents access to rural amenities, which would benefit economic activities in rural areas, including farming and tourism. Improved connectivity could help secondary cities become hubs for services for larger territories, and expose them less to competition from bigger cities.

Notes

1. It is not surprising that the smaller Latin American countries have, at most, one major city.
2. The cities are: Barranquilla, Bogotá, Bucaramanga, Cali, Cartagena, Cúcuta, Ibagué, Manizales, Medellín, Montería, Pasto, Pereira and Villavicencio.
3. Governance structures that result in lack of transport infrastructure and congestion would also be expected to contribute to fragmented labour markets, impeding economic efficiency and increasing unemployment. In addition, longer commutes have a direct negative impact on well-being, and leave less time for parents to take care of their children and for community tasks, which can jeopardise educational outcomes and decrease the social cohesion and resilience of neighbourhoods.
4. The President of Colombia's capital city, the Mayor of Manizales, one of the largest cities in the country, has identified effective rural development as a key national priority to support urban development. He noted that the current influx of low-skilled rural population migrating to cities to look for a job or access to basic services risks overwhelming the cities' capacity to cater to their welfare and overall development. This indicates that key urban stakeholders support a national effort in favour of rural areas.
5. (a) Calculations of DDS-DNP with DANE data (1993-2005 Censuses and 2008-11 Quality of Life Surveys).
6. National Development Plan 2010-2014.
7. The possibility of providing smallholders with subsidies also depends on improved property rights, as already noted. Holding legal title to land gives farmers access to a broad set of rights. This should be considered a dramatic improvement for rural development in Colombia, but it may incidentally also have contributed to the agrarian protests.

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Chapter 3

General system of royalties opportunities in Colombia and challenges behind the reform

This chapter analyses the main characteristics, strengths and potential challenges of the system of royalty payments in Colombia, and notably its contribution to territorial development policy. The chapter is made up of three parts. The first offers historical background on the reform of royalty payments and discusses the political economy of reform challenges that have faced the government in the transition towards the new system. The second illustrates the chief characteristics and advantages of the new system. The third part assesses the system's key challenges and presents a set of policy recommendations.

Key findings and recommendations

Key findings

- Colombia has changed the way in which it handles the royalties stemming from the exploitation of its natural resources. It has shifted from a system in which royalties benefited resource-rich departments to one in which the allocation of royalties is spread out more evenly across the country. This shift has important implications for territorial development policies. The General System of Royalties (*Sistema General de Regalías*, SGR) represents a large share of public investment in Colombia. Revenues from royalties totalled USD 4.6 billion (COP 9 000 billion), or about 1.4% of Colombia's gross domestic product (GDP), in 2012.
- Colombia has an incipient and rapidly growing decentralised government structure, and the SGR provides sub-national governments with scope and funds. The SGR created a network of collegiate bodies (*Órganos Colegiados de Administración y Decisión*, OCAD), active at different levels of government. These, supported by the National Planning Department (DNP), assess and approve investment projects.
- Some factors may work against the capacity of the new system to generate economic development. A significant gap persists between the formal and actual autonomy of municipalities and departments. Many sub-national entities, especially if they are rural, suffer from institutional deficiencies and are not able to take advantage of the SGR. The SGR has become a project-based system based on a myriad of small projects, with limited impact on long-term regional development.

Key recommendations

- Governance and scale: Some confusion persists about the level of intervention. The OCADs operate at different territorial levels. Some of these levels correspond to constitutionally designated tiers of government, while others are used for planning, often *ad hoc*. This complexity could be streamlined. The majority of projects are carried out at a local, municipal level, and few serve a group of departments or a region. Facilitating large-scale projects would require institutions dedicated to development and planning.
- Programming: The current project-based system needs to evolve into medium-term programming. This would mean formulating a vision for every territory and co-ordinating the different instruments of intervention within the framework of the National Development Plan.
- Participation channels: To ensure that development is based on multi-level governance, and to guarantee the support of the local population, there is a need for more participation of citizens and businesses. This would entail a transparent identification of relevant stakeholders and the creation of local fora where information and ideas can be fed into the decision-making process.
- Technical support: Given the lack of capacity in territories, departmental development observatories could serve as advisory technical bodies for planning, implementation and monitoring. The observatories should work in close collaboration with the National Planning Department.
- Fiscal autonomy: Greater fiscal autonomy at the sub-national level is needed to help communities develop a vision for their future. This requires greater local taxation in a context of hard budget constraints, to prevent potentially reckless use of local funds by sub-national governments.
- Innovation linked to business development, especially in resource-based regions: The Science, Technology and Innovation (STI) Fund is underperforming, due to the low capacity of regions to absorb investment in innovation. A possible solution might be to broaden the scope of STI and support enabling conditions for innovation. Furthermore, the fund could also be used to improve innovation and productivity in extractive activities in resource-rich territories.

Introduction

This chapter analyses the main characteristics, strengths and potential challenges of the system of royalty payments in Colombia, including its contribution to territorial development policy. Through this reform, the government has introduced a new framework to support regional development. The reform distributes revenues generated by royalty payments to all departments and selected municipalities throughout the country. Sub-national authorities can invest these funds to implement projects within a self-identified local development strategy. The reform also aims to enhance Colombia's institutional capital. Several new institutions have been created to facilitate and orient the use of royalty revenues. This helps improve multi-level governance.

The system, however, presents some challenges. The most important is that the royalty revenues are used to support a large number of small projects, rather than broader, well-organised and co-ordinated programmes in territories. While the reform needs some fine-tuning in its early stage of implementation, and basic needs must be satisfied at the municipal level, transitioning to a programme-based approach could be helpful. Under such a system, investment projects could be implemented according to a vision for Colombia's sustainable regional development. This would require a multi-level governance framework, to provide territories with the capacity and assistance to fulfil their mandates.

Characteristics and evolution of the royalty system in Colombia

Colombia, like some OECD resource-based countries such as Australia and Canada, has a system of royalty payments covering the production of non-renewable resources. The royalty is the price that the owner of a natural resource charges for the right to develop the resource. The extraction of natural resources typically generates financial rents, in the form of returns that exceed the remuneration of capital and risk-taking in other sectors. These excess returns represent a unique case of a tax base that can be taxed without generating distortions (OECD, 2012a).

Revenues from royalties totalled approximately USD 4.6 billion (COP 9 200 billion),[1] or 1.4% of Colombia's GDP, in 2012. They originated from the production of hydrocarbons (80%) and minerals (20%). Oil extraction generated 73% of royalty revenues and coal and gas generated 16% and 6%, respectively. The royalty rate applied depends on the kind of product, and on the volume of the production. Royalty rates range between 8% and 25% in the case of oil, and between 5% and 10% in the case of coal (Annex 3.A1).

Oil and mining resources are concentrated in a few territories in Colombia. Hydrocarbons are mostly produced by the departments of Meta (48% of the total oil production, in 2012) and Casanare (19%), and, to a lesser extent, by the departments of Arauca (6.1%), Santander (5.3%) and Boyacá (4.7%). In the case of coal, the largest producers are the departments of Cesar (52% of coal production in Colombia, in 2012) and La Guajira (39%).

The production of oil and minerals enjoyed a boom in Colombia in the late 1980s, and led to the creation of a system of royalty payments. At that time, the aim of the system was to manage the use and distribution of the substantial revenues generated by extractive activities. Until 2012, most of the revenues were concentrated in resource-based municipalities and departments. In 2011-12, the government carried out

an important reform of the system, to achieve a more even territorial distribution of the increasing revenues generated by royalties, and with the aim of promoting long-term territorial development.

Historical overview of legislation governing royalty payments in Colombia

The 2011-12 reform is the last of a series of reforms the government of Colombia put in place to manage the revenues generated by extractive activities more efficiently. In general, the aim of previous reforms was to connect royalty revenues with improvement of service delivery in resource-based territories. The first laws organising a framework to manage royalty revenues dates back to 1919.[2] They established that 30% of the tax revenues generated by oil production should remain in the producing departments, with an additional 5% allocated to producing municipalities.[3] In 1953, the Oil Code (*Decreto 1056 de 1953*) allocated 50% of the total royalty revenues to departments hosting extractive activities, and 5% to municipalities.[4] The code required resources to be invested in education, agriculture and transport infrastructure. Law 89 of 1959 raised the participation of municipalities to 10%. Decree 1 246 of 1974 raised the share of oil royalties from concession enterprises to 65% in the case of resource-based departments, and to 15% for municipalities.[5] These resources were earmarked to be invested in public works, education, health, agriculture and livestock development, forestry promotion or environmental protection. In addition, the law stated that deconcentrated national agencies could use the revenues to promote development in the resource-rich departments and municipalities (Consejo del Estado, 1986).

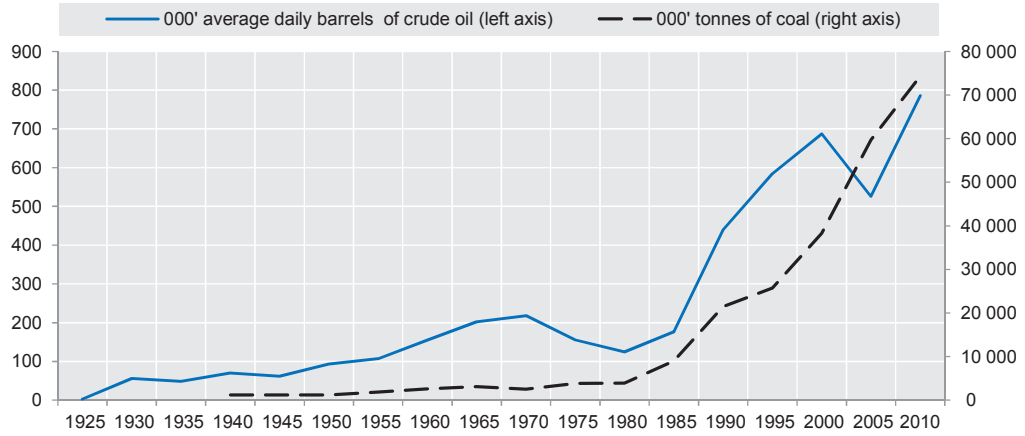
Before the 1980s, mining and oil production was limited and government power very centralised. The production of oil occurred in the Magdalena Medio Valley, and the revenues generated were relatively modest (Indepaz, 2013). Although royalties were allocated to municipalities and departments, the departments were administered by mayors and governors appointed by the President. This reflected a centralised structure of power, in which the presidency had full control of all political and administrative processes in the country.

The situation changed between 1980 and 2000, when the production of natural resources increased dramatically and the mechanisms of national governance were significantly modified. In this period, Colombia's production of oil increased fivefold and its production of coal by a factor of ten (Figure 3.1). This generated a surge of royalty revenues. At the same time, Colombia started decentralising its governance model, and the first direct election of mayors was held in 1988.

The Colombian Constitution enacted in 1991 profoundly affected the system of royalty payments and subsequent regulation in this field. The Constitution devolved powers to sub-national governments and introduced democratic elections of governors. It also established mandatory national transfers to departments (*Sistema General de Participaciones*). In the case of natural resources, the 1991 Constitution laid down the main principles of the General System of royalties and of the participation of resource-rich sub-national governments (including territories involved in the logistics of natural resource transportation) in the revenues generated by extractive activities. Finally, the Colombian Constitution created the National Royalty Fund (NRF) to administer the royalty revenues that were not allocated to resource-based sub-national levels. In 1994, based on the innovative framework instituted under the Constitution, Colombia's government enacted Law 141. This defined the characteristics of the system of royalty

payments and established the rules for the distribution and use of the revenue among sub-national governments.

Figure 3.1. **Oil and coal production in Colombia, 1925-2010**



Source: Ecopetrol and SIMCO.

The NRF managed the share of the revenue not directly allocated to producing departments and municipalities and allocated these funds to the investment projects proposed by departments and municipalities across the country. This was a distinct departure from previous arrangements, under which the revenue that was not assigned to sub-national governments was simply absorbed by the national budget. The goal of the NRF was to promote territorial cohesion, but any territorial entity – including resource-rich departments and municipalities – could present projects to the NRF, even if it had access to direct royalty payments. The redistribution impact of the NRF was thus very limited (Ministry of Mines and Energy, 2011).

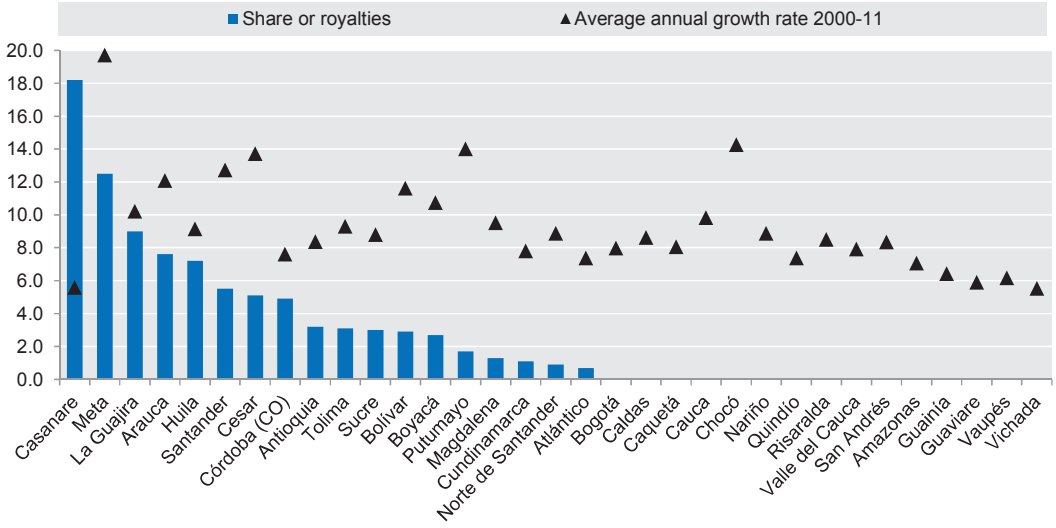
Another key characteristic of the system set in place in 1994 is that most of the funds were earmarked to deliver a basket of selected public services and goods. Direct royalty payments allocated to departments and municipalities had strings attached to them: sub-national authorities were required to use the additional revenue specifically to improve education, healthcare (infant mortality, in particular), clean water and sewage systems, within a general policy framework selecting priorities from the top down.[6] Conversely, projects presented to the NRF were requested to pursue the promotion of mining, the preservation of the environment and to finance territorial investments prioritised in the development plans of the respective territorial entities.

The innovations to the royalty system brought about by the Constitution and the 1994 law were not backed up by technical and project management support to enhance institutional capital at the sub-national level. Recently established sub-national governments had become responsible for implementing an increasing amount of public investment. However, they often lacked the capacities and means to manage this additional revenue in an efficient and accountable way (OECD, 2013a; 2013b). Issues concerning the misuse of the royalty payments were frequently raised against sub-national governments (Olivera and Perry, 2009; Ministry of Mines and Energy, 2011; Indepaz, 2013; OECD, 2013a).

The evidence is that the system to manage royalty payments between 1994 and 2011 was not able to promote inclusive growth in Colombia's resource-rich departments. The

eight most important mining and oil-producing departments – Casanare, Meta, La Guajira, Arauca, Huila, Santander, Cesar and Cordoba – home of 17% of the national population, received on average 70% of the overall royalty revenues between 1995 and 2011.[7] All of these funds resulted in an increase of GDP per capita, which is above the national average in most of the resource-based departments (Figure 3.2). However, in the same period, of the main resource-based departments (i.e. those that received at least 5% of royalties), only the departments of Huila and Santander displayed a net reduction of poverty rates above the national average (Figure 3.3).[8] Service delivery also fell short. Although the 1994 law required resource-rich departments and municipalities to achieve a minimum standard in the delivery of education, healthcare, water sanitation and infant mortality, none of the sub-national entities was fully able to fulfil this mandate (Ministry of Mines and Energy, 2011).[9]

Figure 3.2. **GDP per capita trend vs. share of royalties received per department**



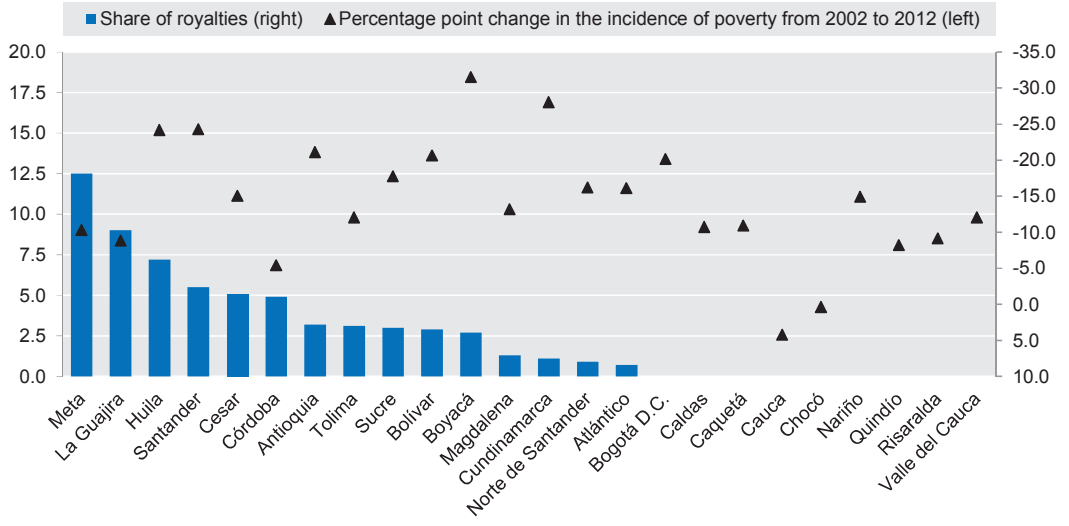
Notes: The figure shows the share of royalties received of departments that received at least 0.7% of the royalties. The share of royalties for investment considers both direct royalties and resources from the National Fund of Royalties. It does not include the Territorial Pension Savings Fund (FONPET), the Stabilisation Fund (FAEP) and other non-territorial beneficiaries.

Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review of Colombia*", unpublished.

Direct royalty payments allocated to resource-based departments increased fivefold between 1995 and 2011, and Colombia instituted a radical reform of the system in 2011 (Figure 3.4). International demand for commodities had put upward pressure on the price of oil and minerals, and Colombia steadily increased its production of natural resources, benefiting from the positive international trend.[10] Furthermore, the high concentration of royalty payments was not consonant with the large regional disparities. Colombia is not the only country to have implemented a reform of its royalty system, owing to skyrocketing international prices for commodities, and its experience reflects a global trend. Many resource-based countries have been reforming their tax or royalty regimes or revenue mechanisms, to respond to changes in market prices and evolving market conditions (Box 3.1).

Figure 3.3. **Change in the incidence of poverty between 2002 and 2012, vs. share of royalties received**

Departments of Colombia

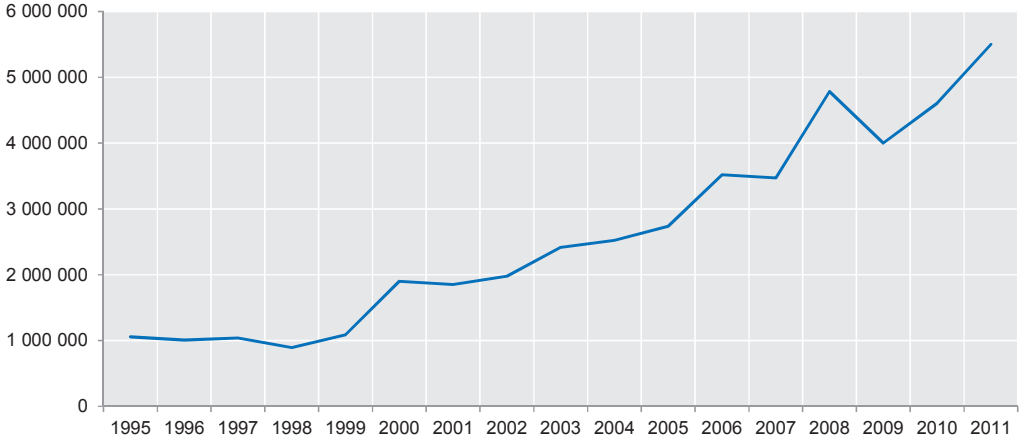


Notes: Poverty data is based on population projections, based on the results of the 2005 Census. The figure shows only departments that received at least 0.7% of the total budget of the General System of Royalties (SGR). Assumptions about poverty reduction performance of the royalty beneficiaries should be approached with caution. Poverty data is produced only for 24 of the 33 Colombian departments. Data are not available for two of the three main beneficiaries of royalties, Casanare and Arauca. The share of royalties for investment considers both direct royalty payments and funds from the National Royalty Fund. It does not include the Territorial Pension Savings Fund (FONPET) and the Stabilisation Fund (FAEP).

Source: DANE; average share of total royalties for the period 1994-2009 provided by local team based on information from CNR-Ecopetrol-ANH; Minercol-Ingeominas; IFI CS DNP-DR.

Figure 3.4. **Direct royalty payments allocated to resource-rich departments in Colombia, 1995-2011**

2011 constant prices (COP millions)



Note: The figure does not include allocations to regional autonomous corporations (CAR).

Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review of Colombia*", unpublished.

Box 3.1. International experience of reforms of royalty payments

Given the substantial contribution of the extractive sector to the public purse in oil and mining economies, the ability of governments to collect royalties and taxes, and to generate and manage volatile revenues, has been subject to increased public debate. When commodity prices are on the rise, as they have been for the last decade, producing countries may become more exposed to public scrutiny. Public demand tends to arise for a fair balance between the need to distribute overall public benefits, share risks and reward investors. Many producing countries have recently undergone or announced the adoption of reforms of tax/royalty regimes or revenue mechanisms in an effort to respond to evolving market conditions. Among OECD countries, in July 2012, Australia imposed a new mining rent tax, widened the base of the petroleum resource rent tax and launched a number of initiatives aimed at spreading the benefits of the mining boom throughout the economy and helping businesses adapt to the transformations under way (OECD, 2012b). In Canada, the province of Alberta introduced a new royalty tax regime in 2009 (revised in 2011) that factors in prices and production volumes for conventional oil and natural gas, while the royalty tax regime for unconventional oil factors in oil prices and project costs. In Chile in 2011, the government approved the Fund for Regional Investment and Restructuring (FIRR). This allocates USD 100 million per year for a four-year period in the mining regions of the country, to fund development projects of regional governments and municipalities. The national government is also negotiating a new fund to be directed to mining municipalities and regions (Fondenor).

Sources: OECD (2013c), "Policy dialogue on natural resource-based development", Scoping Paper, DEV/GB(2013)6, OECD, Paris, available at: www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DEV/GB(2013)6&docLanguage=En; OECD (2012b), *OECD Economic Surveys: Australia 2012*, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_surveys-aus-2012-en; www.gob.cl/blog/2013/04/30/fondenor-un-impulso-para-las-comunas-mineras-2.htm.

Colombia's 2011-12 reform of the General System of Royalties: Principal characteristics

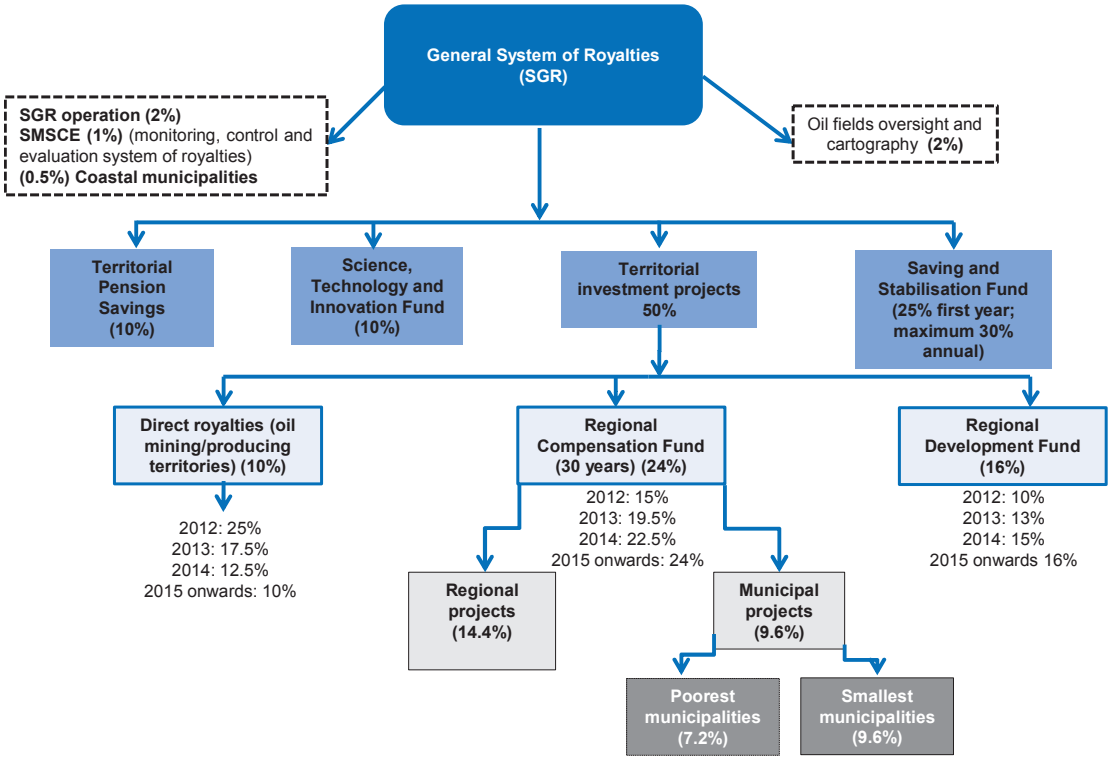
The national government radically reformed the allocation of royalty payments in 2011. The new policy framework involved a constitutional reform and a set of laws and regulations. The former National Royalties Fund was replaced by the General System of Royalties (SGR) that now collects and manages the overall royalty payments. Since 2012, the SGR allocates revenues across six main funds (Figure 3.5). In particular:

- The SGR allocates 10% of the biannual revenue to the Territorial Pension Savings Fund (FONPET), managed by the Ministry of Finance, which covers pensions for sub-national public employees.
- Up to 30% is allocated to the sub-national Savings and Stabilisation Fund (managed by the Central Bank of Colombia). In 2012, this fund absorbed 25% of the overall revenues. In the next few years, this percentage will rise consistently by half of the percentage rate of increase in expected royalty revenues.
- The SGR allocates 10% of revenues to the STI Fund. This fund aims to promote regional STI by supporting projects that contribute to the production, use and appropriation of knowledge, including projects related to biotechnology and information technologies. It is managed by *Colciencias* (the Department of Science, Technology and Innovation of Colombia). Regional universities are involved in the selection process. STI funds are allocated to departments

proportionally with the Regional Compensation Fund (RCF) and Regional Development Fund (RDF) (see below).

- Direct royalty payments are reserved for resource-based departments and municipalities (including those involved in the logistics of natural resources). This fund totalled 25% of the royalty revenues in 2012. The share was set to be reduced progressively to 17.5% in 2013, 12.5% in 2014 and then 10% from 2015 until 2020. The difference between 2012 and 2014 will be allocated to the RCF and RDF.
- The RCF, once fully operational, will receive 24% of the royalties after 2015 and will invest in local infrastructure and economic development projects in the poorest regions and municipalities. It will allocate revenues to departments and municipalities based on poverty rates and on an index of non-satisfied basic needs.[11] The RCF allocates 60% to departments and 40% to municipalities (75% to the poorest municipalities in the country and 25% to the smallest municipalities in Colombia). The fund will last for 30 years, after which its resources will be transferred to the RDF.
- The RDF will receive 16% of the royalty revenues after 2015. Its objective is to promote regional competitiveness, as well as social, economic, institutional and environmental development, by financing investment projects with an impact on large territories. A formula guides the allocation of funds, with a weighting of 60% of the distribution formula to demography and 40% to poverty rates. This fund will operate indefinitely.

Figure 3.5. **Funds within the General System of Royalties**



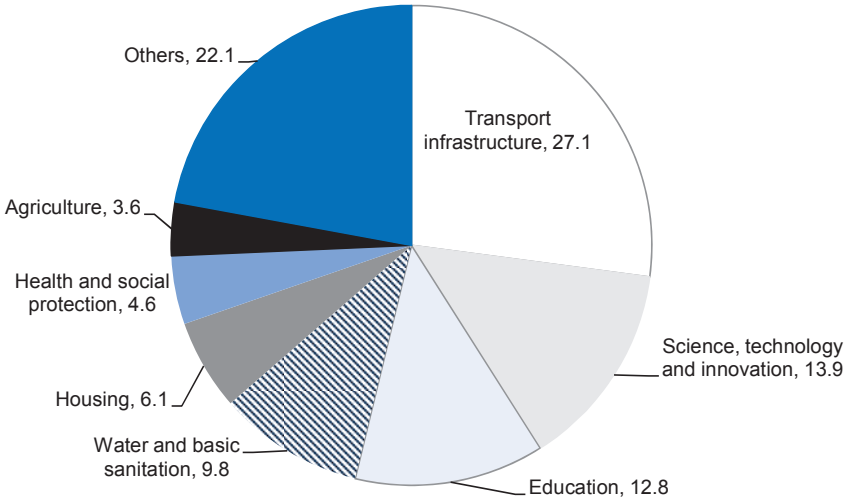
Source: OECD (2013b), *OECD Economic Surveys: Colombia 2013: Economic Assessment*, OECD Publishing, Paris, updated with information provided by the DNP.

The reform introduced two main innovations. The first and most important is that all departments and the vast majority of municipalities in Colombia now have access to royalty revenues, regardless of their specialisation in extractive activities. The second is that funds are not earmarked to sub-national levels. This time, no strings are attached to them. The departments (and selected municipalities) have the possibility of deciding how to invest the additional resources on the basis of their needs, strategic priorities and programming documents.

Most of the investment generated by the SGR has been dedicated to infrastructure, in particular road connectivity and accessibility to education. From the time it was introduced, in September 2013, till the end of the same year, the SGR generated a total investment of USD 5.2 billion. Sub-national governments invested royalty revenues in four main areas. Approximately 27% was allocated to improve road connectivity, including primary and secondary road networks, and 14% was invested in research and development projects. Some 13% of the total annual revenue was invested to improve the delivery of education in the regions. Finally, 10% was spent to purify water (Figure 3.6). It should be noted that investing to improve road connectivity and human capital is also a way to promote competitiveness in the extractive sectors.

Figure 3.6. **Share of royalty payments by sector**

Investment projects approved between 2012 and September 2013



Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review of Colombia*", unpublished.

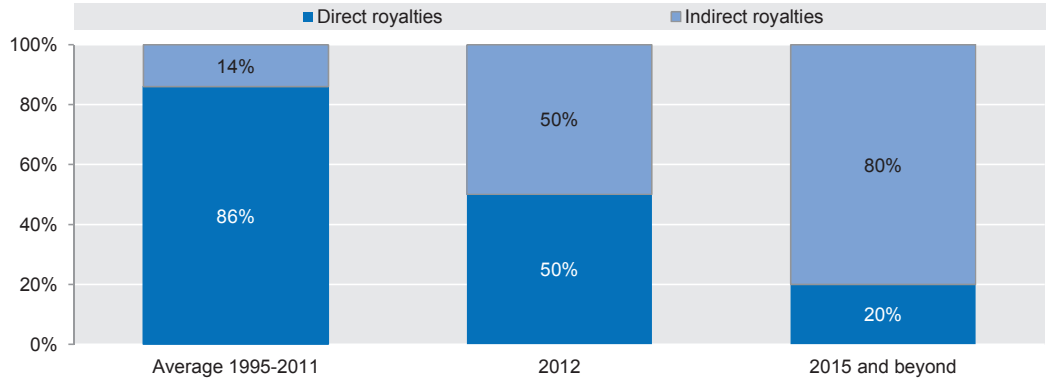
The SGR is exclusively used to support capital investment. Sub-national governments cannot use the additional revenues generated by royalties to finance operating costs. Investment in health or education, for example, is used to build or maintain infrastructure such as schools or hospitals. The operating costs for the infrastructure – for example, doctors, nurses and teachers – must be covered by other sources of public funds. This implies that the sectorial minister in charge of healthcare or education, for instance, must cover the functioning costs generated by the capital investment of a given sub-national government. This requires negotiation, and a formal agreement, between the sub-national authorities and the ministry.

There are some exceptions to this general rule. The SGR can cover some operating costs, but only for limited periods. For instance, a sub-national government can present an investment project that requires capacity building or training activities in the early stages of the implementation.

The reform also restricted investment on capital investment, given Colombia's experience with debts generated by local government. In the 1990s, Colombia's fiscal sustainability was challenged by the high level of debt at the sub-national level. Due to a lack of capacity and accountability, several sub-national governments poorly allocated the public investment they were entrusted with under the Constitution (OECD, 2013b). In fact, they generated high operating costs that reduced the possibility of investing in infrastructure and service delivery.

The SGR has reduced the share of royalty revenues dedicated to direct royalty payments, while increasing the share available for all territories, including those that are not specialised in extractive activities. Under the previous system, of royalty revenues allocated to territorial investment, resource-based departments and municipalities retained an average of 86% of total royalties. After the reform, this was reduced to 25% in 2012, and will continue to drop, to a final target of 20% in 2015 (Figure 3.7).

Figure 3.7. **Evolution of the share of direct vs. indirect royalties**



Note: The figure includes direct and indirect royalties and does not take into consideration the territorial pension savings funds, stabilisation funds or (from 2012) the Science and Technology Fund.

Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review of Colombia*", unpublished.

From a global viewpoint, Colombia's experience of reform provides useful evidence of how to link natural resources to a country's economic development. A recent assessment by the International Monetary Fund (IMF, 2014) of resource-rich economies found a negative relationship between natural resources and the capacity to promote sustainable development, given the negative impact that the availability of natural resources has on the fiscal framework of a resource-rich country. The revenue generated by extractive activities does not add to total national revenue, but crowds out revenue generated by taxation. This reduces the sustainability of the system and impinges on the relationship between citizens and business on one hand, and the government on the other hand. Several resource-rich economies have instituted policy frameworks to redistribute revenue generated by extractive activities in order to promote sustainable economic growth. International experiences (see Box 3.2) vary according to administrative setting and degree of decentralisation (Dietsche et al., 2009).

Box 3.2. **Distribution of royalty revenues in different countries**

The way in which mining and oil revenues are distributed between national and sub-national levels or between producing and non-producing entities varies considerably in different countries, depending mainly on a country's administrative setting. Federal OECD mining/oil-producing countries, like Australia or Canada, generally assign to their provinces or federated states exclusive or shared control over the taxation of natural resources located within their boundaries, and over the use of the revenues they generate.

In Canada, for example, as per the Constitution Act 1867, the provinces are owners of their ground resources, except for those in aboriginal and federal land. Provinces own most of the mineral and oil rights, developing and managing their own fiscal system for imposing royalties and taxes on energy production. For example, in Alberta, 81% of mineral rights are owned by the government of Alberta. The remaining 19% are under federal jurisdiction.

In Australia, the federal, state and territorial governments have differing roles and responsibilities in resource exploration and development. The state and territorial governments are the day-to-day managers of their mining industries. They issue permits to explore and develop land, grant land tenure and ensure that projects meet environmental and occupational health and safety standards. They also collect royalties associated with mineral production in their jurisdictions. The type of royalties varies from state to state. The federal government collects company income tax on mining profits and sets parameters such as depreciation allowances for capital and fuel-excise rebates. The federal government also collects royalties and resource-rent taxes on oil and gas projects in Australia's offshore areas.

On the other hand, in unitary countries, the central government often administers all or most oil and gas public revenues. This is the case in Norway, where all revenues, whether through taxation or ownership, less investment costs, are paid into the Government Pension Fund Global.

In Chile, the central government administers the revenues generated by mining royalties and taxation. These revenues are not earmarked for the territorial jurisdictions (municipalities, regional governments) of the territories where the mining industries are based. However, in recent years, mining regions have received some additional investment. This is the case for the Competitiveness Innovation Fund, which obtains its resources from the 2006 mining royalty. Starting in 2008, 25% of the fund's resources were allocated to regions, 60% of this to mining regions and 40% to non-mining regions. Mining regions also receive funding through the Fund for Regional Investment and Restructuring (FIRR). Since 2011, this fund has allocated USD 100 million annually, for a 4-year period, to fund development projects of regional governments and municipalities. One-third of the total resources is to be assigned to the mining regions.

Finally, in Peru, the most significant mining and gas revenues flow from the corporate income tax paid by mining and gas firms. These are collected at the central government level, and a share of the funds is distributed to the sub-national governments where these firms operate, generating substantial resources for producing localities and regions. Oil royalties (*cañon* and *sobrecañon petroleros*) are also distributed to the oil-producing regions and municipalities.

Sources: Dietsche, E. et al. (2009), "The challenge of mineral wealth: Using resource endowments to foster sustainable development", in: *Minerals Taxation Regimes, a Review of Issues and Challenges in their Design and Application: Analysis and Observations*, International Council on Mining and Metals (ICMM), London; Canada: information provided by Western Economic Diversification Canada; Australia: Griffith, M. (2013), "Measures supporting minerals and primary metals extraction and processing: Case study: Australia", *OECD Trade and Environment Working Papers*, No. 2013/03, OECD Publishing, Paris, http://dx.doi.org/10.1787/5k43n12wlnr0-en; Chile: www.gob.cl/blog/2013/04/30/fondenor-un-impulso-para-las-comunas-mineras-2.htm; Korinek, J. (2013), "Mineral resource trade in Chile: Contribution to development and policy implications", *OECD Trade Policy Papers*, No. 145, OECD Publishing, Paris, http://dx.doi.org/10.1787/5k4bw6twpf24-en; Peru: www.mef.gob.pe/index.php?option=com_content&view=article&id=454&Itemid=100959&lang=es.

The reform triggered an intense debate involving sub-national governments and national authorities in Colombia. Resource-based regions have opposed the new system to allocate royalty revenues, in particular pointing out the need to compensate them for the negative externalities associated with extractive activities. Conversely, departments

and municipalities with little or no natural resources have welcomed the additional revenues that they are now able to invest to promote development. The national government, in turn, stressed the potential of the reform to promote territorial cohesion in Colombia and to trigger capacity building at sub-national levels.

Although resource-based regions may actually suffer a reduction of direct royalty payments, some factors mitigate this impact. First and foremost, as already noted, the reform was implemented due to booming commodity prices and in the level of national production of natural resources. Because of these two factors, resource-rich regions have benefited from a constant and conspicuous increase of direct royalty payments. Taking into account nominal values rather than percentages, the revenue allocated to producing territories did not suffer as large a reduction, and the amount of revenues resource-rich territories receive within the SGR are in line with the direct royalty payments they were receiving a few years earlier.[12] Second, producing territories will still have a relevant participation in the royalty revenues through the other funds within the SGR. For instance, the SGR's estimated budget for 2013-14 allocates about 30% of the Regional Compensation Fund to the eight most important oil- and mining-producing departments, even though they represent only 17% of the national population.[13] This reflects the high poverty rates and the important basic needs that still affect most resource-based departments and municipalities.

Advantages of the General System of Royalties

Additional funds to support development in all departments and almost all municipalities

The new SGR provides all departments in Colombia, and most of its municipalities, with additional revenue to support regional development. The allocation of the Regional Compensation Fund is transparent and based on a formula that measures regional poverty rates and population. The aim is to concentrate additional investment in territories that suffer from poverty and poor access to basic public services. Most of these areas are rural and remote. The fact that these regions can now benefit from additional funds is indicative of a more inclusive approach to regional development in Colombia.

A focus on empowering multi-level governance

The SGR is also designed to empower multi-level governance in Colombia. The implementation of investment connected with royalty payments requires an effort of co-ordination both at the central level (horizontal co-ordination) and between the central government and sub-national entities (vertical co-ordination). For instance, at the central level, the SGR is managed by an Executive Commission (*Comisión Rectora*) that involves the three levels of government. Among its duties, this commission is responsible for defining the basic rules guiding the SGR, approving administrative regulations to ensure its smooth functioning and managing information on how it is performing. The Executive Commission takes decisions based on qualified majority voting.

The following bodies/entities participate in the Executive Commission:

- The National Planning Department (DNP). The director of the DNP, who has ministerial status, is also the chair of the commission. The DNP also acts as the secretariat of the commission.
- The Ministry of Mining and Energy.

- Two governors, including one representing a resource-based department.
- Two mayors, including one representing a resource-based municipality.
- Two members of the Congress of Colombia (one from the Senate and one from the House of Representatives), who participate in the Executive Commission but do not have the right to vote.

Another key component of the multi-level governance framework put in place by the SGR is represented by the *Órganos Colegiados de Administración y Decisión* (OCAD). OCADs are responsible for assessing, evaluating, prioritising and approving investment projects submitted by sub-national governments. According to the Constitution, royalty payments belong to departments and municipalities. Yet, the SGR, through the OCAD framework, put in place a system in which sub-national entities have to obtain approval from these bodies to invest the additional revenue received by royalties. A key characteristic of the Colombian system is that if the OCADs reject a project, sub-national entities do not lose the royalty funds, which accumulate in their budgets until the department or municipality is able to design an investment project approved by an OCAD.

OCADs operate at four territorial scales, at which public authorities handle royalty payments. Some OCADs are organised at the municipal and department level. In addition, to deal effectively with large-scale projects involving several departments (as in the case of primary road networks, for instance), the SGR has divided the national territory into six regions – Región Caribe, Región Centro-Oriente, Región Eje Cafetero, Región Pacifico, Región Centro-Sur-Amazonía and Región del Llano – and created regional OCADs in each of these regions. Regional OCADs are responsible for evaluating investment decisions totalling 60% of the allocation to the Regional Cohesion Fund (the share allocated to departments) and the Regional Development Fund (Table 3.1). Finally, one OCAD operates at the national scale. This deals with investment projects to promote science, innovation and technology throughout the country and implements the STI Fund within the SGR. Its membership differs from that of the other OCADs. For instance, *Colciencias*, Colombia's Department for Innovation and Science, chairs the OCAD. The OCAD also includes representatives from selected national universities.

The SGR has introduced a governance framework requiring departments and municipalities to play a pro-active role in their development. The planning secretariats of departments and municipalities act as secretariats for the OCAD, organising meetings and providing logistics and technical organisation. Sub-national governments are also represented on the National Royalty Executive Commission. Since the approval system requires a qualified majority, sub-national authorities can guide decisions on investment projects.

At the sub-national level, the OCAD functions on the basis of what Colombian authorities have defined as the "triangle of good government". Each level of government is considered a "corner" (or *esquina*, in Spanish) of this triangle, and each level of government has only one vote, regardless of the number of its representatives in a given OCAD. Final decisions are taken when at least two out of three constituencies (or corners) express a favourable vote. This means an investment decision can be approved if the department and the municipal representatives in the OCAD approve it, even if the national government does not support it.[14] The only way central government representatives can oppose the decision of an OCAD is by showing that an investment project does not comply with the SGR regulations.

Table 3.1. **Composition of and projects evaluated by territorial OCADs**

OCAD	Membership	Type of projects
Municipality	– One delegate from the national government – Governor of the department – Mayor of the municipality	– Direct royalty payments allocated to municipalities – Projects related to the Regional Compensation Fund presented by the municipality
Department	– Ministries or their representatives – Governor of the department – A group of mayors representing 10% of all municipalities in the department	– Projects related to the Regional Compensation Fund and to the Regional Development Fund presented by a department or at least two municipalities
Regional	– Four ministries (including the Minister of the Environment) or their representatives – The director or a representative of the National Planning Department – The governors of all departments in the region – Two mayors from each department in the region	– Projects related to the Regional Compensation Fund and to the Regional Development Fund presented by a department or at least two municipalities

Note: Senators and members of the House of Representatives, representatives of indigenous and Afro-Colombian communities and representatives of other minorities also participate in the OCAD system but do not have the right to vote.

Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review of Colombia*", unpublished.

OCADs are held when there is a project, or a number of projects, to approve, or when there is a specific request from a part of the membership. This is to guarantee maximum flexibility for the system and to facilitate implementation of investment projects. Moreover, an OCAD can also be held in video-conference, if one of the members cannot participate in a meeting in person. This is intended to help municipal OCADs run smoothly in rural and remote areas.

The OCAD system in the SGR is Colombia's solution to a challenge that several OECD countries are facing. It is always difficult to develop a governance mechanism for investment decisions that balances the need to tailor intervention to local needs and opportunities (decentralisation) while allowing the central government to retain some control over the investment, and to ensure that it is in line with national goals and regional development strategy.

The SGR facilitates planning and quality control

Another advantage of the SGR is that it facilitates project planning and quality control. Investment projects have to comply with quality guidelines and undergo different stages of assessment. Projects submitted to the OCAD must comply with the following four characteristics:

- Pertinence: The project has to be coherent with the specific conditions and socio-economic, cultural and environmental needs of the territory where it is implemented. In addition, investment projects need to be coherent with the National Development Plan, with the department or municipal development plan, and/or with the development plans established by minorities.
- Impact: The project must contribute to the overall territorial or sectorial goals and comply with the general objectives of the system of royalties.

- Viability: The investment project has to respect legal, technical, financial, environmental and social aspects under the SGR.
- Financial sustainability: The department or the municipality presenting the investment project must guarantee that the project is financially sustainable in the long run, as are the funds to run it.

Under the law that established the SGR, investment projects applying for royalty payments matching the technical requirements listed above were to be scrutinised by a public/private advisory committee nominated by the OCAD.[15] The advisory committee was to involve municipal or department representatives (civil servants), representatives of the local business community and citizen organisations. However, as of the time of writing, advisory committees had not been implemented.

An investment project that requires co-financing from the central government follows a slightly different process. It is worth recalling that direct royalty payments are regional funds. According to Colombia's Constitution, natural resources are owned by departments and municipalities, and royalty payments are intended to compensate sub-national levels for the development of their natural resources. This means that the SGR is a policy framework to use regional funds to promote regional development. The SGR only finances capital investment, and operating costs of an investment project must be covered by other sources of financing. The construction of a school, for example, generates operating costs related to teachers' salaries. The sub-national government must ask the sectorial ministry (the Ministry of Education, in the case of a school) to co-finance the investment and cover the operating cost. In such a case, the DNP is responsible for evaluating whether the central government is in fact co-financing the project. If information is incomplete or technical details are missing, the project is sent back to the sub-national government for amendment or additions. Once these steps have been taken, the OCAD may give final approval to the project.

Monitoring and evaluation are embedded in the system

The SGR allocates 1% of the overall royalty payments to support the supervision, monitoring and evaluation of the system. Half of this 1% is allocated to the Comptroller General's Office (*Contraloría General de la Republica*), which carries out fiscal surveillance of the system. The DNP collects, analyses and verifies information about accounts and the performance of project investments, with the goal of preventing, correcting or, if necessary, imposing sanctions for improper, inefficient or illegal use of the funds. The DNP has created two parallel divisions in charge of managing the processes connected with the SGR. One is in charge of supporting investment while the other deals with the evaluation of all investment projects.

The system for monitoring and evaluation acts selectively and with a preventive approach. The monitoring process consists of the collection, consolidation, analysis and verification of the information concerning the management and execution of the investment projects. Sub-national authorities have to provide accurate, timely and appropriate information to the DNP, and on this basis, ask it to modify the project and even if necessary, impose disciplinary procedures.

Evaluation is conducted on selected investment projects. Its aim is to assess the way in which the project has been managed and its capacity to deliver, compared with the goals set by the initial proposal. The evaluation will also verify the evolution of the project within two years of its implementation. The DNP also monitors investment

projects to prevent, correct or punish improper, inefficient, ineffective or illegal use of funds. In particular, the system can impose sanctions, such as: withdraw approval for the investment project; appoint temporary administrative managers to implement the project and fine sub-national authorities that misused the funds.[16]

A focus on regional innovation systems

The SGR promotes innovation in all regions. As noted, 10% of the overall royalty revenues are allocated to the STI Fund. According to a recent OECD assessment (OECD, 2014a), Colombia's innovation system is highly concentrated in a few urban poles. For instance, bibliometric output suggests that 6 universities (out of 81) accounted for over 60% of Colombia's scientific publications over 2000-11. Non-academic research institutes follow the same pattern and are also concentrated in major cities. The new focus on regional innovation could help reduce these regional disparities and promote a more even distribution of regional research systems across Colombia.

Evidence from OECD countries suggests that learning and innovation capacity is a key source of regional competitive advantage. Moreover, innovation processes have a strong territorial feature (OECD, 2007; 2009a; 2009b). In OECD countries, efforts have been made to connect the public sector with academia and business within regional innovation systems (the so-called "triple helix"). These stakeholders have helped design innovation strategies that take into account the specific needs of users.

The SGR promotes capacity building at the sub-national level

The SGR puts particular emphasis on capacity building at the sub-national level. For instance, one of the challenges of the previous system of royalties was that sub-national governments often lacked the capacity to manage additional funds. The lack of capacity, in turn, generated misuse of public funds. The new system specifically allocates 2% of total funds to capacity-building activities. Part of this is directly allocated to strengthen the capacity of the OCADs and of planning units within departments and municipalities. As a result, in 2013-14, the system will devote USD 30 million to the planning capacity of territorial entities. This represents about USD 25 000 per municipality and USD 64 000 per department.

The DNP has also conducted a lengthy series of workshops and seminars with sub-national civil servants to brief them on the details and requirements of the SGR, and help them formulate projects. Investing in capacity building will not only help improve the performance of the SGR, but will also enhance the capacities of sub-national governments to deal with policy design and implementation. The SGR may thus generate a self-reinforcing dynamic in which sub-national governments can help the central level deliver new and more complex public policies to support sustainable and inclusive development in Colombia.

Through the SGR, Colombia has created a stabilisation fund

The SGR is connected to a Savings and Stabilisation Fund (FAE) to share the proceeds from Colombia's natural resources across generations. The FAE is managed by the Central Bank of Colombia, which is a signal of its independence. Moreover, the FAE was introduced with a new fiscal "golden rule" (June 2011), which will further protect Colombia's economy from the boom and bust of commodity prices. Once fully implemented, the FAE will absorb up to 30% of the total royalty revenues. In particular, the FAE will also accumulate revenue windfalls (i.e. extra revenues from the growth of

the economy or from commodity prices that rise above their long-term level) to finance counter-cyclical fiscal policies during economic downturns. In 2012, 25% of the total revenue generated by the SGR was allocated to the FAE. In the future, this percentage will grow proportionally with the expected increase in royalty revenues (OECD, 2013b). Up to 10% of the budget allocated to the FAE in the previous year can be used to set up counter-cyclical investment programmes. These investment programmes will be shared among territorial entities in the same proportions as the Regional Compensation Fund and the Regional Development Fund.[17]

International experience suggests that a stabilisation fund can help stabilise growth and maintain competitiveness. Counter-cyclical expenditure and stabilisation tools can prevent price volatility from resulting in macroeconomic instability that also harms non-extractive sectors. The Government Pension Fund in Norway and Chile's stabilisation funds are good examples of how extractive-intensive OECD countries can combine the development of raw-material sectors with stabilisation measures to ensure balanced development through benefits derived from the oil and copper sectors respectively (Box 3.3).

Box 3.3. **Stabilisation funds: The experience of Chile and Norway**

Economies that rely on income from natural resource extraction face a number of challenges. Volatile international prices mean that government revenue from taxation of the sector is necessarily cyclical: tax revenue is high when the prices of metals or oil are high, and low when they fall. This may have a destabilising effect on the economy overall, owing to greater consumption and government spending in boom periods, and low consumption, high unemployment and, potentially, the inability to continue government outlays during a bust. Moreover, the exchange rate of economies that rely heavily on their oil/mineral exports may be strongly affected by a substantial rise in the value of their exports. To confront these challenges, strong mechanisms for revenue management are essential. One way to create stable conditions over time for government expenditure is to use stabilisation funds, but for such funds to be effective, incentives need to be built in so that political leaders are not tempted to raid them (Humphreys, Sachs and Stiglitz, 2007: 325). Two of the best-known examples of stabilisation funds are those of Chile and Norway.

Chile's fiscal finances are heavily dependent on the volatile price of copper, its leading export. In the past, the volatility of the price of copper had had an extremely negative impact, and in 1987, the Copper Stabilisation Fund was set up, partly to insulate fiscal revenues from cyclical fluctuations in the price of copper. When this rises above a certain target, the extra revenue is deposited in the fund and is not available for the budget. Similarly, when it falls below a certain target, the revenue shortfall in the budget is compensated for through withdrawals from the fund. In September 2006, the Chilean Congress approved a new Fiscal Responsibility Law (FRL), an important step in strengthening its fiscal framework (de Mello, 2008). This created a legal framework for the structural balance rule; created a Pension Reserve Fund to address pension-related contingencies; transformed the Copper Stabilisation Fund into a broader sovereign wealth fund called the Economic and Social Stabilisation Fund, and introduced explicit, formal mechanisms for capitalising the central bank. The Ministry of Finance regulates the investment of revenue collected through taxes with advice from a Financial Committee, and the Central Bank of Chile is designated as asset manager. Detailed reporting on the investments undertaken, return on investments and the positions of the funds is conducted monthly by the Ministry of Finance.

Box 3.3. **Stabilisation funds: The experience of Chile and Norway** (*cont.*)

Sound macroeconomic management has allowed the Chilean government to run counter-cyclical fiscal policies. In 2001, it adopted a structural fiscal rule stipulating that the government maintain a structural surplus equivalent to 1% of GDP, a percentage that was relaxed in 2008 to 0.5% of GDP, and was further reduced to 0% to allow for a fiscal stimulus during the crisis. The rule was suspended *de facto* in February 2010 due to the earthquake. The government now targets a structural deficit of -1% of GDP by 2014. This structural balance rule involves estimating the fiscal income that would be obtained net of the impact of the economic cycle, and in particular of commodity price cycles, and spending only the amount that would be compatible with that level of income. It is calculated using projected government revenue when the prices of copper and molybdenum, a by-product of the production of copper, are at a sustainable level over the long term, defined as ten years, and GDP growth is at a sustainable medium-term rate. These rates are determined by an independent panel of 20 members of the private sector and academia, as well as (in the case of the price of copper) representatives of COCHILCO, the copper advisory agency, and CODELCO. Every year, at least three members of this committee are replaced to ensure an orderly turnover. Chile's economic outlook shifted drastically during the world economic crisis in the last quarter of 2008. Nevertheless, the structural surplus and the stabilisation funds accumulated during the profitable years were used to launch a fiscal stimulus package in January 2009, which boosted public investment programmes and transfers. This stimulus included investments in infrastructure, small enterprise development and subsidies to low-income households. The Chilean stabilisation fund represented 5.5% of GDP in 2011, down from 13% in 2008.

In Norway, the Government Petroleum Fund was established in 1990 to build up financial reserves to preserve an equitable share of petroleum revenues for future generations and to prevent short-term fluctuations in the oil price from influencing spending in the current and following year's budget. The fund is fully integrated into the state budget, and net allocations reflect the total budget surplus (including petroleum revenues). It remained empty until 1996, as a result of the recession of the early 1990s, but has seen a rapid build-up in assets in recent years. The government decided in 2005 to establish the Government Pension Fund, which includes the former Petroleum Fund (renamed the Government Pension Fund – Global, or GPFG) and the National Insurance Scheme Fund (renamed the Government Pension Fund – Norway). Its real return is to provide a partial prefunding of future pension liabilities. This fund mainly transforms depleting oil and gas resources into financial assets.

The rationale is that since this wealth belongs to present and future generations of Norwegians, the capital should be preserved, and only the returns consumed, to allow future generations to choose how to allocate these earnings. The so-called 4% rule stipulates that the central government deficit excluding petroleum revenues and adjusted for the cyclical position of the mainland economy should, over time, equal 4% of the value of the GPFG at the end of the year prior to the budget year. A non-petroleum structural deficit equal to 4% of the GPFG is not a binding target for any particular year. The government is free to deviate from it under various circumstances, notably when discretionary fiscal action seems necessary to stabilise the economy, or when the value of the GPFG changes erratically. The Ministry of Finance projects the value of the GPFG to increase from about 160% of mainland GDP at the end of 2011 to about 185% by 2025.

Sources: OECD (2009c), *OECD Territorial Reviews: Chile 2009*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264060791-en; IEA (2009), *Chile Energy Policy Review 2009,* OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264073159-en; Korinek, J. (2013), "Mineral resource trade in Chile: Contribution to development and policy implications", *OECD Trade Policy Papers*, No. 145, OECD Publishing, Paris, http://dx.doi.org/10.1787/5k4bw6twpf24-en; OECD (2012c), *OECD Economic Surveys: Norway 2012*, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_surveys-nor-2012-en.

The system avoids over-expenditure at the sub-national level

The SGR is designed to avoid over-expenditure of royalty revenues. Sub-national authorities are allowed to accumulate unspent funds from previous years, as the budgeting period is organised over a two-year period. As noted, sub-national governments can accumulate unspent royalty funds across their annual budgets. This dramatically reduces the pressure on sub-national authorities to spend the funds linked to the SGR, and also reduces the risk of over-expenditure. This system also offers shelter to departments and municipalities that suffer from low institutional capacity and have difficulties using the new system of royalty payments.

Conclusions

Streamline the multi-level governance framework for the SGR to improve the scaling up of investment projects

The majority of investment projects financed by the SGR scheme are small-scale projects implemented by municipalities. However, the size of Colombia's 1 102 municipalities is too small to promote regional growth. They are not large enough and, often, of insufficient capacity to design and implement viable development strategies. For this reason, the SGR system allocates 60% of the Regional Compensation Fund and the overall Regional Development Fund to large-scale regional projects. Meanwhile, these funds are under-utilised by departments, given the lack of governance mechanisms and incentives for collaboration. This may influence the new system's capacity to generate regional development, and may require rethinking of the governance framework linked to the SGR.

The current scheme leaves some confusion about the level of intervention. The OCADs are held at three different territorial levels, and a multitude of different territorial units exist that serve other purposes.[18] Some of these levels correspond to constitutionally designated tiers of government, while others are used for planning, often in *ad hoc* ways. In particular, the poor performance of the regional level may depend on three connected factors. First, there are no regional political bodies that can give their support to a specific large-scale project and balance the transaction costs related to the design and implementation of large-scale, multi-actor projects. Second, regional OCADs encompass a large and diverse membership; some participants may lack basic information about opportunities and needs of territories within the region. In other words, some of the members of the regional OCAD, e.g. governors and mayors from departments and municipalities that are not directly involved in a given proposal for a regional-scale project, could be unfamiliar with the specific challenges and investment opportunities that the project involves. As a result, they may be unable to prioritise regional investment. Third, the SGR poses some limits on the possibility of co-ordinating funds from direct royalty payments (which are approved by departmental OCADs) with the Regional Development Fund and the Regional Compensation Fund (which are administered by regional OCADs). Because of the limits on co-ordinating direct royalty payments with regional funds, and also due to the complex governance of regional OCADs, departments prefer to focus on funds allocated by department OCADs, where they are in full control of the situation and the political bargain.

Greater clarity could be brought into this complexity, bearing in mind that the territorial viability of the unit of intervention is vital for development strategy. The SGR needs to focus on larger territorial units, and departments and regions are the obvious

choice. However, their potential and capacity varies enormously, depending not only on their current level of development and location, but on their constitutional mandate. Departments are enshrined in the Constitution and have elected governments. For regions, on the other hand, institutions for development and planning would have to be created. Establishing a permanent regional council that could select and implement development strategies for a number of departments would be a first and crucial step. Such a council would need to include not only representatives from the different departments, but also mechanisms to give greater voice to civil society and business.

Alternatively, national authorities could consider generalising the use of *Contrato* plans (and other instruments for co-ordination) to encourage co-ordination among different departments. So far, only one *Contrato* plan involves a group of departments, but it could be worth replicating this scheme. The national government could promote the use of contracts by co-financing regional projects. National co-financing would be consistent with the fact that regional projects often involve the development of major infrastructure, for example, primary road networks, which fall under the responsibility of the national government. More extensive national co-financing would also increase the incentive for departments to merge their efforts in large-scale projects. Finally, municipalities could be enlisted to contribute to regional investment projects, by helping to disseminate the successes of regional projects at the local level.

Move from a project-based to a programme-based system

The current project-based system needs to be replaced by medium-term programming. This would entail developing a vision for every territory and co-ordinating the different instruments of intervention. To become effective, this would require the co-ordination of intervention at the different territorial levels (regional and departmental), as well as the co-ordination of the individual programmes with the National Development Plan for Colombia.

In particular, a comprehensive vision of regional development would help co-ordinate sectorial policies at the local and regional level. Evidence from OECD countries demonstrates how integrated policy packages can support growth (OECD, 2012d). Regional economic performance depends on a combination of factors, including demography, industrial mix, productivity, regional accessibility, physical and human capital, and innovation capacity. The impact of a given policy intervention, say transport infrastructure, on the development of a given territory will depend on local stakeholders' capacity to frame this initiative in a broader policy packaging affecting human capital or business development.

Such a vision needs to be supported by sound information on territorial features and trends, challenges and opportunities. The SGR is currently testing a system of spatial information to track the use of investment projects related to royalty payments. Once fully operational, this system will be connected to an Internet platform that makes it possible to visualise the following information at each sub-national level: *i*) the number of projects; *ii*) the amount of investment; *iii*) the economic sectors that are the target of policy interventions; and *iv*) the level of implementation of the project. This information is public, helping to make the SGR more transparent. The Colombian government could consider improving this tool and integrating the current information with data about projects and policy interventions financed not by the SGR but by such sources as transfers from the central government (*Sistema General de Participaciones*) and sectorial investments by ministries. This would provide national and sub-national authorities with

a more coherent vision of Colombia's regional development policy. Certain international examples illustrate the value of a holistic approach to spatial data, as for instance Chile Indica (Box 3.4).

Box 3.4. **Chile Indica, an integrated web platform displaying data on investment in Chile**

Chile Indica is an information tool for disseminating and managing the flow of investment data from the various investment institutions at the regional and central levels. An online site, it allows all levels of government, central and sub-national government institutions to track investment information in a transparent and timely fashion. The system makes it easier to present an overall view of the measures being undertaken in the territory, enhances communication between both territorial and sectorial public institutions, and facilitates synergy between different investment initiatives and sources. This system was created and is monitored by the Sub-secretariat for Regional Development of Chile (SUBDERE). It started as a pilot project in the region of Arica Parinacota in 2008 and was extended to the whole country in 2010. It now has 15 databases, one per region.

This tool seems to be progressively allowing certain regions to strengthen the links between regional investments and regional development strategy. For example, the region of O'Higgins has actively been trying to link all the investments of the *Fondo Nacional de Desarrollo Regional* (FNDR) and the sectoral ministries with the areas and concrete objectives defined in its regional development strategy. This tool, used correctly, could result in synergy between the different investment sources, making it possible to know what other agencies are doing in a given territory.

One of Chile Indica's goals is to open a channel of information to the public, to enhance democracy, promote citizen oversight, support decentralisation and increase the transparency of public service. A SUBDERE team is also developing tools for the network to make it possible to access investment information online through reports, maps and databases.

Source: OECD (2014b), *OECD Reviews of Rural Policy: Chile 2014*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264222892-en.

Make the SGR a tool for improving bottom-up policy making and citizen participation

To ensure the success of development initiatives, the support and engagement of the local population is vital. Channels that allow local stakeholders and civil society to participate need to be set up so development can occur from the bottom up. This means identifying relevant stakeholders and the creation of local fora that can feed ideas, information and energy into the decision-making process.

Although significant progress has been made in the decentralisation process, with abundant transfers of powers to departments and municipalities, questions remain about the real level of autonomy of sub-national entities in Colombia. Since the mid-1980s and, especially since the approval of the 1991 Constitution, departments and municipalities have, at least on paper, acquired significant authority. Departments and municipalities now play an important role in economic development. The departments have the right to plan and promote economic and social development within the territory and to provide technical assistance to municipalities. Local governments' powers are even greater. They provide public services, play a key role in public works, manage development and promote citizen participation. According to the DNP, Colombian sub-national governments now manage more than 70% of total public investment.

However, the autonomy of Colombia's sub-national tiers of government is curtailed both by the absence of real funding and a limited capacity to dispose of the funding. As in many instances of decentralisation, the transfer of power from the top has not been supported by the means to implement those powers, generating a situation of unfunded mandates that is jeopardising the implementation of the new royalties system. After decades of top-down sectorial policies and of key decisions taken by ministries in Bogotá, and after years of armed conflict, many peripheral areas do not have the civic associations and groups that would allow civil society to assist in the development process.[19]

Colombia's departments and municipalities are required to design a development plan that reflects the National Development Plan (OECD, 2013b). The SGR capitalises on the presence of these plans and requires that sub-national governments design investment projects according to the development strategy identified in their development plans. Unfortunately, the planning system in Colombia faces a series of challenges. One is that sub-national authorities consider the planning activity simply a formal exercise. Planning at the sub-national level has often been transformed into a bureaucratic activity. Sub-national authorities consequently do have not a long-term, co-ordinated development strategy to follow as they prepare their investment projects for the SGR, and they often focus on basic projects that are replicated over time. Investment projects are also replicated across regions, restricting the possibility of tailoring investment to local needs, one of the pillars of the SGR.

In this context, Colombia's government might consider introducing an extensive consultation process involving sub-national entities, business and citizen organisations in the departments and the six regions created by the SGR. It is worth noting that the current consultation processes for the design of the four-year National Development Plan leave only a marginal role to sub-national entities in the selection of policies with an impact on their territories. Existing consultative bodies, such as the National Planning Council (*Consejo Nacional de Planeación*) or the territorial planning councils (*consejos territoriales de planeación*), may have a more relevant role in the planning process (see Chapter 7). The government should consider introducing regional and local consultation for bodies backed by regional institutions, such as the regional councils or Regional Observatory. The DNP should play a leading part in making it possible for sub-national entities and civil society to influence national strategy on the allocation of public investment.

Promoting capacity building and technical assistance at all levels of government

The DNP supports the SGR by providing sub-national levels with capacity building, but more could be done. With some exceptions, many local and departmental governments lack the adequate technical, managerial and even political capacity to lead the development process. This is one of the main factors suppressing the level of investment implemented in connection with the funds allocated by the new system of royalties, and also the quality of the territorial projects. Sub-national governments tend to focus on repeating basic projects that have already been undertaken. Investment projects are also replicated across regions, which makes it difficult to tailor investment to local needs. In addition, since there is a degree of correlation between the economic performances of a given territory and its institutional capacity, the poorest territories most in need of public investment are also those that cannot take advantage of the additional revenue provided by the SGR. Some departments, like La Guajira, Meta or Risaralda, have a share of approved projects well above 80% of their budget. Conversely,

departments like Amazonas, Guaviare or Valle del Cauca have a much lower share, at about 35% of their assigned budget.

Capacity building should involve both training local civil servants and decision makers, and setting up the basic institutions to allow for greater transparency and participation of local stakeholders. A project funded by the World Bank to create and strengthen institutional capacities for territorial development represents a first symbolic and necessary step towards improving stakeholder involvement and good governance at a sub-national level in Colombia's departments and 50 municipalities. Its four components – long-term strategic planning, improvement of territorial management, technical assistance for local development, and control and management of public intervention at the sub-national level – are the pillars on which to build capacity and improve the delivery of bottom-up development policies across the poorest, most remote areas of the country.

The SGR could also deliver targeted capacity-building measures and assistance to improve the technical skills available in sub-national governments.[20] For instance, these could help municipalities and departments prepare operative annual plans of investments (*plan operativo anual de inversiones*). These plans activate the actions listed in the local development plan by including them in the annual budget of the sub-national authority. In other words, such annual plans prioritise local investment. It would thus be worth improving the quality of these plans and the underlying processes.

Good and well-informed operative investment plans could be used to inform the OCADs and help them select and prioritise investment projects. The OCADs could also use operative investment plans to identify projects with the greatest potential impact on local development and help sub-national authorities implement local development strategy.

Operative investment plans would also enhance the co-ordination of different policies, for instance, between direct central-level transfers and royalty payments. Effective prioritisation of investment projects would encourage synergy among the interventions within development plans. This could help move the system towards a programme-based framework.

Challenges related to the low institutional capacity of sub-national governments are common in OECD countries. This reflects the increasing decentralisation of government power that allocates more and more responsibilities to territorial levels. For this reason, the OECD (2009d) has developed a set of basic principles that governments should take into account when designing and delivering capacity-building interventions. These are the following:

- efficient multi-level governance arrangements for co-operation and co-ordination
- the progressive relaxation of regulatory constraints that hinder the adaptation of territorial entities to local requirements
- the gradual implementation of a framework of "learning by doing" by offering technical assistance and capacity building and a progressive transfer of responsibilities
- the use of performance management mechanisms and indicators to monitor the processes
- the direct participation of sub-national governments in defining the skills that training programmes should deliver.

Streamline the approval process of investment projects

Capacity building and technical assistance should go hand in hand with simplifying the operation of the SGR framework and, in particular, the approval process. According to some local stakeholders, the selection criteria the OCADs use to approve and comment on a given investment project could be more clearly specified.[21] These stakeholders also argue that the approval process related to the Regional Development Fund and Regional Cohesion Fund is complicated by the fact that each project has to be pre-approved by the DNP. National authorities could consider allowing selected sub-national authorities to self-evaluate projects without submitting them to the DNP beforehand. Meanwhile, the DNP could still supervise the evaluation of the project investments submitted by sub-national authorities that did not have the capacity to self-evaluate their projects, although this should be considered a temporary solution. Locally based bodies co-ordinated by the DNP, for instance, could help departments and municipalities self-evaluate projects.

The way the OCADs operate could also be improved. The OCAD meetings are now called at the request of one of the three parties that participate in the evaluation of projects. No calendar or criteria are specified determining the minimum number of projects required for such a meeting. Evidence collected in the field indicates that this reduces the OCADs' capacity to develop an overall vision of regional and local development strategy. The central government could consider the possibility of establishing a calendar for the OCAD meetings, with the possibility of holding additional sessions when a large number of investment projects are generated in the same territory. This calendar could also factor in the annual budgeting process for sub-national authorities, to facilitate co-ordination between overall revenue and investment.

Make decentralisation actionable by enhancing fiscal autonomy at the sub-national level

The devolution of power called for under Colombia's Constitution has remained largely on paper. The autonomy of sub-national tiers of government is curtailed both by the absence of adequate funding and a limited capacity to dispose of the funding freely. As in many cases of top-down decentralisation, the transfer of powers from the top has not been backed by funding for adequate implementation, generating unfunded mandates that jeopardise the success of the new royalties system.

One of the key principles of the SGR is that royalty revenues can only fund capital investment projects. This in itself should be adequate, given the non-recurrent nature of the royalties system. However, due to the limited own revenues available to most sub-national levels, this mechanism limits the sub-national governments' ability to implement genuinely autonomous development projects. Most capital investments – from the building of new roads or railways to the foundation of schools or hospitals – require recurrent expenditures over time. Since these expenditures can only come in the form of transfers from the central government, the system gives national ministries a *de facto* veto power over local development initiatives. Transfers from the national government are also very inflexible. Not only are they earmarked for a specific sector, such as education, health or water sanitation, but sub-national governments – due to the lack of updated territorial statistics – have received the same amount of transfers since 2005, the year of the last national Census. The system thus has no way to evaluate whether the needs of a given municipality, for instance, have evolved in the last decade.[22]

This situation can only be rectified by the use of own resources by local or departmental governments, i.e. by local taxation or debt. However, the capacity of sub-national tiers of government to generate their own funds can be limited (OECD, 2013a). Because of the differences in development and in wealth across Colombia, municipal and departmental tax revenue varies enormously. Typically, large urban municipalities and wealthy departments with a concentration of firms and economic actors enjoy greater tax revenue than more remote and impoverished municipalities and departments.[23] Except for the largest departments and municipalities, capacity to generate autonomous development strategies at the sub-national level is constrained by the need to reach agreement on recurrent funding with the relevant national ministry for most projects funded through the royalty scheme.

For these reasons, Colombia's government could consider introducing some flexibility in the SGR and, in certain circumstances, allowing sub-national authorities in the poorest territories to finance operating costs. This option should be limited to sub-national governments with low tax revenues. Priority should be given to projects that, while generating operating costs, are likely to improve "enabling conditions" for business. This would affect tax revenues in lagging territories in the medium term.

Finally, and along with enhanced fiscal autonomy, Colombia's government could also consider fine-tuning the current formula allocating royalty revenues to territories, and include indicators that measure how rural they are. At the moment, the formula, illustrated in Annex 3.A1, does not account for the additional cost of delivering public services and maintaining physical infrastructure in rural areas with dispersed settlement patterns.

Link efforts to improve innovation with business development

The STI Fund, within the SGR, aims to deconcentrate innovation capacity in Colombia, and support the creation of regional poles of science and technology. However, the STI funds display low utilisation rates. In 2012, only 52% of the budget allocated to STI was allocated. This compares with the investment projects submitted in connection with the direct royalty payments that absorbed 89% of the available budget (OECD, 2014a). Departments with limited innovation capacity often propose investment and projects that fall outside the mission of the STI Fund. The result is missed opportunities for developing capacity across regions, fragmented projects, and possibly losing out on opportunities to build critical mass and resources that follow the boundaries of natural resources or clusters of industry rather than administrative boundaries.

To promote a regional innovation system, national authorities might consider the following actions:

- Promote a place-based approach to innovation, detecting potential co-operation poles, territorial platforms and clusters. Inspiration for possible co-ordination mechanisms can be sought in the "smart specialisation" approaches to regional STI policy popular in Europe (see OECD, 2014a).
- Involve different types of regional and local stakeholders in the design of innovation policy: regional universities, research institutes and above all business, including small and medium-sized enterprises (SMEs) and agricultural co-operatives. Actors in science and technology can be brought together with actors not generally associated with innovation who can be not only a critical source of innovation but also first users of new technologies.

- National authorities in charge of the SGR may consider shifting royalty payments from the STI Fund to support the creation of enabling conditions for research and innovation, including capacity building. Research conducted in European regions (Rodriguez-Pose and Crescenzi, 2006) has shown that peripheral regions may need investment in education and training more than support for R&D activities. In fact, in such areas, investment in R&D may not yield the expected returns, due to poor framework conditions. Investing in local capacity to assimilate knowledge spillovers rather than in knowledge production is more likely to encourage development in peripheral regions (Rodriguez-Pose and Crescenzi, 2006).

The SGR devotes 2% of overall royalty payments to promote extractive activities, yet resource-rich regions in Colombia suffer from important social and infrastructure gaps. For instance, the departments of Boyacá, Huila and Meta still face major deficits in transport infrastructure. The department of La Guajira's performance in education and in power outages is poor, even though it is one of the departments that produces electricity for the rest of the country. The example of several other countries suggests that providing these departments with better public goods and services could also improve their productivity and the competitiveness of their extractive industries (Box 3.5).

Box 3.5. **The importance of infrastructure, human capital and knowledge in resource-based territories**

The provision of the right skills, transport and energy infrastructure are crucial requirements for optimising the potential of extractive industries and regions. Infrastructure is crucial for resource and non-resource sectors and a particular challenge for land-abundant countries. In particular, transport and energy infrastructure are essential for the development of competitive mining, oil and gas sectors. Moreover, addressing infrastructure needs can boost productivity and offer opportunities in other sectors. In Australia, the provision of water pipelines to gold mines in the interior of the country also enabled land irrigation and the development of significant wheat production (Doepel and Bolton, 2013). Roads and railways to large mining sites can bring much-needed transport infrastructure to remote areas. Where ore processing requires the construction of new power-generating capacity, this can also benefit the wider economy in the area. Partnering with resource-extraction firms to generate more energy than is needed for processing alone could have a large impact on the electricity supply in many developing countries.

Investments in human capital and applied research and development play a crucial role for the resource sectors and structural transformation. The takeover by the United States of world leadership in manufacturing was propelled by the research and education institutions originally established to serve the mining industry. The developments in the mining sector were accompanied by a continuous process of research and learning, which generated technological progress, brought down costs and resulted in the expansion, rather than the depletion, of natural resource stocks. The United States Geological Survey (USGS), a large-scale governmental science project, for example, provided detailed maps of great practical value to miners, as it was highly responsive to their needs. The provision of engineers from schools designed to train mining specialists, such as the Columbia School of Mines, further promoted the expansion of the sector. These mining schools, which later evolved into the University of California at Berkeley and Stanford University, among others, became the basis for technology-driven development in many industries and laid the foundations for structural transformation (Wright and Czelusta, 2004). In Sweden, structural transformation based on the resource sectors was driven by government intervention in research and education. The focus of universities was shifted towards natural sciences, and newly founded technical institutions soon became a source of innovation. Vocational training institutions ensured the dissemination of knowledge and supply of qualified technical personnel. Moreover, study trips and training of Swedish engineers abroad facilitated technology transfer. Later, the long-term focus on technological upgrading and exchange paved the way for the emergence of the telecommunications sector (Blomström and Kokko, 2007).

Box 3.5. **The importance of infrastructure, human capital and knowledge in resource-based territories** (*cont.*)

A growing number of studies of developed and developing economies have indicated that the negative growth implications commonly thought to be associated with high levels of specialisation in commodity production are contingent on other factors, such as low levels of investment in human capital and the absence of institutions that facilitate the adoption and creation of new technologies. Australia, Canada, New Zealand and other OECD countries with significant resource bases have clearly benefited from them, while largely containing potential negative effects on other parts of the economy. They have done so, to various degrees, by knowledge upgrading and investment in resource-based industries, by leveraging resource bases into related industries, and by investing in knowledge creation via knowledge infrastructures.

Sources: OECD (2013c), "Policy dialogue on natural resource-based development", Scoping Paper, DEV/GB(2013)6, OECD, Paris, available at: www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DEV/GB(2013)6&docLanguage=En; OECD (2014a), *OECD Reviews of Innovation Policy: Colombia 2014*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264204638-en; Doepel, D. and G. Bolton (2013), "Extracting the value from the extractive industries: Insights from the Australian experience", *GREAT Insights*, Vol. 2/2, pp. 13-14; OECD (2013e), *African Economic Outlook 2013: Structural Transformation and Natural Resources*, OECD Publishing, Paris, http://dx.doi.org/10.1787/aeo-2013-en; Wright, G. and J. Czelusta (2004), "The myth of the resource curse", *Challenge*, Vol. 47/2, pp. 6-38; Blomström, M. and A. Kokko (2007), "From natural resources to high-tech production: The evolution of industrial competitiveness in Sweden and Finland", in: D. Lederman and W.F. Maloney (eds.) (2007), *Natural Resources: Neither Curse nor Destiny*, a co-publication of Stanford Economics and Finance, imprint of Stanford University Press and The World Bank.

To overcome this situation, Colombia could consider using the STI Fund to incentivise innovation and competitiveness in the extractive activities. The case of the Energy Technologies Program in the province of Alberta in Canada is particularly relevant, and represents a good practice that illustrates how the government and oil companies can co-operate to enhance the competitiveness of extractive industries in resource-based regions (Box 3.6). For instance, in Alberta, the government asks oil companies to present innovative projects in their sector. The government scrutinises these pilot project initiatives and compensates the most innovative company by reducing by 30% the yearly amount of the royalty it has to pay to the provincial government. The introduction of more refined technologies for extracting natural resources, in turn, boosts the output and hence the royalty payments collected by the government.

Box. 3.6. **The Innovative Energy Technologies Program (IETP) in Alberta, Canada**

In 2004, the government of Alberta announced the Innovative Energy Technologies Program (IETP), which supports innovation, research and technology development to increase oil and gas recovery from existing reserves. The IETP is a CAD 200 million commitment by the Alberta government to provide royalty adjustments to pilot and demonstration projects that use innovative technologies to increase recoveries from existing reserves and encourage responsible development of oil, natural gas and *in situ* oil sands reserves.

The programme's objectives are:

- increasing the recovery from oil and gas deposits resulting in incremental production and royalties

Box. 3.6. **The Innovative Energy Technologies Program (IETP) in Alberta, Canada** (*cont.*)

- finding a flexible commercial technical solution to the gas over bitumen issue that will allow efficient and orderly production of both resources, improving the recovery of bitumen resources by *in situ* technologies
- improving recovery of natural gas from coal seams
- disseminating technology and information developed through the projects supported by this programme.

Successful applicants receive a royalty adjustment of up to 30% of approved project costs. Industry must provide the remaining 70% or more of total project costs. It is anticipated that successful technologies supported by this programme will enhance resource recovery and increase royalties to fully recover, over time, the costs of the programme. The total industry/government commitment to important new technologies, assuming full subscription of the programme, will be CAD 1.15 billion with Alberta Energy, the Ministry of Energy of the province of Alberta, contributing CAD 195 million in royalty credits, with industry contributing the remaining CAD 955 million.

The IETP has contributed to some of the largest economic and technical successes in enhanced oil recovery through its support of the first field-wide polymer flood in Canada. Additionally, the IETP also funded the first Steam Assisted Gravity Drainage project in a carbonate rock formation in Alberta, with the potential to tap into an additional 300 billion barrels of bitumen.

Source: Information provided by Western Economic Diversification Canada; www.energy.alberta.ca/768.asp.

Notes

1. This is English billion (short scale).
2. The list of regulations and laws related to royalty payments provided in this report does not intend to be exhaustive, but it provides an overview of Colombia's approach to this matter over the last century.
3. See: www.ecopetrol.com.co/especiales/Libro60anios/esp/cap8-1.htm.
4. Together with other historical departments, such as territorial units, *intendencias* and *comisariatos*.
5. The royalties to be paid to sub-national entities were much lower in the case of the Colombian Enterprise of Petroleum: between 9.5% and 7.5% to departments and 2% to municipalities.
6. Under the 1994 law, earmarks totalled 50% of the direct royalty payments to departments and 80% of direct royalty payments to municipalities. Subsequent legislation modified these percentages. The 2002 law changed to 60% in the case of

departments and 75% in the case of municipalities. Resources were earmarked only until departments or municipalities reached certain minimum standards related to education, health, potable water and infant mortality. Moreover, minimum standards were established as fixed goals for all sub-national entities. For instance, the law required departments and municipalities to reach 100% of enrolment of children 6-14 years old and 85.8% of sewage coverage. This did not take into consideration the conditions in each territory.

7. This figure accounts for direct royalty payments and funds allocated by the NRF. It does not include the Territorial Pension Savings Fund (FONPET), the Stabilisation Fund (FAEP) or the funds allocated to non-territorial beneficiaries.

8. Note that data on poverty rates are available for only 24 out of 33 Colombian departments. In particular, no data for Casanare and Arauca are available.

9. It is possible that these targets for service delivery were not achieved, given the existence of conflicting incentives. The 1994 law stipulated that most direct royalty payments be earmarked until departments and municipalities reached minimum standards. It should also be noted that targets were set at the national level, without being discussed preventively with sub-national authorities.

10. The production of coal and other minerals, like nickel or gold, has increased at a rapid pace since 2000. Coal production in 2011 was more than double that of 2000 (Olivera and Perry, 2009; Ministry of Mines and Energy, 2011). Oil experienced a boom: the average current international price of a barrel in 2010 was three times that in 2002 (López et al., 2012).

11. This index uses a group of indicators including: housing, critically overcrowded; housing with inadequate services; households with high economic dependence; households with school-age children not attending school. See: www.dane.gov.co/index.php/estadisticas-sociales/necesidades-basicas-insatisfechas-nbi.

12. The system also considers minimum thresholds to 2020. In the period 2015-20, producing entities will receive at least 35% of the annual mean of direct royalties, less discounts, allocated in the period 2007-10. However, in case direct royalties fall below this threshold, the amount allocated to compensate them will be moved from their resources assigned to the Regional Development Fund. The compensation will thus only mean having more flexibility to use resources allocated to them.

13. This refers to the eight departments that received at least 5% of the total royalties resources for investment in the period 1994-2011: Arauca, Casanare, Cesar, Cordoba, Huila, La Guajira, Meta and Santander.

14. In 2012, when the new system was instituted, projects presented to the Regional Development Fund, the departmental projects of the Regional Compensation Fund, and those of the Science and Technology Fund, needed a positive vote from the central government for approval. This veto power was rejected in a ruling by the constitutional court of September 2013.

15. It is worth recalling the various steps of the approval process and the differences between the OCADs. For instance: *i)* either the DNP or the OCAD (the latter only for those projects financed with direct royalties) verify that the project complies with all the technical requisites and guidelines for the presentation of projects; *ii)* a public/private advisory committee nominated by the OCAD revises the technical,

financial and environmental aspects of the project, and issues a recommendation to the OCAD; *iii)* declaration of viability: if there is no national co-financing, the given territorial OCAD determines the viability of the project. When there is national co-financing, the DNP is the institution in charge of providing the viability of the project; *iv)* once the project is declared "viable", the information is registered in the system's bank of projects; *v)* finally, the given OCAD is responsible for prioritising projects and giving final approval.

16. Information collected from*:* www.sgr.gov.co/Contacto/PreguntasFrecuentes.aspx

17. Under the previous system, in operation until 2011, Colombia had a stabilisation fund connected to royalty revenues, called FAEP. However, the resources allocated to it were lower, and the fiscal stabilisation rule was frequently not observed, leading to its overuse (Cabrera Saavedra, 2012; Clavijo et al., 2013).

18. Colombia has recently enacted a framework of regulations and institutions governing spatial planning in the country. The Organic Law governing the Territorial Organisation in Colombia (LOOT) has introduced new governance structures that can be created at the sub-national level. Among other things, the LOOT has created specific instruments to co-ordinate regional development and spatial planning, known as *Contrato* plans (see Chapter 7).

19. In principle, under the SGR, any stakeholder (citizens, association, ethnic minorities and firms) is free to present a project to an OCAD, under the formal requirements outlined above. The political nature of the OCADs, however, makes it unlikely that a project presented by an individual citizen could be approved by the collegiate body.

20. Information collected on field visits offered an instance in which the local mining business provides municipal governments technical assistance and capacity building. For instance, the mining company BHP Billiton operating the coal mine of Cerrejón in Uríbia is co-operating with the municipality (corporate responsibility) to improve local skills in dealing with budgeting, administrative practices, management and transparency in the municipality. This collaboration gave an immediate positive boost to its capacity to generate revenues from local taxes. It also helped the municipalities dealing with the design of projects within the *regalías* system. It would be worth exploring how this ingenious form of corporate responsibility could be replicated in other communities with similar characteristics and needs.

21. In some municipalities, stakeholders mentioned instances where OCADs have provided them with a series of incoherent waves of comments about the same investment project.

22. Evidence collected in the field illustrates that local governments use the additional revenue provided by the SGR to integrate national transfers and tailor them to their needs. The problem with this approach is that the royalty funds are then used to satisfy basic needs rather than to promote regional development.

23. The 42 largest municipalities in Colombia extract more than 40% of their revenue from local taxation. This is higher than the amount of funding they receive through government transfers. By contrast, the 1 012 smallest municipalities can only extract about 13% of their funding from local taxation, meaning that they are much more dependent on government transfers – which represent almost 70% of their total revenues – than larger municipalities.

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Annex 3.A1
How are royalty payments calculated in Colombia?

Box 3.A1.1. **Production and distribution of non-renewable resources**

Royalties are generated by the production of hydrocarbons (about 80% of the transfers to the royalty system), and minerals (about 20%). The bulk of the resources are generated by oil, and to a minor extent by coal. Oil represents 92% of the hydrocarbon transfers and gas the remaining 8%. Among minerals, 75% of the resources are generated by the production of coal, 10% by nickel production and the remaining by other mineral and precious metals.

The calculation of the royalties generated by the exploitation of non-renewable natural resources in Colombia follows the following general formula:

$V = C * P * T$

Where *V* is the value of the royalty payable; *C* the volume of oil/minerals produced; *P* the price of the mineral set by the Ministry of Mines and Energy for the payment of royalties; and *T* the tax rate set for oil/given mineral by law.

In the case of hydrocarbons, the largest producers in Colombia are the departments of Meta and Casanare, and to a lesser extent the departments of Arauca, Santander, Boyacá and others. The tax rate ranges from 8% to 25% depending on the volume produced, as follows:

Monthly average daily volume produced by field	Percentage
Up to 5 000 barrels per day	8%
5 000-125 000 barrels per day	8 + (production – 5 000) * 0.10
125 000-400 000 barrels per day	20%
400 000-600 000 barrels per day	20 + (production – 400 000) * 0.025
More than 600 000 barrels per day	25%

In the case of coal, the largest producers are the departments of Cesar and La Guajira. The tax rate also varies depending on the per-mine volume produced, as follows:

Volume of coal mining	Percentage
More than 3 million tonnes per year	10%
Less than 3 million tonnes per year	5%

Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review of Colombia*", unpublished.

Chapter 4

The challenge of industrial diversification in Colombia

This chapter assesses Colombia's industrial policy and its implications for regional development. It is divided into three main sections. The first focuses on Colombia's macroeconomic trends and structural policies in the context of economic diversification, taking stock of prior efforts. The second section describes the role of regions and geography in the diversification strategy. A number of issues important for regional development are explored, including cities, inequality and multi-level governance. Section three describes Colombia's industrial policy and the current diversification strategy, taking into account the role of different types of regions. The chapter concludes with a number of recommendations for national authorities with respect to the current strategy of industrial diversification.

Key findings and recommendations

Key findings

- Colombia has experienced a three-tier economic growth process, with a rapidly, but increasingly vulnerable, mining sector leading the way, non-tradable services also growing and non-mining tradable sectors falling behind. The relatively diversified industrial mix that characterises Colombia as compared with other Latin American countries has not prevented its growing dependency on extractive industries.
- Colombia's resource-rich economy is capital-intensive and may not generate the number of jobs needed for inclusive growth. The internationalisation of the economy, while beneficial, poses challenges because it was for so long protected from competition from abroad. Protectionism has left many Colombian industries and sectors vulnerable, with a limited capacity to compete in open markets. Mechanisms to restructure certain ailing sectors and industries are now needed.
- Project-based systems are prevalent in Colombia at the national and the regional scale. The national government's industrial policy displays an "institutional stratification" of interventions, inspired by different strategies that overlapped over time. This is the result of the creation of new programmes and projects by different administrations, without ending or replacing those in effect. This leads to duplications, fragmentation and excessive complexity.

Key recommendations

- Simplify objectives. "Prosperity for All" is a remarkable effort of design and co-ordination of different policy agendas, with a coherent development vision. However, this coherence does not necessarily map onto reality, particularly as the actions listed in the plan percolate to the regions. Colombia might consider identifying some key strategic goals at the central level, then allocating more responsibility to lower tiers to adapt the national strategy to regional conditions.
- A territorial approach to industrial policy can help reduce the current sectorial focus – mostly based on direct subsidies to firms – and favour the transition toward a policy system in which the public sector becomes a provider of specialised public goods, services and infrastructure to business.
- Regionalise the design, implementation and monitoring of the plan. Streamlining national planning will require a series of structural changes and could benefit from a place-based approach. Colombia's regions face disparate challenges, depending on their location, economic specialisation and the incidence of social unrest. The territorial scale best suited to the plan must be determined. Departments may be too small for this role, given the number of functional economic areas that include different departments. The six regions created by the reform of royalty payments might be considered for this, since they were identified in co-operation with departments that self-selected territories for their economic and social homogeneity.

Introduction

Colombia's specialisation in extractive activities and openness to international trade offers opportunities, but also poses new challenges. In the past two decades, the focus of the Colombian economy has shifted, from specialising in agro-industry and manufacturing to dealing in energy commodities. The increasing production of oil and coal improved Colombia's ability to attract substantial foreign direct investment, particularly between 2002 and 2012 (OECD, 2013a). The commodity boom helped the economy rebound from a sharp deceleration in growth in 2009, caused by natural disasters and the temporary loss of the Venezuelan export market (OECD, 2013a).

However, the success of extractive industries also has its disadvantages, for instance, putting upward pressure on the appreciation of the real effective exchange rate (REER). Compared with other resource-rich economies (Australia, Canada, Chile, Norway and the United States), the Colombian peso experienced the highest appreciation over the period (OECD, 2013a). High REER squeezed the competitiveness of the non-resource tradable sector (Corden and Neary, 1982). The competitive edge of its manufacturing and agricultural sectors on the international market has been doubly hit by the stronger exchange rate and by higher input prices driven by the mining industry (OECD, 2014).

Productivity gains in mining and in services have not been able to improve Colombia's overall labour productivity, which experienced very low gains between 1990 and 2011 (OECD, 2013a; Santa Maria et al., 2013). As a result, Colombia exhibits three-tier economic growth, with a rapidly growing but increasingly vulnerable mining sector leading the way, non-tradable services also growing and non-mining tradable sectors falling behind. According to Santa Maria et al. (2013), Colombia also shows a disjuncture between the strong performance of large companies and sluggish small and medium-sized enterprises (SMEs).

Colombia's resource-rich economy is certainly not a disadvantage, but extractive activities are capital intensive and may not generate the number of jobs needed for inclusive growth.[1] Colombia's mining sector, for example, has become a driver of the national economy, tripling the number of its workers. However, total employment in mining represents less than 1.5% of Colombia's overall employment. The situation has been exacerbated by a loss of jobs in the manufacturing sector and agriculture, which have not been offset by gains in the service sector. Furthermore, most employment in services involves low-skilled and low-wage jobs, in contrast to manufacturing employment, which often requires medium- and high-skilled activities. In addition, manufacturing offers opportunities for entrepreneurship (SMEs) and self-employment, which can help reduce informal labour (Meldolesi, 2000) and are associated with strong local multiplier effects in non-tradable employment (Moretti and Thulin, 2013).

Regional development policy and multi-level governance can help Colombia deal with the challenges consequent on increased international openness. Globalisation and advances in information and communication technology (ICT) allow firms to fragment their production in the global value chain (GVC). As a result, the relevant unit in the economic analyses is not the industry or sector but the "business function" or "activity" along the supply chain (e.g. design, R&D, procurement, operations, marketing and customer services). Countries tend to specialise in specific "business functions" or "activities" rather than specific industries (e.g. assembly operations for the People's Republic of China or business services for India). This rise of the GVC illustrates why specialisation no longer takes place solely in industries but in specific functions or

activities in the value chain (OECD, 2012a). A territorial approach to industrial policy can help reduce the current sectorial focus – mostly based on direct subsidies to firms – and favour the transition toward a policy system in which the public sector becomes a provider of specialised public goods, services and infrastructure to business. Furthermore, place-based policies can help identify the regional potential to specialise in activities and functions within GVCs, and put in place the right incentives to capitalise on territorial propensities. Improving the quality of governance, and a public sector that is reasonably efficient at all levels of government, will be key for Colombia. Indeed, these are the conditions necessary to realise the benefits of place-based policies.

Colombia should also build on its unique economic geography in Latin America as it undertakes industrial diversification. By comparison with its neighbours, it has a more developed urban system, including a greater number of large and medium-sized cities. These, however, tend to be relatively isolated due to poor road connectivity, and social unrest has isolated cities and communities from each other over prolonged periods. The government is now working towards connecting urban poles and promoting industrial diversification and productivity. International experience suggests that enhanced connectivity will reinforce tendencies towards concentration in the largest cities. With this in mind, geography is a vital consideration in designing and implementing industrial policy. The benefits and the potential challenges that could emerge from increased connectivity must also be weighed.

Macroeconomic trends and their impact on Colombia's regions

Colombia is a resource-rich country aiming to diversify its economy

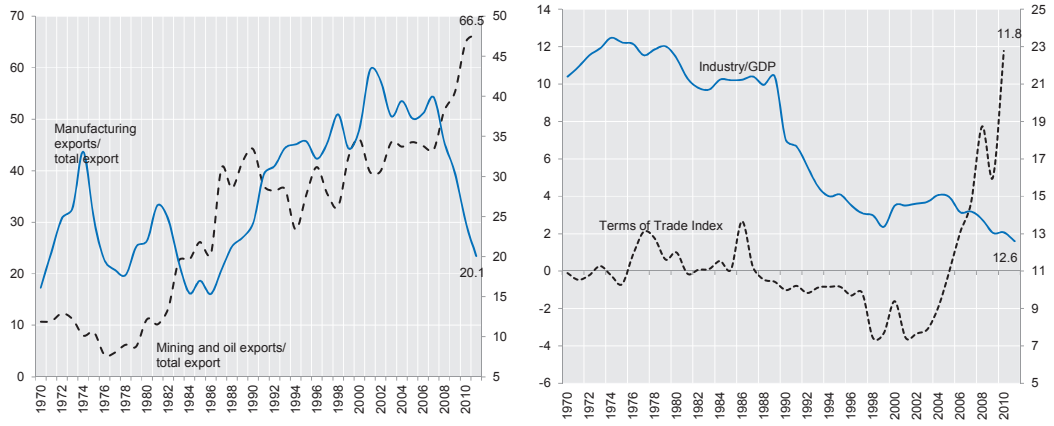
Since the end of the 1990s and in particular since 2005, Colombia has experienced high, sustained economic growth rates, becoming one of the key actors in the Latin America and Caribbean region (LAC).[2] Macroeconomic stability, including fiscal reforms and social stability, have been important in enabling the country to benefit from the exports of natural resources in international markets, mainly in oil and coal. The mining sector alone grew by more than 14% in real terms in 2011. The expansion of the natural resource industry has attracted an increasing amount of foreign direct investment.

Natural resource activity has generated gross domestic product (GDP) growth and, among other factors, helped strengthen the real exchange rate.[3] As in resource-rich OECD countries that do not save the revenues, such as Australia and Canada, the REER has appreciated substantially in recent years (OECD, 2013a). The value of the Colombian peso has increased by about 20% since 1999, as the country abandoned exchange rate bands. The impact on its economy includes a noticeable decline in the competiveness of the non-resource tradable sector, due to the change in relative prices (Corden and Neary, 1982). These sectors have become less competitive, due to the sustained exchange rate appreciation and higher input prices driven by the mining industry (OECD, 2014). Meanwhile, the productivity of manufacturing and agriculture decreased substantially between 2008 and 2011.

Colombia has experienced a three-tier economic growth process, with a rapidly developing, but increasingly vulnerable, mining sector leading the way, non-tradable services also growing and non-mining tradable sectors falling behind. The relatively diversified industrial mix that characterises Colombia as compared with other Latin American countries has not prevented its growing dependency on extractive industries.

Colombia's dependency on natural resource activities has increased significantly. The share of minerals and hydrocarbons in the country's export basket rose from approximately 45% in 1995 to 70% in 2011, while the share of manufacturing in its exports declined substantially (OECD, 2013a; Clavijo et al., 2014). The result of this trend was a net reduction in the contribution of manufacturing to national GDP and a sharp increase in Colombia's trade balance (Figure 4.1). Although the improved terms of trade allowed Colombians to import more goods, this has also exposed the country to terms-of-trade fluctuations with little, if any, leverage over their export prices (Broda, 2004). World markets dictate the price of the goods they export.[4] As commodity prices are often particularly volatile, a situation in which export revenues depend significantly on commodity price developments means that resource-based economies are particularly vulnerable to external shocks.

Figure 4.1. **Export composition (left panel) and terms of trade in Colombia (right panel)**



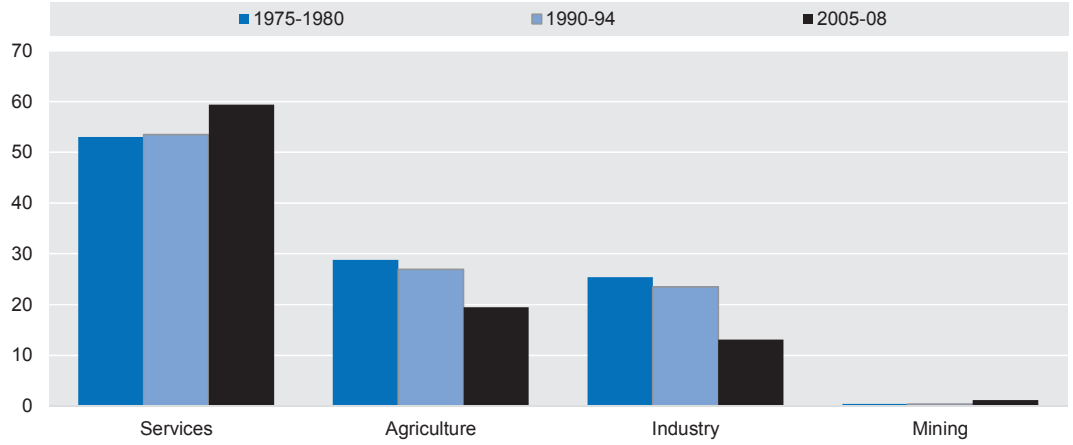
Source: Clavijo, S., A.V. Sandoval and A. Fandiño (2014), "Deindustrialisation in Colombia: Quantitative analysis of determinants", Working Paper Series, Asociación Nacional de Instituciones Financieras (ANIF), Bogotá.

Colombia's manufacturing is currently in a relatively weak position, due to its specialisation in mature productions (portions of global value chains) based on a relatively low level of innovation.[5] These include automotive, textiles and the chemical industry. In 2012, it produced more than half a million automotive units per year, becoming the second-largest producer in Latin America after Brazil. It has also developed a large and established specialisation in car parts. The country produces both for the internal market and also for the surrounding Andean Community countries.[6] However, and partly due to the absence of national brands, Colombia's automotive industry competes on price (low production costs), which exposes it to increasing international competition and also to competition from neighbouring countries. Another important specialisation is textiles, in particular apparel, which represented 9% of manufacturing output and 23% of manufacturing employment in 2005. Finally, the country has a large chemical industry, based on petrochemicals and agrochemicals. Petrochemicals represent about 10% of manufacturing employment. However, Colombia imports more than twice the amount of petrochemicals and agrochemicals that it exports, and the sector does not involve knowledge-intensive activities as part of the supply chain.

Being a resource-rich economy has its advantages, but extractive activities are capital-intensive and do not generate the jobs a country needs to become an inclusive

economy. Colombia's mining sector is a driver of the national economy and one of its most productive sectors. Although it tripled its number of employees in the period 1975-2008, total employment in mining represents less than 1.5% of Colombia's overall employment (Figure 4.2). Colombia has experienced a significant reduction in manufacturing and agriculture jobs, which have not been offset by gains in the service sector. Furthermore, a large share of the employment in services (wholesale and retail, for instance) is represented by low-skill and low-wage jobs. Conversely, manufacturing is often based on valuable jobs and a relevant set of skills.

Figure 4.2. **Composition of Colombia's employment sector, 1975-2008**



Source: Clavijo, S., A.V. Sandoval and A. Fandiño (2014), "Deindustrialisation in Colombia: Quantitative analysis of determinants", Working Paper Series, Asociación Nacional de Instituciones Financieras (ANIF), Bogotá.

Colombian policy makers are well aware of this problem. Previous commodity booms have on occasion destabilised the economy. Since 2008, thanks to the increased openness of the national economy, public authorities have taken steps to address these risks. The national government is promoting a broad and multi-dimensional industrial diversification strategy to identify new and profitable niches in the international division of labour. In particular, the strategy seeks to identify the industrial sectors in which the Colombian productive sector could specialise, to generate more resilience to international shocks and create more job opportunities.

Colombia's industrial strategy, however, faces major challenges. First, cultivating potential for producing established products profitably or creating new business opportunities may facilitate the transformation of the economy through cutting-edge innovations, but it is difficult to predict what new activities might be competitive, given the cost structure of the economy. The existing set of market prices in an economy reveal nothing about the potential profitability of alternative (as yet hypothetical) allocations of resources (Rodrik, 2004). Second, entrepreneurs moving into new economic sectors must often compete directly with established producers elsewhere, before they have attained a critical mass or reached the levels of productivity that could help their industries take off.

Diversifying a national economy is a complex issue, regardless of the specific challenges Colombia faces. Diversification is not a natural process. It rarely takes place on its own and without significant government guidance and assistance (Hausmann and Rodrik, 2003). This makes things rather more complicated, because such assistance so

often fails to deliver. The most successful economies in the world since 1945 have pursued heterodox policies, but they tended to be the exception, rather than the rule. In general, most economies that pursued heterodox, interventionist policies have performed very poorly.

Another factor of complexity is represented by the fact that countries display a changing level of diversification (or specialisation) depending on their level of wealth. As countries get richer, sectorial production and employment tends to become more diversified. Only beyond a very high threshold of development – equivalent to Ireland's current GDP per capita – do production patterns start to become more concentrated again (Imbs and Wacziarg, 2003). This cuts against the logic of comparative advantage, which is one of specialisation. Klinger and Lederman (2004) similarly find that the number of new export products follows an inverted U-curve in income.

It is clear, then, that any diversification strategy poses a serious challenge for policy. It could be argued that efforts to develop new non-resource tradable sectors may be somewhat counter-intuitive; they may be seen simply as a case of fighting the country's comparative advantage. However, the risks of relying on a capital-intensive and highly volatile sector are great. Given the size of Colombia's economy, a policy that puts strong emphasis on resource-extractive and capital-intensive activities is unlikely to generate sufficient high-productivity employment to sustain the high living standards to which the country wishes to aspire. The primary sector is not large enough to support a large workforce employed in low-productivity, non-tradable activities. Although there are some signals that the extractive industry is generating functional linkages with manufacturing (Santa Maria et al., 2013), it is also true that improving equity and efficiency goals suggests a need to develop higher productivity employment outside the primary sector.

Despite progress in Colombia's macroeconomic framework, it faces important challenges

Sound macroeconomic management is a necessary condition for an environment conducive to diversification. In recent years, Colombian authorities have taken important steps in this direction, instituting a new fiscal framework in 2011 that involves a structural balance rule, the creation of a Stabilisation Fund and a new system of royalty payments. These aim to insulate the economy from swings in commodity prices. The structural budget balance rule for the central government will not only help ensure fiscal sustainability across the cycle, it will also limit the degree to which swings in commodity prices affect domestic demand and the domestic business cycle, thus mitigating the pro-cyclical bias of fiscal policies observed in the past. The Savings and Stabilisation Fund (FAE) now accumulates revenue windfalls to finance counter-cyclical fiscal policies during downturns and the costs associated with natural disasters.

The Chilean experience (OECD, 2012a) highlights the role that such a fund can play when, as in Colombia, the automatic stabilisers are limited by the relatively small size of the state and by the spending and revenue mix, which involves low social benefits and a heavy reliance on consumption taxes. Further steps to strengthen this framework, such as those proposed in OECD (2013a), could further reduce both "factor drainage" pressures and limit the risks associated with the volatility of growth (boom and bust cycle). In particular, stronger mechanisms for corrective action in the event of slippage would be welcome. Given the difficulty other resource exporters have found in setting an appropriate reference price for governing commodity revenues, a spending rule could be introduced to further limit the scope for pro-cyclical policies.

National authorities have also carried out a series of reforms to provide business with the right incentives to invest in new tradable sectors, in particular the formalisation of employment. The informal sector provides employment and basic income for millions of Colombians, but it is a drag on development in the medium and long term. Almost by definition, informal firms tend to be small and are not in a position to reap economies of scale, to raise finance for investment or innovate on any significant scale.

International experiences, such as Italy's policy to promote the surfacing of the underground economy, show that regularising the informal sector can also incentivise self-employment and entrepreneurship, and can facilitate the networking of small firms, which dramatically increases their productivity and capacity to innovate (Meldolesi, 2000). Reducing informality must thus be a priority goal for any diversification agenda, and the Colombian government has been pursuing this objective for some time. The 2010 Formalisation Law was an important step in this direction. It introduced a lower income tax, payroll and social security contributions for new (registered) firms and for companies employing groups that are disadvantaged on the formal labour market (see OECD, 2013a). Despite these important advances, more can be done to tackle other obstacles to formalisation. For instance, in 2014, Colombia displayed a relatively high minimum wage: USD 300 per month (or PPP 5 500 per year). The ratio of minimum wage to average wage is much higher than the OECD average (Joumard and Londoño Velez, 2013). Colombia has high non-wage labour costs (45% of total labour costs); social protection is financed mostly through social security contributions as opposed to general taxation. A rigid legislation governing the formal labour market is another factor limiting formalisation.[7] Finally, it could be worth focusing on the need to formalise entrepreneurs as well as workers, i.e. to facilitate access to latecomers in given markets.

Promoting the creation of firms in the manufacturing sector would leverage the creation of jobs in regional economies. Moretti and Thulin's (2013) research on regional economies in the United States shows that every time a local economy generates a new job by attracting a new business in the traded sector, a significant number of additional jobs are created in the non-traded sector. This multiplier effect is particularly large for jobs with high levels of human capital and for high-technology industries.

Reducing the burden of product-market regulation (PMR) offers a sort of double dividend, inasmuch as it would both promote formalisation and also directly address some of the anti-competitive barriers that impede the entry and growth of new firms and activities. While there has been significant progress in recent years, the OECD's PMR indicators suggest that there is still a relatively heavy administrative burden on start-ups, particularly for sole proprietor firms (another impediment to formalisation). Further simplification of the procedures for starting a business, including the generalisation of one-stop shops, would be welcome. One-stop shops would be effective in facilitating access to financing and technical assistance to entrepreneurs.

Human capital and institutional capital are two critical conditions for diversification

Two cross-cutting issues have profound implications for Colombia's ability to diversify its tradable goods production. The first is human capital. As OECD (2013a) observes, despite significant improvements in education coverage in recent years, Colombia still faces substantial challenges here. There are considerable shortages in human capital. First, the number of highly skilled university graduates is limited for a country of Colombia's size. Second, according to the OECD's PISA 2012 scores, there is

considerable room for improvement in the quality of the skills of its 15-year-olds: Colombia ranks 63rd out of 66 countries and territories assessed in 2012, only above Qatar, Indonesia and Peru, and below Chile, Mexico, Uruguay, Costa Rica, Brazil and Argentina (OECD, 2013c). Third, a substantial mismatch exists between educational supply and labour demand, pointing towards an educational system with little relationship with the country's production system.

It therefore comes as no surprise that human capital still accounts for around one-third of the productivity gap between Colombia and the United States. Addressing this will require supply-side responses, to increase the quantity and quality of training, and steps to increase the market's ability to absorb more skilled labour. Moreover, improving human capital could reduce informality substantially (World Bank, 2010), making an indirect, as well as a direct, contribution to Colombia's diversification efforts.

Improvements in human capital have a strong regional dimension in Colombia, given the extremely large inter-regional disparities in the human capital and skill endowments of its workforce. This condition is also mirrored by the large variance of performance in the PISA test at the department level (OECD and Statistics Canada, 2014). A large body of work suggests that human capital is among the key determinants of regional performance and, in particular, that reducing the share of low-skilled people in the workforce probably matters more for a region's growth than increasing the share of high-skilled people. The drag effect on growth of large pools of unskilled or low-skilled labour is substantial (OECD, 2013b) and can exacerbate existing territorial inequalities.

Improving institutional quality is also a key factor for industrial diversification. Colombia has effectively improved its institutional framework. The recent reform of the system of royalty payments (see Chapter 5) empowers public institutions at all levels of government, but there is room for better (more reliable, transparent and accountable) institutions. Recent years have seen important advances in measuring the quality of institutions and their variation across countries (Kaufmann and Kraay, 2008), as well as a considerable debate about the relationship between institutional quality and economic performance. It is now fairly widely accepted that there is a link between the two (e.g. Woolcock, 1998; North, 1990; Acemoglu et al., 2001, 2005; Easterly and Levine, 2003; Dollar and Kraay, 2003; Rodrik et al., 2004), and that this link includes both the quality of formal institutions (i.e. rule of law and the protection of private property) and informal institutions (i.e. corruption, patronage, clientelism) (Rodríguez-Pose, 2013). There is also evidence that resource-rich economies are "intensive in institutions" and require good institutions at an earlier stage of their development, as compared with a country that does not have natural resources (Gill et al., 2014). That said, controversy remains over the nature of the causal links between them. While some argue that better institutions contribute to better economic performance, institutional quality may also be a product of economic performance; i.e. it may be endogenous to the economic process. Higher levels of growth might lead to better institutional quality, through multiple channels. Considerable evidence exists that the public sector, no less than the private, can benefit from the improvements in human capital and technology that growth can bring. Both may be driven by some third factor – most likely, human capital. In fact, these are not mutually exclusive views, and the relationship is thus likely to involve a number of direct and indirect causal links.

Competitiveness is an area where Colombia undeniably faces particular challenges. It ranks 69th out of 144 in the World Economic Forum's (WEF) Global Competitiveness Index for 2012. Even though the ranking reflects Colombia's perceived strengths in

macroeconomic conditions and market size, the WEF survey of Colombia finds that these advantages are largely offset by institutional weaknesses: Colombia ranks 109th in the WEF index of the quality of institutions, 99th on goods-market efficiency and 88th on labour-market efficiency. Corruption and inefficient bureaucracy were ranked as the two most problematic factors in conducting business, with corruption in first place by a substantial margin. The contrast between the WEF's high rating of Colombia on key economic endowments and its low ratings on institutional factors clearly illustrates the need to empower institutions to fully develop its undoubted national strengths.

These findings coincide with other external assessments of governance in Colombia, which point to important progress over time, but nevertheless underscore Colombia's weaknesses in relation both to its Latin American peers and to the most advanced OECD countries (Table 4.1). Transparency International's Corruption Perceptions Index ranked Colombia 94th of 174 countries in 2012. Problems with the rule of law also find expression in the World Bank's "Doing Business" indicators, which rank Colombia a respectable 43rd out of 183 countries overall, but a lowly 154th when it comes to contract enforcement. Institutional inefficiency and corruption particularly affect sub-national governments. In 2013, the bulk of the judiciary actions against corruption were undertaken against public officials from local levels and mayors (although the high rate of mayors that were suspended also depends on the strict, inflexible and sometimes blind rules that govern local finance).

Table 4.1. **Governance indicators, 1996-2012**

Percentile ranks

	Colombia			Brazil	Chile	Sweden
Indicators	1996	2004	2012	2012	2012	2012
Voice and accountability	29.3	38.9	45.5	60.7	80.1	99.5
Government effectiveness	48.8	53.2	56.9	50.3	86.6	98.6
Regulatory quality	55.9	54.9	63.6	54.5	93.3	99.0
Rule of law	22.0	29.2	43.6	51.7	88.2	99.1
Control of corruption	32.7	54.6	41.6	56.5	91.4	99.0

Note: A higher score denotes a better rank.

Source: World Bank (2012), Governance Research Indicator Country Snapshots, The World Bank, Washington, DC.

The institutional weakness in Colombia is an important bottleneck in the context of diversification. Weak institutional environments are far more damaging to newer and smaller firms than to established incumbents. Large capital-intensive firms (i.e. the major players in the resource sector) are generally better able to protect their interests, as well as to bear the costs of corruption when they incur them. For new firms and sectors, which are often on the brink of viability during the early learning-by-doing phase of their development, the cost of impacted information, informal payments to officials, collusion or nepotism and public procurement, or the inability to enforce contracts efficiently can be the difference between survival and exit.

Human capital and institutional quality are highly linked. The correlation between indicators of institutional quality and such factors as income and education suggests that

poor quality of government is not merely a product of elite greed; in many cases, the weakness of public institutions seeps throughout all layers of society and is linked to lower levels of human and physical capital, as well as to poorer technology (La Porta et al., 1999; Botero et al., 2012; Chong et al., 2012). In short, weak institutional contexts affect the productivity of government and the public service, on the one hand, and of private firms, on the other, in a similar way. Combating this can be done both directly, through the implementation of measures aimed at punishing and reducing corruption, and indirectly, through improvements in education and human capital. Moreover, evidence suggests that increasing income and education are also associated with greater demands for voice and accountability and greater capacity for good (public or private) management (Almond and Verba, 1963; Dahl, 1971; Diamond, 1992; Hadenius, 1992; Helliwell, 1994). Thus, it would appear that governance and growth are good for each other, and that education is good for both. The importance of human capital and institutions to diversification strategy needs to be made a priority and the strong regional dimension recognised, given the differences among Colombian regions in these two dimensions. Polices for progress in these two areas need to be integrated into any larger regional policy package that aims to foster the growth of new activities in Colombia's regions.

With this in mind, the Colombian authorities have been implementing the reform of the system of royalty payments (see Chapter 5). Improving institutional quality and capabilities tops the agenda of the reform. The new system requires that sub-national authorities design their investment projects within the framework of a regional development strategy. In other words, the central government pushes sub-national authorities to carry out actions that provide responses to local needs and capitalise on existing development opportunities. To do this, the sub-national governments must develop a set of skills. They have to be able to identify key challenges at the local level, and also to prepare an investment plan and a project that must be discussed with other tiers of government and with technical experts. If they fail to do this, the system does not allow them to use the funds. In the first two years of implementation of the reform, the central government has supported the local and regional process and tried to give priority to investments rather than to the definition of regional policy packages and development strategies. This approach will probably change in the near future, when the reform completes its break-in. In any case, given existing disparities in the quality of local and regional government across Colombia, a greater effort is needed to provide adequate technical support to allow sub-national authorities to design and implement viable development strategies at the local level, especially in lagging areas of the country.

Targeted interventions in Colombia's regions can supplement macroeconomic and structural policies

Even if Colombia effectively addresses all of the economy-wide challenges identified above, this may not be sufficient to attain the desired level of diversification in the economy. Sound framework institutions are a necessary, but by no means sufficient condition, because significant market failures involved may point to the need for public intervention.

- These might be the information externalities concerning the cost structure of the economy (Hausmann and Rodrik, 2003). Entrepreneurs entering new (to the economy) activities generate information (available to government, markets and other entrepreneurs) about the cost structure of the economy. The externality exists whether or not the venture succeeds. If a new activity proves an

unprofitable flop, the failed entrepreneur will bear the price, but others will benefit from the information generated by the entrepreneur's attempt to enter a new field. On the other hand, if the new venture is a success, entrepreneurs will share the value of their discovery with other entrants, unless they are able to restrict entry.[8] While cutting-edge innovation may benefit from patent protection, the discovery that a certain good established in world markets can profitably be produced at home will not. The modifications required to adapt the relevant technology to domestic conditions are unlikely to amount to something patentable or monopolisable.[9] In addition, the "discoverer" (unlike the producer of a cutting-edge innovation), will be competing with established suppliers from the outset.

- The other major externality concerns co-ordination. Many activities require simultaneous, large-scale investments to be profitable: an emerging activity may fail unless upstream and downstream investments are co-ordinated.[10] In established industries, the private sector is often quite capable of co-ordinating its operations. However, if the private sector is not organised – and in a nascent sector, it is unlikely to be – a co-ordinating role for government may be required.

The foregoing implies that diversifying into new activities may be harder in cases where infrastructure requirements and/or economies of scale or scope create natural *de facto* barriers to entry and possibly also exit. (The importance of impediments to exit should not be overlooked, as they can deter entry if ventures are perceived to be risky.)

It is important to highlight the extent to which the challenges and opportunities identified by this analysis are place-based. Lychagin et al. (2010) highlight the extent to which knowledge spillovers, though often large, decay quickly over distance. Their work focuses on innovation, but the same should be, if anything, even truer of self-discovery, where the knowledge gained often concerns specific local conditions and may in large part be tacit or imperfectly formalised and transferable.[11] The co-ordination failures identified above often arise precisely because of the need for up- and downstream suppliers to operate in close geographic proximity – or, indeed, where key inputs are non-tradable (Rodrik, 1996). The technology-transfer literature highlights the extent to which successful transfer depends on adaptation to local conditions that involves a large amount of tacit knowledge. Hausmann and Rodrik (2003) illustrate a number of examples in which local adaptation and co-ordination were critical to successful adoption of foreign technologies (or where their absence contributed to failure). Tacit knowledge increases the need for close relationships along the supply chain (Pack and Westphal, 1986).

Self-discovery is of necessity a bottom-up process, so there should be advantages in being able to address the co-ordination and information externalities closer to where they occur. While it is true that national governments are typically better equipped to intervene, in terms of resources and authority, the information needed for effective action is often local. If lower tiers of government often suffer from capacity gaps, national governments often face information gaps.

All this implies that "one-size-fits-all" development strategies for the whole of Colombia will be difficult to design and implement. They will also be likely to benefit the most developed parts of the country, at the expense of lagging regions. This will increase regional polarisation policies in the short term, and be unlikely to deliver the expected results. It will also make the argument for a spatially blind approach to tackling the development problems in Colombia hard to sustain, if only because the "natural" outcome of market-driven allocation of resources and labour is, to a great extent, the product of

prior public investments and policies. Large-scale investments to address infrastructure bottlenecks will thus not always lead to more sustainable economic development, at the risk of increasing the concentration of economic activity in a limited number of poles. This, in a country as diverse and dependent on a variety of products in sectors, may spell future socio-economic and political problems. The National Development Plan 2010-2014 represents a first important step toward the implementation of a territorial approach in Colombia. There is, however, still room to improve the capacity of the plan (and then of national policy) to diversify the policy framework according to regional needs and in co-operation with regional and local stakeholders.

Regional development policies in contrast can help in this domain:

- The information externalities point to the need for policies that encourage entrepreneurs to explore activities that are new to the local/regional economy. This could be done through subsidies for non-traditional activities. In practice, such subsidies would be very difficult to administer – the information and monitoring requirements would be onerous indeed. Trade protection or restrictions on entry would likewise raise serious practical problems – especially since they would be, in essence, firm-specific (it is the initial investor, not the copycats, who should reap their benefits). Support for access to finance might be a good starting point. OECD (2013a) draws attention to the low levels of domestic credit to the private sector that prevail in Colombia and to the factors that underlie this state of affairs.
- The co-ordination externalities need not be costly to the budget to address, since the logic of the problem is that when simultaneous investments are made, they will end up being profitable (unless some other externality is at work). Rodrik (2004) points to the potential for designing *ex ante* subsidies that need not be paid *ex post* (e.g. an investment guarantee). The key task of regional development may be information revelation and co-ordination.
- Development strategies should aim to embed new activities in the territorial context where they take place. This implies supporting activities that are commensurate with and related to the skills, innovation and infrastructure endowments of Colombia's different regions.
- When addressing both sets of externalities, interventions should logically target new activities, rather than sectors per se.

There is a strong argument for moving policy making away from a sectorial approach altogether. The boundaries between sectors are in many cases increasingly fuzzy, particularly in advanced fields like high-tech manufacturing and knowledge-intensive services. Moreover, the development of increasingly complex global value chains, in which production processes are unbundled across the globe, means that – even in more "traditional" sectors – it makes more sense to think in terms of tasks or activities than entire sectors. The challenge in the age of globalisation is less to push into sectors on the international stage, as countries once sought to do, than to integrate into global value chains at whatever levels their endowments make them competitive (Baldwin, 2006; OECD, 2013c).

Regional policies and their role in the diversification strategy

The regional dimension can help design a more realistic and effective diversification strategy

The geographic dimension should play a vital part in industrial policy in Colombia. The country's urban geography is unique in Latin America, in that it has a relatively large number of cities of all sizes. In addition to the capital, Bogotá, three of the dynamic urban poles stand out: Medellín, Cali and the neighbouring cities of Barranquilla-Cartagena-Santa Marta. Other medium-sized cities include Bucaramanga, Manizales and Pasto, to cite a few that complement and give balance to this urban structure. The presence of this network of cities represents an important potential driver of economic growth in Colombia (Duranton, 2014). It has played a key role in the economic development in the past decade and is likely to play an even more important role in the future. A key policy challenge will be to integrate the urban network, which is currently poorly articulated.

Several smaller cities have benefited significantly from the commodity boom and extractive activities. Cities such as Villavicencio, in the Meta department, or Riohacha, in La Guajira, have experienced a demographic boom, thanks to the success of their extractive sectors. These dynamics affect the productive fabric of the country. As was noted in assessing quantitative trends in regional Colombia, large cities (the five "heads" of Colombia) have increased their economic diversification, while most small and some medium-sized cities have specialised, particularly in the extractive sector (OECD and Statistics Canada, 2014). The coexistence of diversification and specialisation trends in a national urban system is common in OECD countries (Duranton and Puga, 2000), but in Colombia, it may also depend on some unusual characteristics of the country and on its recent history.

Territorial inequalities among Colombia's regions are significant. They are 42 times higher than in Australia and more than 5 times higher than in Canada or the United States, but also higher than in most other neighbouring Latin American countries, such as Argentina, Bolivia, Chile or Venezuela (Cistulli et al., 2014). Territorial polarisation is partly the result of the history and physical geography of Colombia, but has also been enhanced by poor road connectivity and lack of transport infrastructure. The disintegration of the urban network in Colombia has been the consequence of years of armed conflict and criminality. The conflict also hindered transport flows among cities and between urban and rural areas (see Chapter 2). This prompted migration from rural areas into the relative security of Colombia's two large cities, and led to the development of gated communities. These conditions influenced trade and the circulation of workers and contributed to diversifying cities to satisfy local demand. Major cities became production and service centres for their surrounding areas, developing too many functions relative to their size that could have been delivered more efficiently by other cities if the urban network had been better integrated. Poor infrastructure and communication networks among Colombia's key cities thus represent a barrier to economic development. Poor infrastructure also determines the relatively low mobility of the national workforce, a further curb on productivity growth.

In medium-sized and small urban centres, often located in rural regions, local economies are often specialised, entailing challenges that industrial policy should take into account. As Duranton and Puga (2000) have noted, small and specialised cities offer business opportunities with less urban crowding and stronger local economies, given the proximity of closely related producers. However, smaller cities do not have sufficiently

large internal markets and thus depend to a greater extent on surrounding primary activities. Meanwhile, with less innovation, they are more exposed to external fluctuations and shocks. In Colombia, this is even more acute, since some small and medium-sized cities are specialised in extractive activities and subject to international demand and prices. Given its mix of diversification and specialisation, Colombia needs to be pro-active to protect many of its urban communities from sudden downturns.

Besides the intervention of the national government, local governments must be empowered to restructure their economies. The national government lacks sufficient information to assess new investment opportunities at the regional level. Sub-national authorities should be allowed to analyse their potential for diversification and initiate policies that reflect this potential. This option, however, entails large co-ordination costs. The risk is that all regional communities will converge on similar policy interventions to support the specialisation of the region in knowledge-intensive, high value-added industries such as ICT, biotechnology or international tourism – in other words, high-tech fantasies (Castells and Hall, 1994). To avoid this, the national government needs to put in place a system of monitoring and evaluation that could provide sub-national authorities incentives and sanctions if needed. A multi-level governance framework that helps pool information and co-ordinate strategies and policy interventions could help in this regard.

The national urban development policy is an opportunity to support diversification, but carries risks. Colombia is currently defining an ambitious national urban policy, *Misión de Ciudades*, whose goal is to connect large and medium-sized cities. The narrative supporting the policy is that it will provide firms in Bogotá with an international gateway in the port of Barranquilla, with beneficial effects for productivity and national competitiveness. The policy was made possible by the recently approved Organic Law governing the Territorial Organisation in Colombia (known in Colombia as the LOOT: *Ley Orgánica de Ordenamiento Territorial*).

The government, however, should not overlook the potential challenges that the urban development strategy could entail. Improved connectivity will imply changes and adjustments that may be difficult for some cities. Urban functions may start concentrating in some poles. Some cities may thus lose functions, as the urban hierarchy of the country adjusts to higher levels of connectivity and market integration. Overall, international experience suggests that enhanced connectivity will reinforce tendencies towards concentration in the largest cities and result, at least in the early stages, in increasing regional inequality. The authorities may at times need to take action to reduce the cost of adjustment and smooth the transition of the urban system towards a new equilibrium.

Likewise, rural areas crossed by transport infrastructure could be affected by "leaking by linking" dynamics and lose high-skilled workers (OECD, 2012b). Greater integration will almost certainly lead to winners and losers. While some regions – and, most likely, the largest urban areas – would benefit from a better articulation of the Colombian urban system, the impact on other parts of the country remains uncertain, and the risk of social and political instability may rise. The national government must anticipate this sort of challenge and establish the mechanisms – including adequate technical support to regions and municipalities, and an effective regional development fund targeting areas of the country the most affected by changes – that could help minimise discontent and maximise the growth potential of the country.

Colombia should avoid key pitfalls in the design and implementation of its industrial policy

Colombia would do well to consider a series of general policy lessons concerning industrial policy and productive diversification. One is that distorting prices to "push" resources into more advanced sectors (e.g. via import-substitution on Latin American lines) is likely to be a bad idea, for two reasons (Rodríguez-Clare, 2005). First, such policies are often based on the idea that so-called "Marshallian externalities" (MEs) – the knowledge spillovers, labour pooling and proximity of specialised suppliers that can arise from concentration of production in a specific location – are an intrinsic characteristic of an industry. They are not: the same industry could generate MEs in some places and not in others, at some stages of development and not at others. Secondly, the benefits of clustering are unlikely to be realised unless the economy enjoys a comparative advantage in the sector. Rodríguez-Clare concludes that "industrial policy is not about 'creating comparative advantage', but about achieving the high productivity that comes from a cluster in the sector where it has a comparative advantage" (Rodríguez-Clare, 2005). MEs are linked to technologies (including organisational and transactional "technologies" no less than production technologies), rather than to specific industrial sectors. The activities targeted, moreover, should have the clear potential to generate positive externalities (spillovers, demonstration effects, etc.).

Another important lesson concerning productive diversification is that process matters more than specific outcomes, which are inherently difficult to predict. Of course, policies should be evaluated for their contribution to growth/diversification – criteria for success and failure must be clear – but the key is that outcomes cannot be identified with precision in advance. If the intent is to promote discovery, it is never clear what will be discovered. The purpose of policy should be to stimulate experimentation, creating incentives for firms and the government to learn more about underlying costs and opportunities. A few successes are likely to pay for a large number of failures, as long as the mechanisms in place ensure that failures are allowed to fail, and quickly. The approach to policy itself, moreover, should be experimental.[12] Discovering the best ways to foster discovery will involve some trial and error. Even failures can have some value, to the extent that they generate useful information and learning. Indeed, there should be plenty of mistakes – the key is not to avoid mistakes, but to avoid persisting in them. A policy of stimulating decentralised experimentation should mitigate the market failures, while retaining the benefits of decentralised search. Sunset clauses are key. Support for new activities should not be open-ended, and resources should not be tied up for long in support of activities that are not taking off.

Close collaboration between public and private sectors is required – which also implies a need for transparency, clear procedures and effective accountability (i.e. for sound institutions of public governance). This should help to reduce the risk of political capture, rent-seeking and corruption. Avoiding a sectorial focus for policy should also make it less likely that instruments will be captured by special interests representing those whose behaviour they aim to alter.

The emphasis on experimentation points to a final and very important conclusion: the outcomes of successful diversification policies will be difficult to predict. Policy makers should resist the temptation to try to define the production structure in the direction they believe the economy should evolve. Markets will always produce surprises, as Hayek (1988) famously observed. The example of Finland is instructive. Its comparative advantage in forestry products is long-standing and obvious, but most of its other

competitive strengths are not: not even the most well-informed economist could have foreseen its development of strong comparative advantages in such products as lifts, satellite navigation equipment, off-shore drilling equipment or – to name the most famous of all – cellular telecommunications. In 1990, the last of these products would hardly have merited a mention in any industrial strategy for Finland; ten years later, they were a cornerstone of Finnish growth, and a decade after that, the country as a whole felt the fallout from the rise of the iPhone, the eclipse of Nokia being as unexpected as its rise. Yet new sources of growth rapidly began to emerge based on the human capital and infrastructure associated with the telecommunications sector. Finland thus continues to adjust, its success a product not of anyone's ability to predict, let alone direct, the productive structure of the economy, but of a set of transversal, sectorial and regional policies that create conditions favourable to innovation and entrepreneurship.

There is a thin line between the emergence of successful new sectors and the implementation of high-tech fantasies. Success in diversification is more likely to happen in those parts of Colombia that have adequate endowments to let new sectors emerge: i.e. those regions with a critical mass of human capital and firms. In other parts of the country, it is unrealistic to expect new sectors to emerge out of the blue. It is therefore essential to promote diversification on the basis of existing potential. Building up the bases in terms of skills, innovation capacities and infrastructure can prompt existing firms to relocate or new firms to emerge in sectors that are related to current comparative advantages.

Capacity to experiment can be achieved only if the new National Development Plan (NDP) 2014-2018 allows for a certain degree of flexibility of policies and governance mechanisms.[13] The increasing complexity of Colombia's economy in industrial activities and the increase in the number of stakeholders call for improvements in the planning system. The NDP should allow for the fact that sectorial ministries have begun to play a more active role in formulating and implementing policy. This should not be seen as a challenge to the coherence of the plan, but as an additional source of political capital that could strengthen capacity for the goals specified in the planning document. The NDP should be able to capitalise on the empowerment of sub-national authorities, a key objective of the reform of royalty payments. The NDP may give sub-national authorities a degree of autonomy in setting priorities for investment decisions. This may help scale up regional development plans and allocate public investment to programmes with many stakeholders that do not necessarily fall within the administrative borders of departments and municipalities.

Colombia's industrial policy and the implications for regions

This section focuses on Colombia's current strategy, assessing the gap between the approaches to industrial policy discussed in the previous section and what is happening on the ground. This policy framework is closely linked with the current internationalisation of the country's economy, which poses several challenges. The first, as noted above, involves the higher rate of the exchange rate and its impacts on the competitiveness of non-extractive tradable sectors. The second concerns the sudden exposure to international competition of national firms that operated in relative isolation for many years. The third challenge – particularly relevant for countries that, like Colombia, are transitioning towards higher income levels – concerns the role of international agreements on industrial diversification. An emerging economy cannot always replicate the development paths of other OECD countries (despite the experience

of latecomers such as Korea). Its industrial mix is influenced by two related factors: the increasing regulation of international trade and the increasing number of players in the global arena. An emerging economy has less freedom to build its own industrial base, since it has to discuss and bargain with other potential commercial partners in industries where it will face international competition. Governance mechanisms may well be helpful in this regard, but add complexity to the task of designing an industrial policy.

The current strategy reflects an increasing openness to international markets

Colombia's industrial policy parallels the increasing globalisation of the national economy. After a period of relative isolation, between the 1980s and late 1990s, Colombia is now becoming an active player in international markets. Although Colombia still has a relatively low trade-to-GDP ratio at 22% (as compared to Chile's 41% or the BRIICS'[14] average of 33%) (OECD, 2014), it has signed several free trade agreements (FTAs) since 2008, including ones with Japan, Korea and the People's Republic of China. In 2010, after negotiations that started in 2006, Colombia finalised FTAs with the United States and the European Union. This approach has started to bear fruit. One result has been its remarkable capacity to attract foreign direct investment (FDI) in recent years, peaking in 2008, when total flows were USD 10.6 billion.

This internationalisation of the economy, while beneficial, poses challenges because it was for so long protected from competition from abroad. Protectionism has left many Colombian industries and sectors vulnerable, with a limited capacity to compete in open markets. Mechanisms to restructure certain ailing sectors and industries are now needed. The government has designed and implemented a broad industrial policy to buffer the impact of international competition on domestic economic players, and to reorient national comparative advantages. Industrial diversification is now a top priority.

The current policy capitalises on Colombia's experience in the field of industrial diversification. Since 1990, successive governments have supported the competitiveness of specific sectors, i.e. hydrocarbons, flowers, leather products, fruits, mechanics and graphic arts, that were identified in collaboration with international experts and consultants (Haussmann, Klinger, 2008; Proexport, 1998). Some of these sectors already controlled a significant share of the international market. In the past 40 years, Colombia has developed a comparative advantage in the cut-flower industry, becoming one of the largest exporters in the world (Mendez, 1991). Other sectors, although relevant for the national economy, e.g. car parts, have not been able to compete successfully on the international market, despite considerable public support. Since 2010, with the National Development Plan "Prosperity for All" ("*Prosperidad para Todos*"), and in particular since 2012 (when the Agenda for Competitiveness was launched), Colombia's approach to industrial diversification has become more holistic. New policy interventions do not have a specific sectorial focus, and aim to support value chains, clusters of firms and the promotion of enabling conditions.

The new approach to industrial diversification coexists with the old strategies. Sectorial interventions, based on direct subsidies to sectors and firms, persist within the framework of the industrial policy. Constituencies representing specific sectors of Colombia's economy and vested interests do not want to forfeit the public subsidies, and some resistance has caused a fragmentation of public investment in the national industrial policy. Excessive policy fragmentation and stratification, for instance, have made it impossible to ascertain the overall government investment in industrial diversification (i.e. support for non-extractive tradable sectors) since 2010.

Main institutions and programmes underpinning the national strategy for diversification

Starting with the institutional side of the industrial policy, the key component of the current strategy is represented by the *Agenda de Competitividad* (hereafter, the Agenda), which was launched in 2012. It is based on short-/medium-/long-term interventions to increase productivity and generate a yearly growth of GDP of above 6%. It represents a co-ordination effort that integrates existing sectorial policies within a strategy to improve performances in nine key areas of Colombia's economy (Table 4.2). Within each of these sectors, the government has set a series of policy targets. For instance, for education, targets include a strong improvement in service delivery (access to education in all regions), as well as actions to increase the quality and numbers of researchers and highly skilled workers. Likewise, actions on infrastructure encompass road connectivity, energy and ports. The rationale is that, to take advantage of its increased openness, Colombia should progress in all these fields and related sub-issues. In other words, the Agenda aims to provide a big impetus to the Colombian economy.

Table 4.2. **Key areas in Colombia's National Agenda for Competitiveness**

Education	Labour market	Infrastructure
Product market	Financial market	Institutions
Technology	Innovation	Business sophistication

Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review of Colombia*", unpublished.

The government has connected the Agenda to the National System of Competitiveness and Innovation (*Sistema Nacional de Competitivitad e Innovación*), which was created in 2006. This is co-ordinated by the Ministry of Trade, Industry and Tourism, with the support of the national Network of Chambers of Commerce (*Confederación Colombiana de Cámaras de Comercio*). It involves sectorial ministries, industrialist associations (ANDI) and academia. The National System of Competitiveness and Innovation is chaired by the President and supported by a technical secretariat.

The National System of Competitiveness and Innovation has a strong regional dimension, encompassing 33 regional commissions for competitiveness operating in 32 departments and in Bogotá. Regional commissions are formed by local governments (departments and municipalities), entrepreneurs, academia, non-governmental organisations (NGOs) and other stakeholders involved in regional development. These commissions are in charge of designing and implementing regional development strategies, to be defined in a participative way. This decentralised system is intended to pool knowledge and information about the concrete potential for industrial diversification across the country. A specific body within the National System of Competitiveness and Innovation (the *Coordinación Nacional de las Comisiones Regionales*), chaired by the Ministry of Trade, Industry and Tourism, is in charge of co-ordinating the action of the regional commissions for competitiveness.

In parallel, the government created a network of 32 bodies specifically dealing with policies for micro, small and medium firms, in 2008. These are the *consejos regionales de micro, pequeñas y medianas empresas*, or Mipymes. These local councils have three main tasks. First, they assess market potential and export opportunities for SMEs. Second, they facilitate access to financial services for SMEs. Finally, they support technology and learning in small businesses.

Other bodies and policies complete the institutional framework underpinning the national industrial policy. An important body is the Bank of Foreign Trade, or Bancoldex. This is a state-owned commercial bank that operates as Colombia's entrepreneurial development and export-import bank, providing long- and short-term financing to firms and specialised financial products to support Colombian exports and other foreign trade-related activities. Bancoldex has a specific focus on SMEs and is connected to the Ministry of Trade, Industry and Tourism. In 2012, Bancoldex began the process of becoming a development bank, following the launch of the Agenda for Competitiveness. It was also bolstered by the creation of a specific Unit for Development and Innovation, also known as INNpulsa Colombia. This operates through a network of regional commissions located in 21 departments that support innovation and entrepreneurship, and specifically tackle job creation and informal labour. INNpulsa has co-operated with some 700 firms since its creation.

The new system of royalty payments also contributes to the diversification strategy. Colombia introduced a radical reform of its royalty payments in 2012 (OECD, 2014). Royalty payments are now allocated to different funds with different functions. The bulk of the funds are currently invested in improving road connectivity and infrastructure across the country, a key condition for promoting national competitiveness. Other funds are more specifically designed to support R&D and innovation – and international competitiveness – at the firm level. For instance, since 2012, the STI Fund has allocated USD 400 million per year to innovation and technological improvements in Colombia.

Policy interventions for territories and economic actors

Current industrial policy in Colombia is overly fragmented and complicated. It involves multiple institutions and numerous programmes and policies, which percolate to territories and economic stakeholders through a large number of interventions. The piecemeal nature of planning has limited its impact. Colombia's normative approach to economic and industrial planning has led to a multiplicity of interventions, many of which are often extremely detailed and ineffectual. In addition, as already noted, the national strategy recently shifted from a space-blind sectorial approach, to industrial diversification, to a more holistic and territorial approach. Some programmes are still inspired by the old paradigm, some by the new one, and some display characteristics of both approaches, adding to the complexity and lack of clarity.

Among the interventions that have a sectorial focus, the most relevant is the Programme for Productive Transformation (*Programa de Transformación Productiva*, or PTP). This is a private-public alliance created by the Ministry of Trade, Industry and Tourism that seeks to boost productivity and competitiveness in sectors with export potential. The programme's objectives are: improving sector productivity and competitiveness; facilitating co-ordination between public and private players; helping sectors and companies to benefit from the opportunities that result from trade agreements; and contributing to a better quality of life for Colombians, as a result of the good performance of productive sectors and companies that create more and better jobs.

The PTP aims to promote competitiveness in 20 sectors across 20 departments. For agribusiness, it supports aquaculture, beef, chocolates, candies, fruit and vegetables, dairy, palm, oil, fats and biofuels. In manufacturing, the PTP supports cosmetics and personal hygiene products, publishing and graphic design, the auto parts and vehicle industry, the fashion system, metal-mechanics, ironworks and dockyards. Finally, the PTP supports services related to outsourcing of business processes (OBP), software and

IT, electricity and related goods and services, health and well-being tourism, and nature tourism.

The large number of sectors affected by the programme is not, however, supported by adequate funding. The total financial allocation for this intervention is relatively small, about USD 20 million per year. The disconnect between the large number of sectors (and then firms and departments) that this programme serves and its paltry financial underpinning is worthy of greater scrutiny. The evolution of the policy illustrates the challenges Colombia faces in implementing its industrial policy. The PTP is a legacy of programmes for diversification that have been in place since the end of the 1990s. These were based on the idea that it was important to identify national champions within the economy and to support their competitiveness on the international market. Based on the findings of national and international experts, the first policies promoting national competitiveness and diversification focused on a small number of sectors (less than ten), located in few departments with a clear manufacturing specialisation. However, due to political pressure from departments and productive sectors (industrialist associations) that were not included in the initial list of beneficiaries, the programme was expanded to include new territories and new economic activities. As a result, the Programme for Productive Diversification has become more of a tool to assess trends and performance in the national economy than an instrument promoting Colombia's comparative advantage.

The large number of free-tax zones scattered across Colombia is another policy example aimed at supporting business that lost direction. In 2013, the country had 120 free-tax zones and, under certain conditions, a single new company can even apply to become a single-firm free-tax zone (Free Trade Zones Directory, 2013).[15] While the virtual absence of taxes on economic activities in a given area can attract FDI, free-tax zones present challenges that should be evaluated before they are extensively used as a tool of regional development. First, this may trigger competition among regions, generating a zero-sum game in which FDI is simply moved around the country. Second, the evidence is that foreign investors are more attracted by clear rules and good framework conditions, such as infrastructure (regional accessibility, for instance) and above all human capital and skills (OECD, 2014). Finally, in a country that needs to improve its capacity to collect more tax revenues by enlarging its tax base, especially at the local level, too large a use of free-tax zones could become detrimental in the medium- and long-term, as it may reduce the capacity of sub-national governments to produce enabling conditions for business.

Overall, there is a clear need to revisit the free-tax zones. To a large extent, they may simply be benefiting FDI that would in most cases have ended up in Colombia anyway, given foreign firms' interest in the larger, more stable Colombian market, while simultaneously reducing state revenues.

The Colombian government is aware of these problems and has shifted the focus of industrial policy. According to national stakeholders, the objective is to create policy tools less distortive of the productive fabric (i.e. not picking winners) and promoting a more efficient use of incentives. An example of this is in the ICT cluster in the Santander region (Box 4.2). Support for clusters of firms and supply chains across the country is now a greater focus.

Colombia's support for supply chains, and regional initiatives to favour clusters, have the features of experimental policies. The government aims to deliver policy interventions directly to firms. To do so, it has established co-operation with research bodies that encompasses academia and the private sector and other intermediate institutions active in

regions. One such example is the Centre for National Productivity (*Centro Nacional de Productividad de Colombia*). Active since 2000, the centre has already delivered support to 500 firms involving 2 000 workers. The government contracted with the centre to deliver policy interventions to firms throughout the country. These interventions cover different aspects of business. They range from improving management skills to supporting innovation and product development. In its activity, the centre involves public agencies like the National Service of Learning (SENA), which deals with worker training and vocational education training, local universities and chambers of commerce. The DNP directly monitors the quality of interventions and, most importantly, the overall impact of the policy. For instance, the DNP is analysing the effect of a number of support tools and programmes through experimental design by comparing the firms receiving a "treatment" with those that do not receive treatment in the control group.

Box 4.1. **ITC cluster in Santander: Relinking the local economy with extractive industries**

The national government, in particular the Ministry of Information Technologies and Communications and the department of Santander, are working together to support the development of an ITC cluster in the department (CETICS). Small and medium-sized enterprises (SMEs) that are part of this cluster are expected to work as suppliers of the oil companies located along the Magdalena River, on the western border of the department. Santander presents a good example of the way in which globalisation can pose challenges to economic actors that cannot keep up with the pace of development. Its experiment demonstrates what can be achieved through co-ordination among different levels of government and different bodies, both public and private. Its experience will yield evidence about the possibility of linking the extractive industry with other sectors of the Colombian economy.

Santander is one of Colombia's oil-producing regions. Resource-rich, the department is specialised in refinery and petrochemicals. Oil production started in the 1920s and was ramped up in the 1990s, when plants and related businesses began to locate along the banks of the river, creating an industrial cluster. The cluster encouraged entrepreneurship, and a large number of SMEs began to provide oil companies with services ranging from ICT to logistics and support (cleaning operations, for instance). Small firms, however, were not able to keep up with the evolution of the cluster. In the early 2000s, when the scale of production and globalisation began to require higher standards delivered by certified firms, most of these firms were put out of business or forced out of the oil supply chain.

Colombia's Ministry of Information Technologies and Communications, in co-operation with the department, the regional commission for competitiveness and other groups supporting industrial diversification (e.g. INNpulsa), has instituted a policy to create an ICT cluster in Santander and help local firms position themselves in the oil supply chain. The public sector invested USD 25 million to help SMEs dealing with certification standards and to upgrade their capacity to meet the requirements of the local oil companies, which are also involved in the venture. The policy also aims to diversify services offered by the ICT cluster, to create new investment and development opportunities. One project, apps.co (which has received USD 1 million of public support) is a platform to help entrepreneurs develop their ideas and find a potential market.

Source: Apps.co, www.apps.co (accessed March 2014); CETICS, www.cetics.com.co (accessed March 2014).

The centre, with the support of the DNP, is now attempting to focus interventions in the Pacific Region, both to improve the performance of firms and the framework conditions in which they operate. The centre has also started providing capacity building to public actors in the region and is supporting integration by organising information about regional needs and investment opportunities.

The Pacific Region includes four departments: Choco, Cauca, Nariño and Valle. It accounts for 17% of the national population and produces 15% of Colombia's GDP. It has a relative specialisation in manufacturing and few natural resources: its contribution to national exports is quite low, at 9%. It is one of the six regions created by the General System of Royalties, each of which has an OCAD that evaluates and approves large-scale

investment projects. These regions do not have administrative powers. However, in the case of the Pacific Region, departments are implementing a process of policy integration that may help create some regional administrative bodies. This process of regionalisation started in 2010 as a result of the Pacific Alliance, a major international agreement involving several Latin American countries, to promote trade with Asia.[16]

A cluster policy for the least developed areas of the country faces numerous risks. Questions remain as to whether the number of firms available can benefit from such a policy and/or absorb the new transfers of knowledge they encounter through their interaction with research centres and institutes. In many parts of the emerging world, research institutions lack the capacity either for cutting-edge research or for the transfer of any new knowledge generated to local industry (or often both). As a result, the limited new knowledge may be funnelled into the clusters, leading to lock-in and disappointing results (Rodríguez-Pose and Hardy, 2014). Colombia is not necessarily in any better a position in this respect than many other emerging countries. Close monitoring of the results of the cluster policy is thus called for.

Policy interventions specifically designed for agro-industry

A specific national strategy has been initiated to promote the competitiveness of agribusiness, a promising prospect for the national economy. Colombia's potential in agriculture and in agro-industry is high. The country now uses only a small percentage of the total agricultural land, approximately 5 million out of 60 million hectares. Its agro-industry faces several challenges, even in the products and supply chains in which it has a comparative advantage, such as coffee or sugar cane.

- Colombia is one of the most important coffee producers in the world. It produces around 8.5 million 60-kilogramme bags per year, around 12% of global production. Colombian coffee is recognised for its quality, but farmers cannot capitalise on this. Their profit margins are relatively low, despite the increasing global demand for quality coffee, due to the lack of a successful branding strategy and product traceability. Colombia's coffee producers are price takers on international markets that are mostly influenced by other countries with much greater production volume, such as Brazil. The coffee sector's below-par performance, especially given the quality of its coffee, can be attributed to several factors. First, coffee producers have created a fund to buffer price fluctuations in international markets. This fund, managed by the National Confederation of Coffee Producers, buys coffee from farmers at a set price, regardless of the quantity they produce. This may be influencing farmers' concern about the quality of their product and their inclination to adopt technological improvements, since the price is inelastic and not related to demand. Second, additional government subsidies to coffee producers may be creating additional disincentives. Public subsidies are likely to have the same impact as the Stabilisation Fund discussed above. Finally, although it is such an important and specialised producer, the country has not been able to develop a robust national market for high-quality coffee. Several examples in OECD countries demonstrate the importance of internal demand in supporting national productive specialisation and international competitiveness.
- A similar dynamic can also be observed in sugar cane production, where Colombia ranks as the most productive country in the world. Production is concentrated in the south of the country, in the Cauca department. Sugar cane is

harvested up to four times a year, and no rotation is required, given favourable soil and climate conditions. Unlike coffee producers, sugar cane producers are large-scale, capital-intensive firms. Producers have created institutions, such as Cenicaña, to lobby for them with the government and also to help them with R&D. In this case, too, Colombian producers are price takers on the international market, which is dominated by Brazil and other large producers. The appreciation of the Colombian peso in the last decade has eroded the margins of a sector that has become increasingly dependent on public subsidies. This, however, reduces the incentives for exploring the possibility of diversifying output and extending the value chain by including manufacturing and specialised services. Despite the fact that producers are located in the same region, spillovers are limited. Machinery is imported from other emerging economies, like India. Finally, this case demonstrates the impact of FTAs on the Colombian economy. Foreign car producers connected with the national industry that produces car parts have imposed limits on the percentage of ethanol (a by-product of sugar cane) that Colombia can mix with gasoline. National producers have little or no incentive to specialise in the production of biofuels, which would be an easy way to differentiate their product.

Other key challenges of Colombia's agriculture relate to the lack of certainty over property rights and scarce regional accessibility. This is a legacy of the armed conflict and illicit crops. To date, only 40% of Colombian farmers have a certified property title to their land. The others have to deal with the possibility that the land they cultivate is expropriated or reassigned to other farmers. The result is that most farmers have little inclination to invest in the land. To reduce uncertainty, these farmers cultivate crops that require little investment and that can be harvested in a relatively short time. Such crops, however, do not generate much income and often trap farmers into poverty. Road connectivity in rural areas is also poor, with little transport infrastructure compared with other Latin American countries. Because of high transport costs, most farmers cannot ship their products to urban markets, let alone overseas. Again, this generates a poverty trap for farmers and dramatically reduces their likelihood of investing and innovating.

In this context, the government has conceived a strategy to boost the productivity of agro-industry, and the capacity of rural dwellers to generate income. It focuses on the following key issues:

- Reducing production costs. To achieve this, the government intends to support better use of machinery and establish an associative sale and distribution system (co-operatives, for instance). This will require the creation of specific institutions (national markets) and improved regulation of freight and transport of agricultural goods, including livestock.
- Improving utilised agricultural area. This issue is connected with property rights, land use and spatial planning. In the case of disputed property rights over agricultural land, priority will be given to farming activities. The policy will also support large farms over smallholdings. In case of conflict over a property title, the government will favour the solution with the highest productivity. Finally, the government intends to upgrade spatial planning in rural areas, to facilitate the task of sub-national levels in charge of improving road connectivity (secondary and tertiary road networks).
- Promoting skills in rural areas. Rural areas in Colombia suffer from extreme poverty and lack of basic services, including education and training. As a result, a

large number of smallholders have limited skills and limited capacity to generate new sources of income. The government is planning a large-scale programme to improve their skills and their farms' productivity.

- Rationalising water management. Better agricultural productivity requires irrigation and drainage. This is linked to the availability and maintenance of infrastructure, and the capacity to build public-private partnerships for sustainable management of water in the long term. In Colombia, water management is also associated with hydrogeological risks; more advanced farming would probably help manage risks and avoid disasters such as those caused by heavy rain in 2011.

Conclusions

Key recommendations

Colombia's effort to diversify its industrial base and to create new, higher value-added jobs faces three key challenges.

- Due to increasing openness and the success of extractive commodities (among other forces) the Colombian peso has appreciated in the last decade. A stronger currency erodes profits and negatively affects the international competitiveness of non-extractive tradable goods, including manufacturing and agriculture. One of the consequences is a substitution effect on the job market: jobs lost in the industrial sector are being replaced by low-wage, low-skilled jobs in the service sector.
- The country has a relatively high number of urban poles by comparison with other Latin American countries. However, these cities have so far failed to establish a true urban network. Most of them remain relatively isolated, due to years of civil strife and a lack of adequate transport infrastructure. Poor road connectivity has further contributed to a split between urban areas. Likewise, access is poor between urban and rural areas and among rural areas.
- Finally, low institutional capital and capabilities at the sub-national level reduce the possibility of involving local authorities in the design and implementation of the diversification strategy.

The national government has set up numerous policy interventions for this purpose. Its industrial policy, in particular, displays an "institutional stratification" of interventions, inspired by different strategies that overlapped over time. This is the result of the creation of new programmes and projects by different administrations, without ending or replacing those in effect. This leads to duplications, fragmentation and excessive complexity. For instance, one programme for productive (or industrial) diversification lists sectors and departments to subsidise so that they can become national champions. Similarly, in agro-industry, the government provides coffee producers with subsidies to buffer the fluctuation of international prices. These policies coexist with newer, more holistic strategies that aim to create enabling conditions for businesses, rather than to pick winners. Support for industrial diversification is also provided by the reform of royalty payments, which should improve institutional capital at the sub-national level and affect the national transport network and public goods in general, across the country.

Despite these efforts, there is room for improvement. The following recommendations can help the country advance in its efforts to attain a more diversified economy, less dependent on extractive industries, less exposed to international shocks and price fluctuations, and with the capacity to produce more value-added jobs for inclusive development.

- A general recommendation concerns the upcoming National Development Plan 2014-2018. Industrial policy requires experimenting with different policy options. Many of these will fail, some may prove effective, and the priority is creating conditions that incentivise an environment for experimentation and innovation (Lester and Piore, 2004). It is thus vital that the next National Development Plan provide some flexibility. It should provide the general guidelines and principles, but also allow sufficient room for sub-national authorities to pursue regional priorities for investment and regional development policy interventions in a more autonomous way.

- The plan should further help reduce the complexity of the whole system of intervention in support of firms in sectors. The current system should be revised and simplified, monitoring all programmes and closing those that are no longer relevant, devoid of content, piecemeal, ineffective or inadequately funded. The aim should be to cultivate a more select number of interventions, closely related and linked to the overall strategy of the plan.

- The regional dimension can play a key role in decentralisation, compensating for the limits of policies that select and pick winners. Carefully designed, a regional strategy can focus on setting up the enabling conditions for the medium- and long-term competiveness, tailoring policy portfolios to the needs of different regions. Finally, regional policies can combine top-down and bottom-up development that can initiate sustainable growth in regions that depend on subsidies and external interventions.

- Experimentation requires information and monitoring. The country should make an effort to improve its knowledge of regional needs and investment opportunities. This requires developing a new set of territorial indicators, and also the capacity to monitor regional trends. In addition to Censuses, Colombia may consider putting in place regional observatories for economic development that would provide data and feedback on the result of interventions. The national government also needs to set up a clear system of support and capacity building for sub-national authorities. There is scope for experimentation with different approaches for empowering them, capitalising on private business in extractive activities. Stimulating social corporate responsibility within the framework of the reform of royalty payments would be one option. In La Guajira, private business has helped the local municipality to improve its capacities, an example that could be replicated in other extractive regions (Box 4.3).

- Colombia's industrial policy should take into account the geographical dimension. While a territorial approach is increasingly evident in the national approach to industrial diversification, Colombia might consider setting up a multi-level governance mechanism to manage national industrial policy. The national government may consider granting more autonomy to regional bodies and business communities to design and implement policy. In particular,

interaction with business should not be based merely on lobbying, as has mostly been the case to date.

Box 4.3. **Public management modernisation: An innovative approach to corporate responsibility in La Guajira**

Colombia's department of La Guajira is experimenting with an innovative approach to corporate responsibility that hopes to empower local governance. The private sector conducts capacity-building exercises to help public authorities improve their capacity for regional development. This initiative, started in 2012, has positively affected the quality of local public goods and services and is likely to increase the chance that the region will start to diversify its economy, developing business opportunities that are not connected to extractive activities.

Companies operating in resource-rich regions commonly compensate hosting communities by investing part of their profits in improving public goods and services. An extractive company can sponsor the construction of a road, a school or a hospital. On paper, the aim of these interventions is generally twofold: to improve living standards in the community and boost productivity. In reality, it is often challenging for the private sector to identify investment projects that can benefit the host community. Resource-rich regions, especially in developing countries, are likely to have weak institutional settings, and in the worst case, are susceptible to corruption. This makes it difficult for them to provide the business sector with information on local needs and opportunities. In such cases, the extractive company may attempt to deliver a public good or service through direct intervention, often in collaboration with international co-operation agencies or international organisations. The result often falls below expectations. A school, for example, may not have access to the energy grid or water sanitation facilities. A hospital may be poorly connected to the road network, limiting its accessibility. This indicates how important the public sector is to buffer and co-ordinate corporate responsibility.

In La Guajira, the local mining company has implemented an approach to corporate responsibility that resolves some of these basic problems. La Guajira is one of the poorest departments in Colombia, extremely remote and with the largest aboriginal community in the country. Local governments lack capacity, and the regional economy is highly specialised in the extractive industry, with few businesses active in other sectors. The company finances four "foundations" with specific missions to promote regional development. One deals with aboriginal issues; another with water and food security (key issues in this arid area); a third with large-scale projects for regional development; and a fourth foundation to empower the local institutions and populace (*fortalecimiento istitucional*) and small-scale regional development projects. This last foundation has played a key role in supporting La Guajira's development since 2012, when the government implemented the reform of royalty payments.

La Guajira is one of the productive departments that has suffered a net reduction of royalty payments due to the new system. However, royalty payments had previously been used to satisfy basic needs, such as water sanitation and healthcare, rather than to promote sustainable and inclusive development. Despite the substantial resources generated by extractive activity, the department suffers from high poverty rates. The royalty payment reform aims to establish a link between public funds and inclusive regional development. In the new framework, local governments have to play a pro-active role if they are to access public funds (OECD, 2014). The reform nevertheless entailed a level of administrative complexity that La Guajira's departmental and municipal governments were unable to handle. Within a year of the reform, the department presented only a single project to be financed. This could have caused a sudden and dramatic reduction of public resources available in the region and the risk of generating civil unrest.

Box 4.3. **Public management modernisation: An innovative approach to corporate responsibility in La Guajira** (*cont.*)

At the request of the DNP, the foundation launched a programme called "Public Management Modernisation" to help local governments deal with the reform of royalties and improve their capacity to become active players in the new policy framework. The programme involved three key actions. First, it started to provide technical assistance to municipalities and to the department to design investment policies. The foundation did not prepare the projects in place of public authorities, but helped them identify key areas for investment. Second, the foundation helped the department create a co-ordination framework for municipal projects, to reduce fragmentation of investment and maximise the impact of projects on regional development. Third, it created a series of workshops in which municipalities presented their projects to the local population to improve accountability, transparency and ownership. The DNP capitalised on this effort by launching an extended OCAD (or OCADTON) including the department OCAD and the municipal bodies. This accelerated the process and improved co-ordination among projects. As a result, the OCADTON approved a total of 33 investment projects at the department level, for a total investment of USD 800 million (COP 162 000 million) and 45 municipal projects totalling about USD 37 million (COP 67 000 million). The foundation is now active in evaluating the interventions, promoting citizen participation in the process. It has also created a framework to co-ordinate with international co-operation agencies active in the region, to avoid duplication of projects.

Local stakeholders, the DNP and international collaborators have all been supportive of the initiative in La Guajira. Several businesses (including some that are not involved in extractive industries) are trying to replicate the model across Colombia. Local stakeholders note that the initiative did not involve the extractive company giving money to the local community, but helping it to empower local governments and citizens. Enhancing governance in the region could have a dramatic impact on the quality of public goods and services and on productivity, thereby also benefiting the company. This approach to corporate responsibility also reduces the risk of generating corruption in the host community. In general, the experience illustrates the positive impact that the reform of royalty payments may have on regional development. Challenging the capacity of local governments by introducing a structural reform, such as the one governing royalty payments, can be beneficial even if the starting conditions of a community are poor, as in La Guajira's case. However, the public sector must forge strategic alliances with key regional actors like the foundation.

- All this will involve replacing the dominant project-based systems still prevalent in Colombia by medium-term programming at the national and the regional scale. A vision for every territory is needed, as is integrated development planning over a specified period. This would mean co-ordinating intervention at the different territorial levels (regional and departmental) through the multi-level governance mechanism, and co-ordinating individual programmes with the National Development Plan.

- In addition, adequate channels for participation in the development process should be set up. This would entail transparent identification of relevant stakeholders and the creation of new mechanisms to allow ideas, information and energy to be fed into the development process.

Notes

1. A subtle but important difference distinguishes the terms "resource-rich" and "resource-based". Resource-based economies are often – although somewhat arbitrarily – defined as economies in which natural resources account for more than 10% of GDP and 40% of exports. Colombia can be considered a country that is in transition from a resource-rich economy to one that is resource-based. If the relative specialisation of exports and GDP composition in natural resources continues to increase, Colombia's economy will become increasingly exposed to commodity price fluctuations.

2. Colombia's GDP was USD 474 billion in 2011. It is an upper middle-income economy, with a per capita income of USD 10 103 in 2011, slightly below the LAC average and about one-third of the OECD average. While the poverty headcount is still at a high level of 34.1% – driven up by the long-standing internal conflict and large-scale displacement of people, it has fallen significantly since 2002 (49%). Inequality remains high, with a Gini coefficient of labour income at 0.53 as compared to the OECD average of 0.40, higher than that of Chile, Mexico and the United States, which top the OECD list (OECD, 2014).

3. Ultimately, the exchange rate is a reflection of the relationship between tradable and non-tradable prices in the economy.

4. Building on the fact that terms-of-trade shifts in developing countries are largely exogenous, that is, determined by forces outside the countries' control, Mendoza (1995) and Kose (2002) find that terms-of-trade movements can account for roughly half the output volatility in these countries.

5. It is worth noting that the challenge is not the specialisation in mature sectors per se, but in parts of supply chains with little technology and innovation. For instance, Colombia has many firms that produce car parts, but most are engineered in other countries. The challenge is not being specialised in a mature sector, but to host key portions of global supply chains that are information- and knowledge-intensive, even if they are part of relatively mature sectors.

6. The Andean Community (*Comunidad Andina*, CAN) is a customs union comprising the South American countries of Bolivia, Colombia, Ecuador and Peru. The trade bloc was called the Andean Pact until 1996 and came into existence with the signing of the Cartagena Agreement in 1969. Its headquarters are in Lima, Peru. The Andean Community has 98 million inhabitants living in an area of 4.7 million km², whose GDP amounted to USD 745.3 billion in 2005, including Venezuela, which was a member at the time. Its estimated GDP PPP for 2011 was USD 902.86 billion, excluding Venezuela.

7. The impact of the minimum wage on employment has been much debated in the empirical literature, but the balance of evidence suggests that, if too high, minimum wages exclude those who are the least productive or experienced from the formal labour market (Bassanini and Duval, 2006; Koske et al., 2012). In Colombia, the

yearly minimum wage is adjusted by a centralised bargaining process between representatives of trade unions, businesses and the government. By law, the minimum wage is raised to reflect the central bank inflation target for the year, plus productivity changes. Since 1999, the Constitution further stipulates that yearly adjustments in the minimum wage should at least match the past year's inflation. This institutional set-up has generated upward pressures, with the minimum wage increasing by 21% in real terms between 1998 and 2010 (and by 4.4% in 2013), i.e. well above productivity developments (Hofstetter, 2006). The minimum wage is particularly binding in the poorest, low-productivity regions, where its level is above median and average income and where informality is also most prevalent (OECD, 2013a). Furthermore, Mondragón-Vélez et al. (2010) argue that the increases in non-wage labour costs and in the minimum wage between the 1990s and 2006 have both excluded low-skilled workers from the formal labour market and triggered a move from the formal to the informal labour market, increasing the informal market's relative size.

8. See Klinger and Lederman (2004) for evidence that the number of new products exported by a country is positively associated with the height of entry barriers. More burdensome regulation of business formation and market entry appears to contribute to a higher rate of self-discovery in exports. Ease of entry, which facilitates imitation, dissipates the rents that would otherwise accrue from self-discovery. Desjardins' (2010) comparison of infrastructure improvements to tariff reductions should alert us to the need to think about infrastructure policy with some regard for its impact on self-discovery. The point is not that we would favour infrastructure bottlenecks to protect uncompetitive local producers but that the sequence and package of policies adopted could make a big difference in determining whether better infrastructure stimulated or impeded self-discovery.

9. Hausmann and Rodrik (2003) observe that some hugely valuable innovations – such as the discovery that Ethiopian seed-coffee could be planted in Central America – were not patentable at all.

10. Rodrik (1996) argues that co-ordination failures are especially likely where new industries exhibit scale economies and some inputs are non-tradable or require geographic proximity. These are most likely to be categories of specialised labour: a worker's investment in a particular skill depends both on demand for that skill and on the existence of complementary skills in the local economy.

11. Lychagin et al. (2010) focus on the United States. According to Rodríguez-Pose and Crescenzi (2006), a similar result is obtained for Europe: they find that, in the EU-25, proximity is crucial for the transmission of economically productive knowledge. Spillovers show strong distance-decay effects: only the innovative efforts pursued within a 180-minute travel radius have a positive and significant impact on regional performance.

12. "Appropriate policies and institutional arrangements have a large element of specificity, and experimentation is required to discover what works locally. … Most first-order economic principles come institution-free. Incentives, competition, hard budget constraints, sound money, fiscal sustainability, property rights are central to the way economists think about policy and its reform. But these principles do not map directly onto institutional solutions." (Mukand and Rodrik, 2002: 3-4). Decentralised experimentation appears to have been important to China's success since 1979. See, *inter alia*, Naughton (1995) and Jefferson and Rawski (1994).

13. Over the past 50 years, Colombia has developed a capacity to plan its economy that has not been seen in many Latin American, or for that matter, OECD countries. The planning process is synchronised with presidential elections, so that the plan represents the implementation of the President's political agenda for the four years of his/her mandate. At the core of the planning process is the National Department for Planning, in charge of compiling the document and of the governance mechanism that produces the plan.

14. Brazil, Russian Federation, India, Indonesia and China (People's Republic of).

15. The Single Company Free Trade Zone (FTZ) regime enables the declaration of a FTZ in favour of a specific new company, in any location within the country, for the development of an investment project with high economic and social impact. The company, to be eligible, must create 50-500 direct jobs, depending on the sectors, in the first 3 years from the creation of the single-firm FTZ.

16. The most recent initiative, which gathered a lot of political momentum in the region and attracted attention globally, is the Pacific Alliance (*Alianza del Pacífico*), a trading block formally launched in June 2012 by Chile, Colombia, Mexico and Peru. Recently, Costa Rica has also joined as a full member, and Ecuador, France and Portugal became observers during the summit in Cali in May 2013. Overall, there is a lot of enthusiasm about the initiative, which proclaims as its primary objective facilitating trade and investment (in particular with Asia Pacific) and boosting productivity in the region. The focus seems pragmatic and the goals include co-operation between the countries' investment promotion agencies, exchanges of experiences with single windows for trade and the introduction of an electronic system for certifications of origin, along with other trade facilitation measures. Member countries have by now removed visa requirements for each other's citizens, are promoting student and professional exchanges, and have agreed to issue joint tourist visas for third countries. Colombia's President Santos chairs the Alliance *pro tempore*.

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Chapter 5

Negotiated territorial development in Colombia: The *Contrato* plans

*This chapter analyses governance tools to co-ordinate public investment across levels of government in Colombia. In particular, it focuses on the use of intergovernmental contracts, so far applied in seven regions (*departementos*). The chapter is organised into four main sections. The first outlines the characteristics of the seven contracts that have already been drawn up and discusses the financial aspects and key strategic priorities selected by each region. The second section assesses the instrument, discusses the policy/legal framework of the contracts (*Contrato *Plan), and makes some international comparisons. The third section evaluates opportunities and challenges for the use of contracts in Colombia, presenting evidence from case studies. Finally, specific recommendations to improve the use of contracts are outlined.*

Key findings and recommendations

Key findings

- The *Contrato* Plan is an instrument for improving the public sector's capacity for regional development in lagging territories in Colombia. The seven *Contrato* plans total an (anticipated) investment of USD 6.7 billion, for an overall population of 6 million.
- Contracts focus on improving road connectivity, but better service delivery in general, of education, healthcare and water sanitation, is also a priority.
- Colombia does not have a fully-fledged regional development policy, and the contracts are project-based. However, they may create a set of enabling conditions for a strategic approach to regional development: regional partnerships, local capabilities, and better understanding of local needs and opportunities.

Key recommendations

- Mainstream technical assistance within all seven *Contrato* plans to raise local expertise. Allocation of deliverables listed by contracts should be realistic; for instance, acknowledging that the sub-national level may lack the capacity to deliver large infrastructure projects. National authorities should guarantee technical support to sub-national governments to ensure implementation and promote learning.
- Promote mutual support and exchange of good practices among sub-national authorities, which should also improve co-ordination among different departments. A regional network for disseminating good practices could be helpful, as would a national forum where sub-national authorities involved in the implementation of a contract can exchange information about challenges related to project implementation/management. These institutions would create shared knowledge and provide regional constituencies with support, when demanded. The national forum should also involve sub-national authorities that are not specifically included in a contract, to promote the use of the instrument and disseminate good practices. Co-ordination may trigger collaboration among departments belonging to the same functional economic region.
- Each *Contrato* plan could set a series of measurable targets to be achieved within a given period. This would facilitate monitoring at the sub-national level. Targets should be realistic and measurable (performance indicators) and the government could institute dedicated incentives for sub-national governments that have achieved their targets within a contract.

Introduction

Colombia is growing fast, but growth is constrained by the lack of infrastructure, especially of transport infrastructure, and by poor accessibility to key services such as education, healthcare and sanitary water. The low endowment of public goods and services is spatially concentrated in rural and intermediate areas. These regions have been challenged by the lack of development strategies and by social unrest and crime. These conditions have also affected the quality of local governments, which, in many cases, lack capacity and accountability. In these circumstances, while it is relatively easy to identify regional needs, it is difficult to deliver policy interventions to fill regional gaps, co-ordinate sectorial sources of public investment and promote more inclusive development across the country.

The *Contrato* plans, also described in this report as contracts, were created to deal with these situations and help public authorities deliver development policy to local communities. The contract is a binding agreement between the central government and a department, a group of departments or a group of municipalities. The parties commit to co-ordinate their investment agendas among sectors and across tiers of governments. In addition, they agree to deliver their interventions within a given timeline. The aim is improve the public sector's capacity to implement policy interventions.

Colombia's negotiated territorial development is part of a broader national strategy whose aim is to create institutions and capacity that can support development policies. Contracts were introduced in 2012 by the Organic Law governing the Territorial Organisation in Colombia (known in Colombia as the LOOT: *Ley Orgánica de Ordenamiento Territorial*) and by the National Development Plan 2010-2014, "*Prosperidad para Todos*" ("Prosperity for All"). The LOOT is a key achievement for Colombia, because it demonstrates that public authorities have regained control of the national territory after decades of conflict. Its intent is to improve Colombia's multi-level governance and to provide public authorities with flexible governance instruments to deliver policy interventions where they are needed the most. The *Contrato* Plan was instituted as a result of the 2011 reform of royalty payments. This important reform distributes revenues generated by extractive activities to all departments in the country. Sub-national authorities can use this additional revenue to co-finance interventions listed in the contracts. Finally, contracts also connect with innovative approaches to rural development that seek to improve service delivery to poor households in remote communities.

As of 2013, seven *Contrato* plans had been signed in Colombia, for a total (anticipated) investment of USD 6.7 billion over 5 years.[1] The policy affects almost 6 million citizens, most of whom live in rural/remote areas in 9 departments. The contracts identify infrastructure, and in particular road connectivity, as their main objective. Basic services such as healthcare, education and water sanitation are also priorities. While these objectives are supported by national transfers earmarked by the central government to all departments and municipalities, the contracts add flexibility to the policy and allow sub-national authorities to tailor action to their specific needs. In short, departments and municipalities have more funds, the possibility of co-ordinating different sources of investment from different levels of government (co-financing mechanisms) and improved capacity to promote development and fight poverty.

The *Contrato* Plan is a new policy instrument, so it is not yet possible to evaluate the impact of negotiated territorial development in Colombia. Some of its results, however,

were assessed on field visits. For instance, contracts have "reactivated" development planning at the department level. Department plans, in fact, identify measures to be taken within the contracts. Another key advantage is the opportunity for learning that the contracts provide departmental governments. They offer sub-national authorities the possibility of working with national representatives as they execute the measures, including large infrastructure projects. In general, contracts are a first attempt in Colombia to connect spatial planning with development policy. Challenges, however, remain. For instance, contracts are simply an instrument of implementation. Regional development strategy – i.e. a department's development plan – must align with the National Development Plan. This limits the possibility of tailoring interventions to the area's specific developmental requirements. In addition, because strategic priorities for regional development are set in Bogotá, it is more difficult to enlist the participation of local stakeholders who are not visible at the national level, for example, small businesses, small agricultural co-operatives and small non-governmental organisations (NGOs).

Main characteristics of the *Contrato* plans

A *Contrato* Plan is a binding agreement between the central government and a department, among a group of departments or a group of municipalities. Based on this legal agreement signed by the President and the governor(s), or mayors, the different levels of government make a commitment to co-finance, implement and finalise a series of policy actions considered to be strategic for regional development. Interventions are focused on the poorest municipalities within a department. Given these characteristics, contracts in Colombia are "relational" rather than "transactional". In other words, the contracts do not define a series of precise deliverables or actions that the parties are required to produce to respect the terms of the agreement, but rather provide a platform for facilitating interaction and decision making across levels of government.[2]

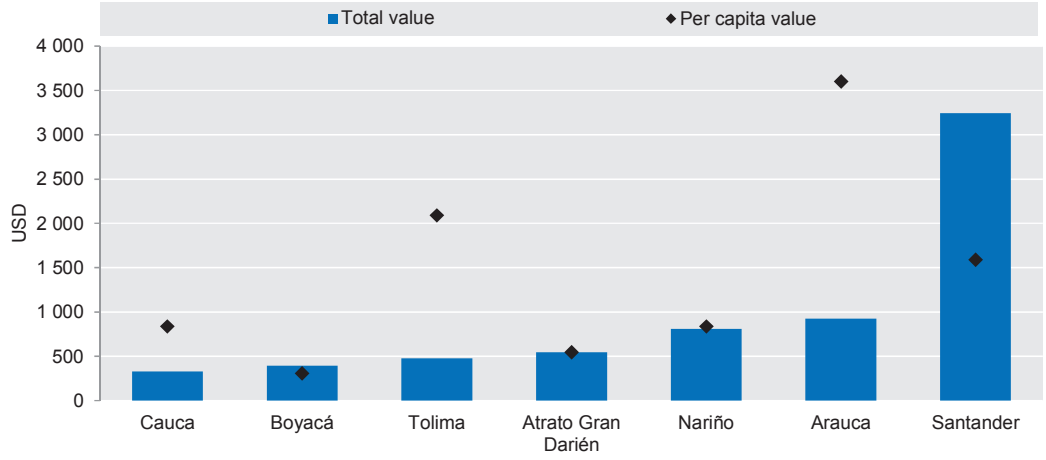
Despite a certain degree of flexibility, however, the contracts are not a development strategy. Interventions are identified – one by one – within the framework of the department's development plan (*Plan de Desarrollo Departamental*), which in turn reflects the priorities identified by the National Development Plan. Once the intervention has been determined, the parties agree to co-finance the project and realise it within a given amount of time, which is also stated in the contract. If one party fails to deliver the project within the time agreed upon, the other party will take over implementation. If, for instance, a department is not able to finalise a given transport infrastructure, the central government will take it over for completion.

Colombia introduced negotiated territorial planning in 2012. Seven *Contrato* plans were signed between the end of 2012 and the first half of 2013. The first, the Contrato Plan of Atrato Gran Darién, was signed on 10 November 2012, while the last, the Contrato Plan of Santander, was signed on 27 July 2013. Contracts total an (expected) investment of USD 6 719 million, for a population of some 6 million people. The richest contract in terms of its total amount of resources is Santander's, with around USD 3 243 million, almost the total amount of resources devoted to all other 6 contracts (Table 5.1). The allocation of resources to contracts depends on the number of poor municipalities covered by the agreement, as well as the total population. Based on these two dimensions, the department of Santander, with a population of 2 million people and 87 municipalities, has the lion's share of the resources allocated to contracts. Conversely, the contract in Cauca is not as generously endowed, with a total investment of USD 330 million, for a population of some 394 000 in 13 municipalities. Overall, the

central government provides 78% of total funding available for investment within the 7 *Contrato* plans. About 19% of funding comes from royalty payments allocated to departments (and represents the main source of co-financing), and the private sector is expected to provide the remaining 3%.

Per capita investment across contracts averages USD 1 162, with a wide disparity among per capita investment values across departments. For instance, Boyacá receives the lowest investment per capita, USD 308, and the department of Arauca has the highest, USD 3 600 (Figure 5.1). These values are not related to the economic performance (gross domestic product, GDP) of the department, which are not taken into account by the contracts in the allocation of resources. Departments involved in the contracts have, on average, performed well (see Chapter 3).

Figure 5.1. **Comparison between total value (USD millions) and per capita value (USD) in *Contrato* plans**



Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review: Colombia*", unpublished.

Contracts have an average duration of five years. The two exceptions are Cauca's contract, whose duration is three years, and the contract in Arauca, which is based on an eight-year timeline. Considering five years as the average timeline of *Contrato* plans, it is possible to calculate annual average investment per contract of USD 1 343 million. The annual investment ranges between USD 78.4 million in Boyacá and USD 648.6 million in Santander (Figure 5.2).

One of the key characteristics of the *Contrato* Plan is that it requires departments to co-finance policy interventions. Co-financing is important to enhance the effectiveness of the binding agreement. It also increases ownership of local constituencies and makes departments more selective in the choice of interventions that are listed in the contract.

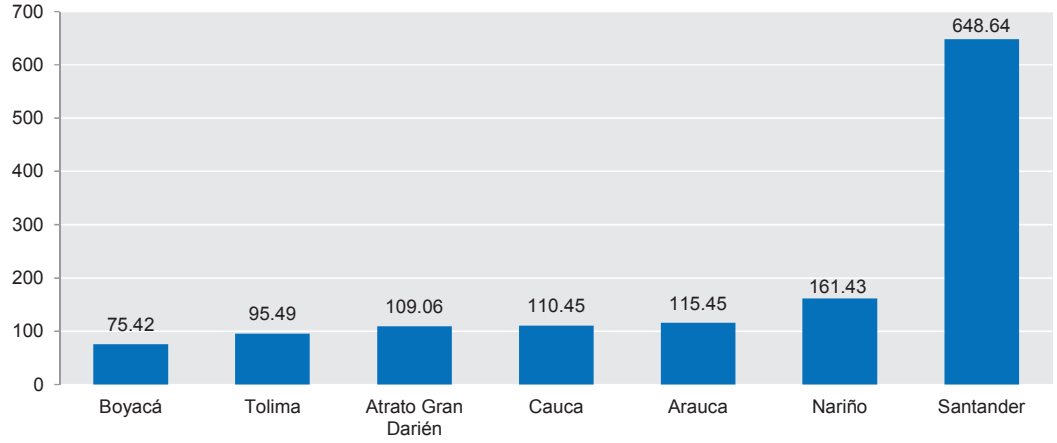
Table 5.1. **Main characteristics of the *Contrato* plans**

Contrato Plan	Area of intervention	Population 2013	Date of subscription	Duration (years)	Total amount of investment (USD)	Annual value of the contract (USD)	National financing (USD)	Percentage of national co-financing	Priority axes
Arauca	All 7 municipalities of the department	256 527	02/16/2013	8	923 607 165	115 450 896	578 414 004	63	Productivity and competitiveness
Boyacá	117 municipalities	1 272 855	11/10/2012	5	392 076 393	78 415 279	262 970 822	67	Road connectivity
Atrato Gran Darién	3 departments, 25 municipalities	1 004 151	09/13/2012	5	545 314 058	109 062 812	370 036 074	68	Sustainable social development
Tolima	9 municipalities South Tolima	228 552	01/12/2013	5	477 453 581	95 490 716	364 986 737	76	Connectivity infrastructure
Cauca	13 municipalities North of Cauca	394 408	01/19/2013	3	330 357 660	110 119 220	268 075 670	81	Infrastructure and environmental management
Nariño	14 municipalities	585 565	01/06/2013	5	807 148 712	161 429 742	656 142 343	81	Infrastructure
Santander	87 municipalities	2 040 932	07/27/2013	5	3 243 181 177	648 636 235	2 771 792 927	85	Competitiveness
Total	9 departments, 272 municipalities	5 782 990			6 719 138 746	1 343 827 749	5 272 418 578	78	Local and regional development

Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review: Colombia*", unpublished.

Figure 5.2. **Annual investment per department**

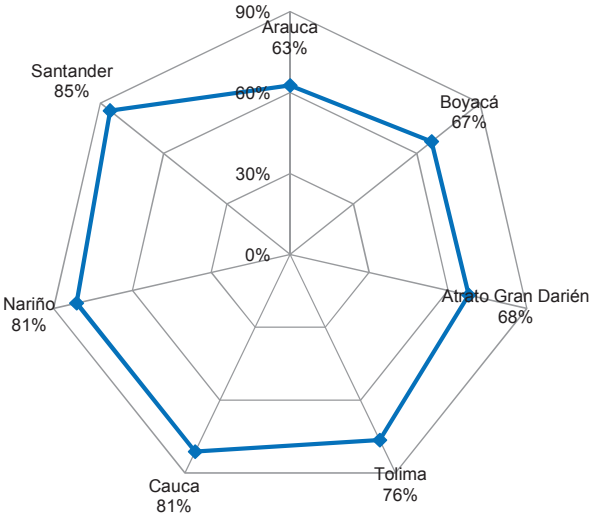
USD millions



Source: National Planning Department of Colombia (2013), background report prepared for the *OECD Territorial Review: Colombia*, unpublished.

On average, the central government is responsible for 78% of the total investment related to contracts, or about USD 5 200 million. Departments also exhibit significant differences, depending on economic performance. For instance, the department of Arauca co-finances up to 37% and the department of Santander up to 15% (Figure 5.3).

Figure 5.3. **Financing the central government provides for each *Contrato* plan**



Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review: Colombia*", unpublished.

In addition to a department's co-funding of interventions, the *Contrato* Plan requires sub-national authorities to match the following requirements:

- First, the department government has to ensure effective and timely monitoring of the measures taken. Since this is Colombia's first experience of contracts to deliver policies at the local level, monitoring is needed to determine whether the

policies are carried out in the anticipated direction, and to ascertain where and how to intervene to correct the trends, if needed.

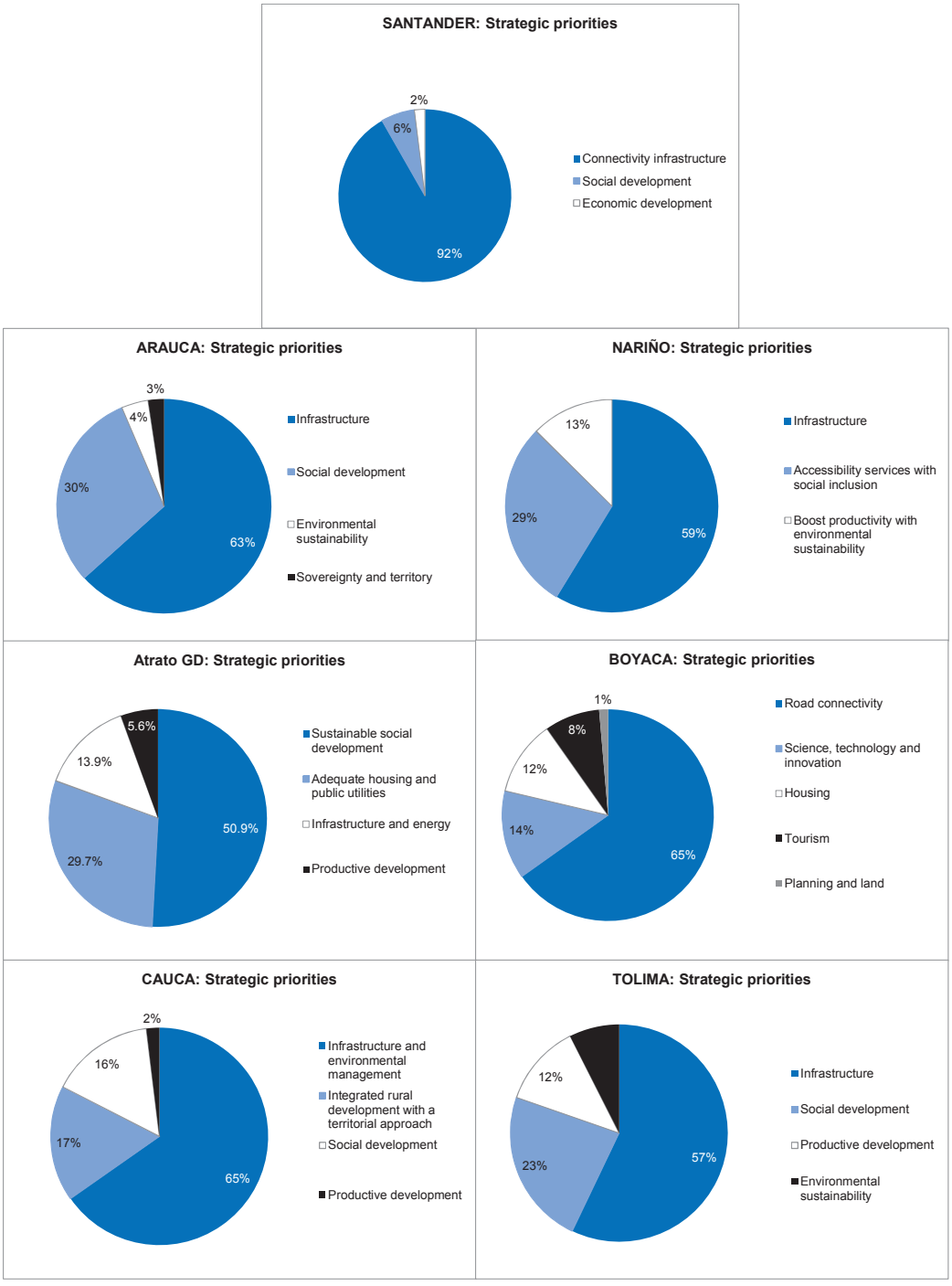
- Second, sub-national authorities must commit to evaluation of the project. In particular, they have to set up a coherent framework for monitoring both different stages of implementation and evaluation after the fact. The aim is to ensure that *ex post* evaluation does not suffer from a lack of data about baseline conditions and implementation processes (Lichfield et al., 1998). Evaluations based on this approach can have a dramatic impact on the quality of datasets at a local level.
- Third, the contract requires the creation of a partnership of the relevant local stakeholders who must be involved in the design and implementation of the contract. The intent is to ensure that the contract contributes to the creation of intermediate institutions supporting regional development.

Strategic priorities of Contrato *plans*

Contrato plans are intended to improve the capacity of Colombia's public authorities to deliver policy interventions, and in particular transport infrastructure. This is evident in surveying the strategic priorities of the seven contracts. Infrastructure is the most relevant objective in six out of seven contracts (Arauca, Boyacá, Cauca, Nariño, Santander and Tolima). The only exception is Atrato Gran Darién, which devotes the most resources to "sustainable social development" (Figure 5.4). In general, however, contracts exhibit some differences in the wording used to describe similar interventions.

- Arauca is investing USD 585 million (63% under the plan) to "productivity and competitiveness", which mostly focuses on transport infrastructure. In the same department, more than USD 391 million is being invested to improve the primary road network and some USD 80 million to improve the secondary road network. USD 280 million (30% of the total plan) is being invested to improve the housing supply and promote citizens' quality of life. Finally, the department plans to invest about USD 30 million to improve the delivery of education.
- Atrato Gran Darién is devoting USD 277 million, i.e. around half of the total investment allocated under the contract, to sustainable social development. In particular, more than USD 200 million is allocated to social inclusion, USD 51 million to health and USD 25 million to education. USD 162 million, or 30% of the overall investment in the contract, is allocated to housing and public utilities and USD 76 million to infrastructure. Finally, the plan allocates more than USD 30 million to productive development, in particular to enhancing local agricultural supply chains.
- Road connectivity tops the investment agenda of the *Contrato* Plan in Boyacá. The department devotes more than two-thirds of the overall investment to transport infrastructure. In addition, USD 53 million is devoted to science, technology and innovation, with the aim of creating two technological parks and a technology and innovation centre in the city of Tunja.
- In the department of Cauca, the majority of resources, around USD 216 million (or 65% of the total investment) is allocated to infrastructure and environmental management. USD 87 million is devoted to the road network in the north of Cauca and USD 85 million to water sanitation. Other relevant priorities are rural and social development, with instalments of USD 57 million and USD 51 million, respectively.

Figure 5.4. **Strategic priorities in the seven *Contrato* plans**



Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review: Colombia*", unpublished.

- The *Contrato* Plan of Nariño, which involves 14 municipalities, invests more than half of the total investment in transport infrastructure. In particular, USD 38 million is invested in improving the department's local airport and main port. USD 87 million is allocated to information and communication technology

(ICT). USD 231 million (29% of the overall investment) is allocated to social inclusion, with USD 83 million to water sanitation and water distribution systems. Education absorbs USD 57 million. The remaining USD 101 million is devoted to productive sectors, with USD 67 million for the development of new business opportunities and USD 34 million to help farmers substitute for illicit crops.

- Santander is investing 92% of its resources (i.e. USD 2 975 million) in transport infrastructure. More specifically, USD 2 411 million is allocated to the primary road network and USD 531 million to the secondary road network. USD 205 million goes to social development (with almost USD 100 million to water sanitation and water distribution systems, and USD 80 million to healthcare services). Finally, the contract allocates USD 63 million to economic development, mostly to develop tourism.
- Infrastructure is the key priority for the *Contrato* Plan of Tolima. Here, the total investment is USD 272 million, or 57% of the total budget of the *Contrato* Plan. Under this heading, USD 109 million is destined to the road network, USD 78 million to rural electrification, USD 53 million to water sanitation and water distribution systems, and USD 33 million to ICT to improve accessibility to mobile networks and the Internet. Other priorities are: social development, for a total of USD 111 million (USD 4 million to healthcare and USD 44 million to education); rural development, with a total of USD 58 million; and, finally, environmental sustainability, with an investment of USD 36 million.

The policy and legal frameworks supporting the *Contrato* Plan

The *Contrato* Plan is the result of a process of stratification of institutions, policies and norms to support regional development in Colombia. The country simultaneously faces the challenge of producing a realistic and actionable strategy to support regional development, along with the tools and governance to design and implement such a strategy throughout the country.

The *Contrato* Plan is linked with three sets of norms. First, it fulfils the constitutional mandate of a more developed devolution of powers to sub-national entities (OECD, 2013). Enacted in 1991, the Constitution of Colombia states that the national government creates national development policies, the municipalities organise and provide basic services and the departments serve as intermediaries between the other two levels, while also supporting the provision of basic services. Articles 339-342 of the Constitution establish that territorial entities must play an important role in the design and implementation of the National Development Plan, to ensure the efficient use of funds and the proper performance of the duties assigned therein. Second, the *Contrato* Plan is to be carried out in concert with the National Development Plan. Law 1 450 of 2011, which defines the National Development Plan 2010-2014 "Prosperity for All" ("*Prosperidad para Todos*"), identifies contracts as a way to deliver the plan at the sub-national level. Contracts are also linked to Law 1 454 of 2011, better known as the LOOT, which is an addendum to the Constitution and regulates land use and spatial planning. Among other things, this law strengthens territorial association models to promote local and regional development. More specifically, Article 18 of the LOOT establishes that the central government should be able to contract or agree with territorial entities, associations of territorial entities and metropolitan areas, on the joint implementation of strategic territorial development projects.

The LOOT and the Contrato *Plan*

The LOOT – albeit in line with the Colombian tradition of enacting very detailed laws – represents a dramatic innovation for the country. It required a lengthy process of deliberation and was enacted at a particular political conjuncture (OECD, 2013). Before its passage, it was not clear which level of government was responsible for spatial planning in the country. The law provides sub-national authorities with a set of financial allocation, capacity-building actions and key responsibilities for spatial planning. The LOOT provides for territorial entities, associations of territorial entities and metropolitan areas to become parties to an agreement with the central government.[3]

The LOOT created national and regional commissions to support policy makers at all levels of government and to harmonise spatial planning in Colombia. At the central level, it created the Land-use Planning Commission (whose Spanish acronym is COT). This is a technical advisory body that evaluates reviews and makes recommendations both to the government and to the special monitoring commissions for decentralisation and land-use planning in the Colombian Congress. The COT also deals with the adoption of policies, legislative developments and criteria for improving state entities within the national territory. At the regional level, the LOOT created regional land-use planning commissions active in all departments. This network of commissions facilitates and co-ordinates spatial planning at the local level and also provides the national government with information and feedback.

The LOOT aims to make Colombia's territorial governance more flexible. It introduces new instruments to co-ordinate spatial planning across administrative boundaries: administrative and planning regions (between two or more departments), planning and management regions (among territorial entities from different administrative-political jurisdictions), administrative and planning provinces (two or more municipalities within a single department), associations among metropolitan areas, among municipalities, and between affluent regions and poor territorial communities, to promote social equity and solidarity.

The *Contrato* Plan is part of the framework of territorial governance introduced by the LOOT. The contracts allow the national government to delegate competences to sub-national entities. The national government can contract or make arrangements for the joint execution of strategic territorial development projects with sub-national governments, associations of sub-national governments and metropolitan areas. Through the contracts, the LOOT promotes a model for regional integration that encourages strategic partnerships to generate economies of scale, productive projects and competitiveness, in order to promote development. In theory, sub-national governments could sign a *Contrato* plan that did not include the participation of the national government. However, at present, each of the contracts has established a new form of co-ordination between the central government and territorial levels.

The Contrato *Plan within the reform of the system of royalty payments*

The *Contrato* Plan is closely linked with the reform of royalty payments. This redistributes the revenue produced by extractive activities to all departments. Before the reform, the bulk of revenues remained in resource-based departments. The reform aims to co-ordinate regional development in Colombia and promotes the principle of solidarity: affluent departments are required to support development in the poorest territories. Under the reform, departments that are not endowed with extractive activities can use the

additional funds generated by the reform of *regalías* (royalties) to co-finance measures detailed in the *Contrato* Plan.

The *Contrato* Plan provides departmental governments with a clear framework within which to organise their investment and design their projects, and helps to ensure the implementation of the interventions. This may help ease the relationship between the department and the *órganos colegiados de administración y decisión* (OCADs), the political bodies in charge of evaluating projects financed with revenue from the royalty payments. Departments that have signed a contract with the central government may have a higher number of projects approved by their OCAD.

The Contrato *Plan supports rural development*

The *Contrato* Plan signals that the government is now supporting development in all regions, rural and remote areas included. Contracts are designed to facilitate the delivery of regional development policy in poor municipalities. Most of these are located in sparsely populated and remote areas. This marks the first time that Colombia has instituted a policy with a strong territorial dimension that is specifically targeted to rural areas. Hitherto, Colombia's approach to regional development had suffered from an urban bias. National policy concentrated investment and policies in major cities, expecting development to trickle down to surrounding territories. The evidence is that this has not taken place; and the country is now suffering from a marked division between the urban and the rural.

In the departments of Cauca and Tolima, contracts support the implementation of the Integrated Programme of Rural Development with Territorial Approach (or PDRIET, its Spanish acronym – see Chapter 2), which aims to combat extreme poverty in rural households. The National Department of Planning launched PDRIET as a pilot project in the municipality of Chaparral (Tolima) in 2012. The launch of the *Contrato* Plan – which suddenly improved the institutional capital in the departments that signed such contracts, along with co-ordination of sectorial policies, allowed the National Planning Department to extend the PDRIET to seven municipalities in southern Tolima and nine municipalities in northern Cauca in 2013 (Box 5.1). The PDRIET is a platform that co-ordinates sectorial policies and bodies to promote a new approach to rural development. This both supports poor households and promotes the creation of an enabling environment to improve access to income-generation opportunities: i.e. employability and entrepreneurship.

Contrato Plan: Similar international experiences

Colombia's experience parallels good practices in OECD countries, including that of the European Union. Annex 5.A1 provides an overview of the use of contracts in OECD countries. In particular, the *Contrato* Plan may be compared to the territorial pacts developed and implemented in the European Union during the 1990s (Box 5.2) within the framework of the EU's Cohesion Policy. The Cohesion Policy provides additional public investment to those regions whose GDP per capita is 25% lower than the EU's average GDP per capita. Territorial pacts were created to pool knowledge of development opportunities in lagging regions, and were based on a "bottom-up" approach. This implied the creation of a regional partnership among key stakeholders co-operating on a regional development strategy.

Box 5.1. **Integrated Programme of Rural Development with a Territorial Approach (PDRIET)**

The Integrated Programme of Rural Development with Territorial Approach (PDRIET) blends social policy and territorial development policy. The government of Colombia intends to use it to deliver policies directly to households, and is implementing measures to create an "enabling environment" to facilitate their access to income (endogenous development). The PDRIET, for instance, identifies what type of crops a territory can produce to increase its income-generating capacity. Poor households are identified in co-operation with local authorities (municipalities), to compensate for the lack of clear data at the national level. The PDRIET functions along three main axes, as listed below.

1. The first axis concerns social and productive planning. The PDRIET aims to formalise property rights in rural areas and – based on soil and market analysis – to assess the kind of crops and productive systems that would improve regional competitiveness.
2. The second axis focuses on service delivery. The aim is to provide poor households and local businesses with access to a broad range of services, including healthcare, water sanitation, education and transport infrastructure.
3. The third axis concerns skills and human capital. The PDRIET implements capacity-building activities to improve the employability of rural citizens, as well as their capacity for self-sustainability. The PDRIET also supports businesses and entrepreneurship and promotes the accumulation of assets.

To achieve these objectives, the PDRIET co-ordinates different sectorial policies at the local level. In particular, it is working with several public bodies formulating policies for rural communities. These are: the Colombian Institute of Rural Development (INCODER); the Ministry of Agriculture and Rural Development; the Ministry of Water and Water Sanitation; the National Service of Learning (SENA); Colombia's agriculture development bank (*Banco Agrario de Colombia*); the Department for Social Prosperity (DPS); the Ministry of Labour; the Special Administrative Unit for Assistance and Integral Reparation for Victims; and the Territorial Consolidation Administrative Unit. It is worth noting that all interventions within the PDRIET are monitored and evaluated to maximise the learning opportunities provided by this experimental approach to rural development.

The PDRIET is based on four phases: a diagnostic phase, a development phase, an execution phase and, finally, a monitoring and evaluation phase. The phases required for the implementation of the programme are not necessarily sequential, as it is possible to undertake parallel interventions that complement each other.

Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review: Colombia*", unpublished.

The *Contrato* Plan parallels the European experience, with some differences. Under the contracts, the department is not simply the passive recipient of development interventions, but the "activator" of a set of vertical and horizontal institutional relationships generating a process of cumulative development and learning. The contracts require local and national actors, for the first time in the Colombian context, to define common guidelines and procedures for elaborating projects and jointly managing, monitoring and evaluating them.

The *Contrato* Plan and territorial pacts have other differences. For instance, Colombia has not created an integrated regional development strategy that specifically targets lagging regions. In the EU, the territorial pacts were an instrument of Cohesion Policy, which focuses specifically on lagging regions. While, in theory, all European regions

could create a local partnership and then a pact, only lagging regions could receive additional funds to promote economic development (or catching up). In Colombia, contracts are not designed to tackle a specific issue, as cohesion plans are. Any department can thus sign an agreement with the central government to promote a co-ordinated investment strategy.

Box 5.2. **Territorial pacts in the European Union**

Territorial pacts represent a substantial innovation. Previous policies aimed at regional convergence featured a substantial degree of "centralism", in a special class of public programmes known as "negotiated planning", which placed particular emphasis on the involvement of local communities in designing the policy. The guiding principle of the territorial pacts is that to maximise their effectiveness, development programmes should originate with local stakeholders. In particular, the rationale is that an agreement among agents in potential conflict (e.g. trade unions and entrepreneurs), should be better able to deliver an effective development strategy in which all agents are willing to co-operate on a common goal of economic growth.

The European experience in regional policy has involved the development of an adequate, well-constructed mechanism of partnership as part of a wider and modern system of relationships between the community, national, regional and local institutions of each member country. These and the organisations representing collective interests, known as the partnership, sustain the governance process. The European Commission devoted a White Paper to this delicate issue, presented in 2001, which established the guidelines on which such relationships should be based. This document recommends greater openness in preparing EU policies, increasing participation from citizens and organisations in identifying and presenting these policies, and thereby fostering greater openness and responsibility among the parties involved. In this way, citizens should be able to see that public institutions take into account the social, economic and institutional perspectives of the collective interests, so as to offer the best solution for their concerns and expectations. The European Commission thus indicated to member countries, and to those planning to become part of the EU, that open governance is a better way to strengthen administrative activity, make the decision process more transparent, and bring public institutions and public administration closer to citizens.

Source: Accetturo, A. and G. de Blasio (2012), "Policies for local development: An evaluation of Italy's 'Patti Territoriali' ", *Regional Science and Urban Economics*, Vol. 42, Nos. 1-2, pp. 15-26, Elsevier.

Evidence from case studies: Opportunities and challenges for negotiated territorial development in Colombia

This chapter illustrates information gathered in three case studies, each involving a *Contrato* Plan: the department of Nariño, the municipality of Chaparral in the department of Tolima, and the department of Santander. The case studies selected provide a chance to assess contracts from the perspective of both departments and municipalities.

The Contrato Plan of Nariño

The department of Nariño is an agricultural area bordering Ecuador. Its highly diverse topography includes a tropical coast, a mountainous central area crossed by the Andes mountain range, and a rain forest on its eastern border, where the Amazonas region starts. Its population includes various ethnic groups and the total population is 1.7 million in a territory of 33 268 square kilometres. The capital, Pasto, with half a million inhabitants, is the largest urban pole. The rest of the department is predominantly rural, and remote rural

along the Pacific coast. Its economy is based on smallholdings (micro-farms in the Andes) and small-scale fishery. The department struggles to deliver basic public services to rural residents. Enrolment in primary school is 68%, with only 5% in secondary school. Since much of the population lives in Pasto, the percentage of school enrolment is dramatically low in rural areas.

The national government supports the department by earmarking funds for education, healthcare, water sanitation and infrastructure. However, transfers from the central level can only be used to cover citizens' basic needs and not for economic development. The reform of royalty payments has provided the department, which has no extractive activities, with additional public funds for regional development. As noted above, revenue generated by royalty payments was a key precondition for the implementation of contracts.

The *Contrato Plan de Nariño* is active in 14 (out of 64) of the department's poorest municipalities, which are located along the Pacific coast. Its strategic focus is to increase local productivity. This goal is supported by several actions. The contract puts in place interventions to support the use of technology in agriculture, especially in smallholdings. Other interventions aim at improving the local transport infrastructure (the port and airport) and road connectivity. Another set of projects aims to reduce the cost of energy, which is a burden on local competitiveness.

The case of Nariño illustrates the way in which different levels of government co-ordinate to deliver interventions listed under the contract. The national government is in charge of building major transport infrastructure. Department authorities do not have the capacity to deal with large, complex projects, which involve a high degree of bureaucratic complexity (procurement, for instance). The departmental government, conversely, can capitalise on its profound knowledge of the territory and on its understanding of its needs and opportunities. For instance, the department of Nariño delivers those interventions in the contract designed to support business and farming.

According to local stakeholders, the contract also facilitates the use of funds generated by the royalty payments. The reform of royalty payments distributes revenues generated by extractive activities to all departments in Colombia. However, departments need formal approval by the OCADs to use these funds. Regional OCADs are political bodies that involve three constituencies: the central government, representatives of regional departments and representatives of the National Department of Planning (DNP). Projects are approved when two out of three constituencies vote for them. Investment projects presented by a department implementing a *Contrato* Plan already have the support of the national government and the DNP. They thus have a greater chance of being approved by the OCAD, compared with projects presented by departments that are not involved in a *Contrato* Plan.

In Nariño, the local partnership plays a key role in the implementation of the contract. In fact, the *Contrato* Plan is simply a list of interventions. The fact that both national and regional authorities agreed on this list does not necessarily mean that they will be implemented. Local actors, and in particular the co-ordinator of the *Contrato* Plan, have a decisive role. The co-ordinator is selected by both the national and local authorities. The co-ordinator, supported by a small team of experts, "animates" the contract by interfacing public authorities and local stakeholders, and by promoting the co-ordination of different sectorial policies.

The Contrato *plan in the municipality of Chaparral*

The municipality of Chaparral has a population of 150 000 and is part of the department of Tolima, in central Colombia. The local population is dispersed over 2 224 km², so population densities are quite low. The main city centre is surrounded by 120 *veredas* organised in 5 *corregimientos*. *Veredas* are small urban centres (sometimes simply some families living in the same area), which can be remote from the main area and from main roads.

Chaparral is a hub for Colombia's regional development policies. In addition to its poor economic performance, it has drawn the attention of the national government for specific local conditions. Chaparral is part of the rural region where a variety of guerrilla groups coalesced to create the Revolutionary Armed Forces of Colombia (FARC) in the 1920s and 1930s. Thanks to the presence of opium poppies and coca plantations, the municipality was a focus of "Plan Colombia" (and later on, the "Consolidation Plan") and has suffered the displacement of a large share of its rural population. The municipality of Chaparral is one of the nine municipalities covered by the *Contrato* Plan of Southern Tolima, and it is also the location for the DNP's first PDRIET pilot project.

The experience of Chaparral parallels that of Nariño, yet key differences emerge in the way the local government is implementing the contract. In Chaparral, the contract has "activated" the local government, which has been implementing the interventions listed in the contracts. For the first time, the municipality of Chaparral can handle resources and manage funds. This has had a positive impact on local capacity and improved the co-ordination of policies at the local level. As distinct from Nariño, however, the municipality of Chaparral was not involved in the selection of interventions included in the contract. These were selected based on the department of Tolima's Development Plan. The municipality thus does not "own" the contract but considers the *Contrato* Plan the most recent policy percolating from the upper level of government. Of course, this may also depend on an excessive stratification of national policy interventions in the municipality, which may reduce the marginal utility of the *Contrato* Plan for local stakeholders.

Another difference concerns the local partnership involved in implementing the contract in the municipality. The relationship between the business community, citizen organisations and NGOs at the local level is very weak. The impression is that the contract did not take into account small-sized "intermediate institutions". An example: Chaparral produces a high-quality coffee. Local small producers are organised into co-operatives that produce services for their members, including business services. Interestingly, the *Contrato* Plan does not include these bodies in the local partnership, and does not implement any specific intervention to support small coffee producers in the municipality, despite their past involvement in drug production.

One other issue concerning the implementation of projects funded by *regalías* is worth noting. The municipality of Chaparral, like Nariño, does not have any extractive activities. The royalty reform provided the municipality the additional resources to invest in local development. To invest these funds, the municipality must prepare an investment project, which must be approved by the OCAD, and a municipal OCAD has not yet been set up. This means the municipality has to present its project to the departmental OCAD or to the regional OCAD, which meets less frequently. At these levels, the municipality of Chaparral is just another municipality under the *Contrato* Plan, in no position to enjoy the advantage Nariño has, whereby the department presents projects to the OCAD organised

at the department level. To be fully effective, the contract needs to be supported by a set of institutions that facilitate the implementation of the projects listed in the agreement.

The Contrato *Plan in the department of Santander*

The department of Santander is located in the northeast of Colombia. It covers an area of 305 000 km² and has a population of more than 2 million (2012). Its territory is divided into two large geographical regions. The western part is flat and borders the shores of the Magdalena River. The eastern part is a mountainous region where the departmental capital, Bucaramanga – the fifth-biggest city in Colombia and one of its main economic centres – is located. Santander is one of Colombia's economic powerhouses. The department is specialised in manufacturing (see Chapter 1) and in particular, in oil refining. Large oil refinery plants are located in the city of Barrancabermeja (known as the oil capital of Colombia) on the banks of the Magdalena River. As a result, the department performs well in terms of service delivery (education and healthcare, for instance) and also in terms of employment rates.

The *Contrato* Plan of Santander focuses on regional competitiveness. As already noted, this contract is the largest in terms of total investment and also among those for which the central government provides a large share of the funding. Because Santander is one of Colombia's manufacturing powerhouses and has a pro-active and well-organised business community, public investment may trigger a growth dynamic that benefits the national economy as a whole.[4] Second, the department is among those that received direct royalty payments before the 2011 reform. This makes it important that the share of public investment not decline because of the change in the system of allocation of royalties. In this sense, the contract is intended to maintain the pace of public investment, and co-ordinate different sources of investment in the department. Third, the regional economy has so far been growing, despite the lack of transport infrastructure. Improving connectivity within the department (within the broader national strategy of connecting main urban poles, called *Misión de Ciudades*, as discussed in Chapter 4) is likely to be beneficial to one of the most dynamic regions in the country.

The case of Santander illustrates the advantages of the contract framework, and also some of its limits. First, the *Contrato* Plan is a flexible tool, which can be adapted to different regional contexts and strategic aims. It can be an instrument to reduce poverty, as in the case of Nariño and Chaparral, but it can also be used to promote competitiveness, as in Santander. Second, regional political leadership, stakeholders and constituencies play a key role in the contract. Their quality and capacity to develop a vision for their region are key to the success of the *Contrato* Plan in terms of the pace of investment and coherence of investment projects. However, as some of those involved in local businesses have noted, the contract does not resolve one of the key problems of territorial governance in Colombia: the fact that all regional policies are designed and implemented at the department level. Santander's economy is functionally connected with areas in the two neighbouring departments: Boyacá in the east and Antioquia in the west. Firms and workers from these departments interact with Santander-based economic agents on a daily basis. Yet, departmental governments do not have incentives for co-operation and co-ordination, and territorial policy interventions implemented by the central government do not take into account the existence of functional economic areas that do not fall within their administrative borders.

Conclusions

The *Contrato* Plan was introduced in Colombia in 2012, so it is still too early to evaluate the policy's full impact. Based on available information, however, it is possible to determine that the new formula has introduced a series of innovative elements that enrich Colombia's approach to regional development, including co-ordination among sectorial policies (in particular between spatial planning and economic development); the creation of partnerships supporting the implementation of policy (multi-level governance); and helping departments' plans support medium- and long-term development strategies.

These are substantial achievements, given that Colombia does not have a fully-fledged regional development policy. As shown by Barón and Roca (2003), Colombia had not instituted a regional development policy to reduce regional inequalities, despite its large and persistent income disparities. Improvements have been noted in recent years, with the National Development Plan "Prosperity for All", and – in particular – with the reform of royalty payments. In general, however, the approach is still project-based, rather than programme-based, representing a series of disconnected short-term policy interventions, rather than a long-term development programme.

The *Contrato* Plan has introduced a *modus operandi* that could help Colombia develop a regional development strategy. The contracts require the creation of a partnership among local authorities, which may involve business and citizen organisations. Such partnerships could better inform policy interventions of the needs and opportunities in a given territory, demonstrating the value of multi-level governance to national and sub-national authorities. The *Contrato* Plan could also have an impact on the national industrial relations system. For instance, contracts could introduce a new form of decentralised collective bargaining, which would facilitate productive diversification in under-utilised areas.

The use of the *Contrato* Plan, and other forms of agreements supporting territorial development, may facilitate the devolution of power to local authorities. Many aspects of policy implementation could be left to local governments (and partnerships). This would help tailor projects to real local needs and relieve the pressure on national authorities (especially the National Department of Planning), which now have to design, implement, deliver and evaluate policy interventions throughout the country.

The effectiveness of the *Contrato* Plan could be compromised in a number of ways. Contracts may be exposed to the disruptive effects of opportunist behaviour or collusive coalitions. According to Sabel (1992), such instruments can be fragile because they depend on the adherence of all the actors involved. The more actors search for *ad hoc* solutions to overcome obstacles, the more necessary the consensus-based co-ordination of initiatives becomes. Joint definition of pacts or agreements, or at least of shared norms, helps establish common parameters and set limits on actors' discretion. This is necessary in an area where parameters and constraints deriving from norms fixed by national laws or agreements are not clear, or at the early stage of implementation (Regalia, 2003).

Such considerations of the fragility of agreements involving multiple actors may be applicable to Colombia. Territorial planning has a relatively short history in Colombia and is superimposed on a top-down, sectorial approach to policy design and implementation that is still in place. Its territorial planning has been subject to divergent corporate interpretations and approaches, almost always limited to the preservation of natural resources. Most importantly, these have entailed a lack of normative and legal

developments that should serve as support for the management of territorial entities, thus reducing the possibilities of legitimising such management (Andrade, 2013).

The *Contrato* Plan, despite its potential positive impact on Colombia's strategic approach to regional development, is simply an instrument of implementation. As noted above, the contract is an agreement to implement a series of interventions already defined in the department's development plan. At this early stage, contracts focus on transport infrastructure. It is relatively easy to identify the lack of road connectivity as a problem for regional development. However, in the near future, once the infrastructure gap has been filled, or is no longer the top priority on local political agendas, other regional priorities must be determined. In other words, improving the quality of departments' development plans will help build a strategic framework for delivering interventions through the contracts.

Finally, the *Contrato* Plan may be an effective way to support regional development in territories that have enough institutional capital to participate in this instrument. The analysis and field visits suggest that the departments that are participating in a contract display relatively good performances in terms of economic growth and public service delivery. This is not a negative characteristic per se. The government should nevertheless recognise the need to design a regional development strategy that can promote economic growth in territories suffering from a lack of institutional capital and where citizens suffer the most from a lack of accessibility to key services and to opportunities for generating income.

Policy recommendations

Colombia could improve the effectiveness of the *Contrato* Plan by taking the following steps:

1. Mainstream technical assistance within all seven *Contrato* plans, to increase local expertise. The contract is a binding agreement in which all parties commit to deliver a series of policy interventions. For departments, and especially for local governments, the contract represents their first experience with policy implementation and management. They have to articulate national and local resources and manage funds according to a given deadline. While sub-national authorities are willing to commit, the implementation could represent a challenge for them. The national government should ensure that sub-national authorities at all levels are supported in the implementation of the part of the agreement that is their responsibility. This can be done by providing local and regional stakeholders with technical assistance that accompanies them, without taking over their tasks.
2. Network the seven *Contrato* plans to promote mutual support and exchange of good practices. The contracts function in parallel. While the National Department of Planning is involved in the implementation of all seven *Contrato* plans, co-ordination among sub-national authorities is lacking. This is a missed opportunity for mutual learning. In fact, sub-national authorities could illustrate and discuss among themselves the opportunities and challenges linked with contracts. They could also lobby the national government to improve the current model, if needed. A network of sub-national entities (including municipalities) could facilitate the collection of examples of good policy practices and help replicate them for other *Contrato* plans. Where possible, these good practices could also be "exported" to regions that are not part of contracts, but face similar challenges promoting regional development. This is particularly true for lagging

regions, whose lack of capacity has hampered their chance of signing a *Contrato* plan with the national government. Finally, networking departments could trigger some form of co-operation, which – as shown in the case of Santander – is needed to promote regional economic development in territories that include two or more departments.

3. Set a series of measurable policy objectives to facilitate monitoring and evaluation, and introduce an "incentive mechanism" to validate the experience of sub-national levels achieving their objectives. Colombia should promote the monitoring and evaluation of public policies, in general. Evidence is scant on the impact of the policies it has undertaken in recent decades to support regional development. Such experiences could be instructive and would represent a reserve of knowledge of key challenges and opportunities in local communities. It is thus important to step up efforts to monitor and evaluate interventions implemented within the framework of a contract. The *Contrato* Plan requires sub-national authorities to engage in monitoring and evaluation. This is a step in the right direction. Monitoring, however, could be easier if the *Contrato* Plan set a series of measurable targets to achieve in a given period. Of course, policy targets should be realistic, and not be limited to "low-hanging fruit". The national government could also set up incentives (some additional funds, for instance) for the sub-national authorities, including local government, that are able to meet the targets set by the contract. Several international cases show the positive impact of such incentives on the implementation of territorial contracts or other such instruments supporting regional development (Box 5.3).

Box 5.3. **Example of a rewarding mechanism: The use of performance reserves in Italy**

Within the 2007-2013 National Strategic Reference Framework (NSRF) budget for the Mezzogiorno, Italy set aside a performance reserve for regional policy (*obiettivi di servizio*) of EUR 3 billion, almost 3% of the overall budget, to reward well-performing regions. Like the EU performance reserve established for the 2000-06 programming period, the Italian performance reserve intended to achieve lasting improvements in regional governance in "Objective 1" (lagging) regions, as well as to strengthen some administrations operating at the central level of government. The scheme set aside an additional 6% of funds, effectively making access to 10% of regional development policy funds conditional on performance. While the overarching goal of the reserve was to promote institutional capacity building, its specific objectives were to modernise public administration, to promote and anticipate reforms in certain sectors deemed crucial for achieving development objectives, and to mitigate somewhat the incentives for rapid Structural Funds spending implicit in the N+2 de-commitment rule, by creating incentives to select and organise more complex and higher quality projects. The extension of the reserve until 2013 has focused on outcome and equity indicators, ensuring uniform access and quality of public services, especially education, child and elderly care, water and waste management.

This practice has had different advantages. First, it introduced a programming approach based on results within all levels of governance. This has shifted the logical sequence of programming from expected results to needed actions, rather than the other way around. Secondly, it has encouraged decision makers to co-ordinate financial resources, contextual conditions and responsibilities. Thirdly, it strengthened the role of monitoring and evaluation practices. Further, it has provided transparency and accountability rules. Finally, the scheme has not only rewarded the regions: if a region misses a target, its better-performing municipalities could still receive up to 50% of the resources assigned to an indicator, while the remaining would go to better-performing regional authorities.

Box 5.3. **Example of a rewarding mechanism: The use of performance reserves in Italy** (*cont.*)

One recent assessment (Anselmo, 2012) suggests a number of lessons from the Italian experience that may have wider relevance. First, financial incentives have been effective because they reinforce reputational incentives in the context of clearer accountability. Financial incentives alone might not induce a results-oriented attitude in all relevant actors. Secondly, the scheme has worked well in part because it is focused on a few policy areas and indicators, excluding domains where the institutional setting is too complex or causality too difficult to assess. Thirdly, it is important that the final results largely depend on the actions of the managing authority subject to the incentives; if outcomes depend too greatly on the actions of others, incentives are likely to have little effect. Fourth, the choice of how to attain the desired results has largely been left to the regional authorities. However, technical assistance from the centre has, in some cases, been required to support the preparation of the action plans. Finally, revision of milestones/targets during implementation can be challenging, but may be necessary.

The Italian experience has thus far achieved satisfactory results, and indicates that the financial incentives of a performance reserve can be effective for increasing quality and the accountability of the authorities involved. However, such performance schemes are best accompanied by regional methodological capacity building and technical assistance resources, to ensure the quality of the indicators and the information collection effort.

Sources: Venanzi, D. and C. Gamper (2012), "Public investment across levels of government: The case of Basilicata, Italy", report for the 28th OECD Territorial Development Policy Committee, 4-5 December 2012, www.oecd.org/regional/effectivenessofpublicinvestmentatsub-nationallevelintimesoffiscalconstraints.htm; Anselmo, I. (2012), "The 2007-2013 Italian Performance Reserve – Measurable objectives for public services provision in Mezzogiorno", Ministry of Economic Development, Rome; OECD (2009), *Governing Regional Development Policy: The Use of Performance Indicators*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264056299-en; Mizell, L. (2008), "Promoting performance: Using indicators to enhance the effectiveness of sub-central spending", *Working Papers on Fiscal Federalism*, No. 5, OECD Publishing, Paris, http://dx.doi.org/10.1787/5k97b11g190r-en.

4. Improve the quality of departments' development plans. Colombia intends to develop a network of regional observatories that could play a key role in supporting development planning at the department and municipal level. Thanks to the *Contrato* Plan, development plans at the department level have become important policy documents, because the contract selects interventions to be implemented from those listed in the local development plan. For the time being, most contracts focus on road connectivity. In the future, policy interventions to support development will be less evident and require reliable analysis of regional needs and opportunities (territorial indicators) as well as an effective, participatory development strategy that presents a vision for the future of the territory. A cross-sectorial approach is needed. For this reason, improving the quality of development planning at the department and municipal levels is vital. Local governments should be supported by technical bodies that can provide them with reliable assessments and information about policy approaches implemented in other parts of the country. It is also worth noting that Colombia's economic development will add complexity to the national economic structure and to development challenges in general. The effectiveness of the planning system will depend on the capacity to co-ordinate development plans across all levels of governments.

Notes

1. Currency conversion values are as of December 2013.

2. OECD research draws an important distinction between "transactional" and "relational" contracts. "Transactional" contracting involves an *ex ante* determination of the complete set of binding and enforceable rights and duties of the parties, including the co-ordination arrangements. The key challenge concerns the incentives needed to encourage the parties to make good on their obligations. The resulting contracts are contingent, complete (in theory, at least), often complemented by an incentive mechanism and ultimately enforced by third parties, such as the judiciary. By contrast, "relational" contracting involves parties committing to co-operate *ex post facto* (after the signing of the agreement). Supervision of compliance with the agreement tends to be bilateral, relying on a spirit of co-operation. Their primary purpose is not to cement the parties into a complete set of binding and enforceable commitments, but rather to serve as a mechanism for collective decision making that generates trust and facilitates co-operation, information sharing and capacity building. In practice, most contracts fall somewhere on a continuum between transactional and relational (OECD, 2007; 2013).

3. The Organic Law governing the Territorial Organisation in Colombia n. 1454 of 2011 (LOOT) establishes the rules of land use in Colombia and also strengthens territorial association models in order to promote local and regional development. More specifically, the law's Article 18 establishes that the nation may contract or agree with territorial entities, associations of territorial entities and metropolitan areas, on the co-ordinated implementation of strategic territorial development projects.

4. Colombia's regional development councils, which operate at the department level, are associations that bring together the local business community. In Santander, this private body actively promotes economic development and provides the public sector with information on investment needs and opportunities. It also facilitates the co-ordination of different sources of financing and promotes private investment in the department.

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Annex 5.A1
How selected OECD countries use contracts to support regional development

OECD work has looked at specific cross-governmental contracts for regional development in Canada, France, Germany, Italy and Spain (OECD, 2007). The aim of the investigation was to understand the rationale of contracting, as well as the type and implications of the different levels of government. Since then, the use of such contracts has spread. The examples in Table 5.A1.1, although they do not give a complete picture of all of the existing contracts across levels of government in OECD countries, suggest some important lessons that can inform the future development of cross-governmental contracts for regional development:

- The territorial employment pacts (TEPs) in Austria have been found to be effective in bringing all labour market actors across levels of government together to tackle local employment challenges and policy (Committee of the Regions, 2012). The TEPs aim to implement the National Reform Plan for Growth and Jobs that seeks to co-ordinate across relevant policy areas, including employment, education, regional economic and structural policies, using an integrated, place-based approach.
- The new government in the United Kingdom abolished England's local and multi-area agreements (LAA and MAA) and replaced them with local enterprise partnerships. Nevertheless, a number of lessons can be learnt from the previous contracts. Contracts across levels of government in the United Kingdom have tended to remain relational and non-binding, leaving substantial discretion to sub-national authorities. Although the LAAs succeeded in fostering a partnership approach among local actors, they were unsuccessful in promoting local accountability. Instead, they reinforced the accountability of local actors to their central-level departments. This blurred the lines of responsibility for delivering outcomes (Department for Communities and Local Government, 2011). An evaluation of the MAAs found similar challenges. The persisting centralisation, and thereby fragmentation, of funding mechanisms at the local level (a number of separate funding streams) undermined central- and local-level co-ordination across sectors. Fragmented funding was accompanied by separate targeting mechanisms, albeit in the context of an integrated local strategy. This further undermined co-ordination at the local level. Furthermore, the MAAs posed a serious capacity challenge for national and local actors in terms of time and resources, as well as in the development of a culture of collaboration and a better understanding of mutual needs (Russell, 2010).
- The initial regional contracts in Poland served as a learning device preparing the regional authorities for the management of the EU Structural Funds in a multi-level setting (OECD, 2008). These contracts created a stable and multi-annual framework for vertical co-ordination, allowing regional authorities to complete long-term investment plans. Nonetheless, it has been argued that the contracts remained stuck in what was previously a centralised framework, rather

than putting the regions at the centre of regional development policy making. Instead of introducing a co-ordinated, place-based approach, the contracts served as a tool for the local implementation of national programmes, the need for which arose because fiscal decentralisation did not match the regions' assigned responsibilities. This reinforced their financial dependence on the central government. The centre's approach to managing EU Structural Funds further undermined the regions' role, reducing the regional contracts to an instrument of the EU-funded programmes rather than instruments for regional policy planning and co-ordination (Ferry, 2003; Regulski et al., 2012). The National Regional Development Strategy for 2010-2020, which replaces the existing contracts, aims to introduce a more integrated, place-based approach. Its intent is to create synergy between all regional policy instruments with a territorial impact across levels of government, in particular by specifying the sources of funding for the measures envisioned under the strategy.

- The experiment with the regional growth agreements (RGAs) (OECD, 2010) created scope for the emergence of new forms of governance in Sweden's regions, drawing on the country's strong traditions of co-operation and inclusiveness. Nonetheless, the scheme suffered from a lack of clear lines of accountability and from conflict, owing to the lack of settled and institutionalised authorities at the regional level (Svensson and Östhol, 2001; Svensson, 2001). The central government also retained strong control over the priorities of the RGAs, which ultimately failed to recognise regional needs and requests. As a result, the scheme has been discontinued and replaced by regional development programmes (RDPs), strategic documents designed at the regional level and backed by regional growth programmes (RGPs). The RGPs serve as voluntary operational sub-programmes that specify in greater detail the priorities and measures outlined in the RDPs. While the RDPs have the advantage of being genuinely bottom-up and designed by the regional actors, they hardly fit the definition of a contract, because no strong enforcement mechanisms and little in the way of dedicated resources have been provided for. Instruments other than contracts have thus been required for co-ordination.

The preceding examples of cross-governmental contracts for regional (local) development suggest three common conclusions. First, contracts appear to be an effective instrument for introducing a co-ordinated approach to regional (local) integrated development policies. They seem to succeed in bringing actors together to form a joint policy strategy. Secondly, however, many contracts remain largely unsuccessful in changing existing fragmented and compartmentalised structures, because the relevant competences often remain unchanged. In addition, contracts may not be sufficiently integrated with budgetary processes, so that financing – and thus implementation – are not assured. Thirdly, while contractual arrangements can be employed as a capacity-building device, they sometimes also limit existing capacity, both at the local and the national level. They can create structures that are parallel to existing administrative processes, which increase the administrative burden and the need for expertise at the local and higher levels to engage in these new structures. It is thus crucial to ensure that contractual arrangements are, as far as possible, aligned with existing ways of doing business and are accompanied by training for all levels of government in how to implement them.

Table 5.A1.1. **Inter-governmental contractual arrangements for regional policy across OECD countries**

	Austria	Belgium	Finland	Netherlands	Poland	Sweden	United Kingdom
Contract name (year created)	Territorial employment contracts (1997)	Flanders 2020 Pact	Oulu Growth Agreement (2002)	Rural contracts (2006)	Regional contracts (2001)	Regional growth agreements (2000)	Local strategic partnerships
Why this case study is interesting	"Model" relational contracts focused on a given policy area applied in a federal setting	Horizontal contractual arrangements at the sub-national level, co-operation mostly on a strategic level, but also an emphasis on quantifiable targets and performance assessment	Contractual arrangement in a highly fragmented institutional setting, key role played by municipalities rather than regional authorities, example of innovation policy and partnership	Rare example of a transactional contract focused on rural policy, which operates in the context of the Netherlands, where strong inter-dependencies exist between rural and urban areas	Contracts modelled on the French *Contrat de projets État-région* (CPER) applied in a decentralised setting (however, with strong centralisation traditions); example from Central and Eastern Europe, where regionalisation and regional policy are still a relative novelty and where most EU Cohesion Funds are allocated	Contractual arrangements applied in a bottom-up setting, experimental and ongoing regionalisation in traditionally centralised Sweden	Example of loose relational contracts implemented in the context of devolution institutional flux
Type of contract	Relational	Relational	Relational	Closed, transactional	Relational, with transactional elements	Relational, with transactional elements	Relational
Government actors (lead co-ordinating unit in **bold**)	– **National government (Federal Ministry of Economy and Labour)** – Federal states – Local/district authorities – EU Social Fund – Social and economic partners (including the Chamber of Agriculture, trade unions, etc.)	– **Flemish government** – Social Economic Council of Flanders (representing the key social and economic partners) – United Associations (umbrella organisation for civic organisations)	– Municipality of Oulu – Municipalities of the Oulu Region – **Oulu Region Centre for Expertise** – Regional Management Committee of Northern Ostrobothnia – Regional partners: local industrial clusters – Higher education institutions	– National government – Provincial authorities	– **Regional governments** – Central government – EU (indirectly)	– **Regional authorities** – County administrative boards – Central government (Ministry of Trade and Industry)	– **Local councils** – Central government (various departments) – Public, private, voluntary and community stakeholders

Table 5.A1.1. **Inter-governmental contractual arrangements for regional policy across OECD countries** (*cont.*)

	Austria	Belgium	Finland	Netherlands	Poland	Sweden	United Kingdom
Contract objective	Increase the co-ordination of employment policies across levels of government to enhance labour market performance	Provide a framework for co-operation and assessment of progress towards Flanders' strategic priorities and Europe 2020	Increase co-ordination at the regional level to deliver more effective industrial and innovation policy and ensure the efficient use of EU Structural Funds	Increase the co-ordination of rural policy between levels of government by shifting competencies to the provincial level	In theory, a tool for co-ordinating regional development policy across levels of government. In practice, however, it is a legal framework for inter-governmental transfers for the implementation of regional operational programmes (ROPs)	Increase cross-level co-ordination while stimulating reflection on regional priorities at the sub-national level and introducing a "regional lens" for a range of sectorial policies of the central government	Increase co-ordination for local development priorities through the design of a Sustainable Community Strategy (and local/multi area agreements)
Contract description	Co-ordinate co-operation between labour policy actors: improve the flow of information and harmonise strategic and operative labour market policies between the federal, *Land* and district authorities; includes the development of a strategy as well as joint programme development and financial co-ordination	A partnership-based instrument operationalising and translating the region's broad strategic goals into measurable targets, while providing a framework for monitoring progress towards those targets	Instrument based on broad partnership intended to co-ordinate the strategies of municipalities, regional authorities and the key business and education actors; sets qualitative and quantitative targets as well as a system for monitoring progress; closely linked to EU Structural Funds – sets conditionalities concerning the projects to receive EU funding	Instrument for translating the goals of the central government's Agenda for a Living Countryside into measurable targets to achieve at the provincial level; negotiating financial allocations for rural policy interventions by provincial authorities. Strong monitoring of compliance with the targets based on negative sanctions rather than performance rewards	Instrument for co-ordinating regional policy and regional public investment across levels of government, with a strong bias towards the use of EU Structural Funds	Instrument for enhancing horizontal and cross-level co-ordination, by aligning the priorities of the regional strategic programmes to the central government's overarching goals; aligned with the EU Structural Funds framework; emphasis on strategic co-ordination; little attention paid to implementation and monitoring	Local strategies and agreements for implementation should consolidate efforts at the local level through the development of joint priorities, as well as targets and indicators against which they are measured, and subsequently rewarded, based on performance

Sources: Austria: Huber, P. (2001), "Territorial employment pacts in Austria", Austrian Institute for Economic Research (WIFO), discussion paper; Committee of the Regions (2012), "Third CoR Monitoring Report on Europe 2020", final report, Committee of the Regions, Brussels; United Kingdom: Bailey, N. (2003), "Local strategic partnerships in England: The continuing search for collaborative advantage, leadership and strategy in urban governance", *Planning Theory & Practice*, Vol. 4, No. 4; Russell, H. (2010), *Research into Multi-Area Agreements: Long-term Evaluation of LAAs and LSPs*, Department for Communities and Local Government, London; Department for Communities and Local Government (2011), *Long Term Evaluation of Local Area Agreements and Local Strategic Partnerships 2007-2010: Final Report*, Department for Communities and Local Government, London; Poland: Regulski, A. et al. (2012), *Kontrakty terytorialne jako instrument polityki rozwoju. Optymalizacja kontraktów terytorialnych w kontekście wdrażania Krajowej Strategii Rozwoju Regionalnego 2010-2020*, Instytut Badań Strukturalnych, Warsaw; Ferry, M. (2003), "The EU and recent regional reform in Poland", *Europe-Asia Studies*, Vol. 55; Svensson, B. and A. Östhol (2001), "From government to governance: Regional partnerships in Sweden", *Regional & Federal Studies*, Vol. 11, No. 2.

Chapter 6

Sub-national public finance in Colombia*

This chapter assesses public finances in Colombia from a regional perspective. In particular, it looks at how fiscal limitations on sub-national governments may undermine the feasibility of moving towards a territorial approach to economic development. The first section gives an overview of fiscal decentralisation in Colombia, and highlights the impact direct transfers from the central government have on the propensity of the sub-central governments to raise their own revenues (fiscal inertia). The second section discusses budget balancing and debt at the sub-national level. It also focuses on public investment and fiscal discipline at the territorial level. Finally, the third and final section contains a set of recommendations to improve the efficiency of sub-national public finances and establish a better framework to promote public investments.

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

Key findings and recommendations

Key findings

- Sub-national governments depend on transfers from the centre to deliver services. Funds are earmarked for departments and municipalities according to a formula based on poverty rates and demographic size. Yet, the lack of territorial data makes it difficult to take account of Colombia's rich diversity, and the amount of funds allocated through transfers has remained virtually unchanged since 2005. Given the large internal migration flows, it is possible that local needs have changed. Also, some local governments are likely to have improved service delivery, but the sectorial allocation of transfers, set by the central level, cannot be modified.
- The reform of royalty payments may complicate the General System of Transfers (SGP) in the medium term. To protect financial sustainability at the local level, sub-national governments can only use additional revenues generated by royalty payments to finance capital investment. However, most capital investments (roads, schools, hospitals, etc.) generate recurrent expenditures, which will put pressure on funds from the SGP in the medium and long term.
- Tax revenues at the sub-national level are low. The fiscal inertia of many sub-national governments is a consequence of the existing tax regulation, which does not allow municipalities and departments to create taxes. In addition, territorial governments have no incentives to assume the political cost of raising taxes, if the extra funds collected are used to fund a basket of goods and services selected by the central government. In many cases, local taxes are not related to the quality and accessibility of services. This compromises accountability and transparency.

Key recommendations

- Implement a reform of the SGP to improve autonomy, flexibility, responsibility and solidarity among sub-national governments. National authorities may consider reducing earmarked transfers, simplifying the way the SGP allocation criteria are determined, and introducing new equalisation mechanisms, as well as co-ordination mechanisms between the SGP and the General System of Royalties. The SGP will have to bear a dramatic increase in current expenditure as a consequence of the capital investments built with royalties.
- Implement a tax reform to increase tax collection at the sub-national level. The portfolio of taxes levied by departments and municipalities should also be streamlined, and replaced by taxes shared between the central and sub-national governments. The cadastral and land registry should be updated to improve the performance of the municipal property tax, and clear incentives established to enhance tax collection at sub-national level. Sub-national government could be given more leeway to manage tariffs and fees associated with local public service provision.
- Promote a fiscal framework conducive to public investment. Co-ordination across levels of government could be reinforced and a multi-annual budgeting/planning framework adopted at the sub-national level. Adopting a "golden rule" in the sub-national fiscal discipline framework could help boost public investment. Meanwhile, sub-national government in general should be associated with the governance of public finance.

Introduction

Colombia exhibits a significant infrastructure gap, after decades of low and often inefficient public investment that has not been compensated for by private sector projects. The country needs more public investment, and better infrastructure could play an important role in reducing the large regional income disparities. It could also promote regional development, as well as increase the competitiveness of domestic firms (OECD, 2013b). Generalised access to infrastructure services, from water and sanitation to transport infrastructure and telecommunications, could also help reduce income inequality and fight poverty. Although the coverage of key public services (education and health) has increased, there is a wide consensus on the need to improve the quality of public services throughout the country.

Achieving the government's objectives of raising the quality of public services, increasing infrastructure and addressing poverty will require joint efforts on the expenditure and revenue side. Increasing spending efficiency does not seem to be enough to satisfy these ambitious objectives. A reform of the tax system is also needed to increase tax collection, reduce distortions and increase fairness. Any reform of public finances in Colombia to raise revenues or to boost public spending efficiency must involve sub-national governments.

Given the current challenges facing the sub-national public finances framework, the main conclusion is that Colombia should consider a comprehensive reform modernising the sub-national funding system, including central government transfers, royalties and sub-national taxation. This would make the system more flexible, increase fiscal autonomy, boost fiscal co-responsibility, establish incentives to promote sound management of public finances with a regional approach and encourage co-ordination.

The fiscal decentralisation process in Colombia

A historical overview of fiscal decentralisation

Colombia, traditionally a centralised country, undertook a major decentralisation reform in 1986 that has advanced at a steady pace. This process was intensified in 1991 by the new Constitution, which declares that "Colombia is a legally organised social state under the form of a unitary, decentralised [r]epublic with autonomous regional entities": that is, departments, municipalities, districts and indigenous territories. The adoption of a new Constitution significantly enhanced the process of decentralisation, combining political, administrative and fiscal perspectives.

The 1991 Constitution considerably expanded the financial resources devoted to sub-national governments. For instance, it generated a substantial increase in central government transfers allocated to sub-national entities. More than 80% of these grants are earmarked for education and healthcare. The constitutional reform also created the General System of Royalties (*Sistema General de Regalías*, SGR), which provided departments and municipalities affected by extractive activities (as producers or providers of logistics) with a large share of the royalty payments generated by the business. In addition to these transfers, the Constitution implemented a National Co-financing System (*Sistema Nacional de Cofinanciación*), in which conditional grants from the central government complemented sub-national government funding for projects in specific sectors (e.g. roads or urban infrastructure). Moreover, sub-national governments were allowed to issue debt through bonds or to have access to the credit system. Finally, the

Constitution provided sub-national governments with the rights "to administer their resources and establish the taxes necessary for their operation", confirming the sub-national own-source taxation system regulated by Law 14 (1983) and other complementary regulations.

The Constitution also established a new framework of competences and responsibilities for departments and municipalities. Policies such as education, healthcare, drinking water, sanitation and sewage, and public infrastructure became the direct responsibility of sub-national authorities. This also established the main spending categories for sub-national governments. However, responsibilities for expenditure were not clearly specified, leading to a duplication of spending between the central and the decentralised governments, especially in the health and education sectors.

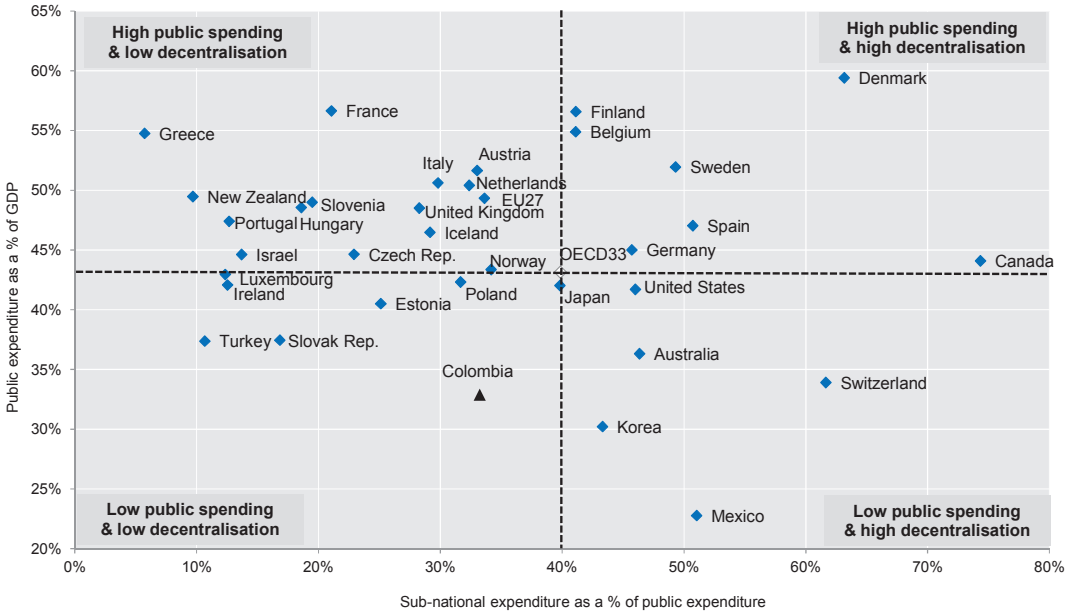
The fiscal framework established in 1991 affected Colombia's fiscal sustainability. It created an imbalance in local finances as a result of automatic and high increases in transfers (from 2.5% of gross domestic product [GDP] in 1991 to more than 5.5% of GDP in 2001). Growing expenditures and the absence of fiscal sustainability regulations generated unsustainable levels of deficit and debt. This situation, coupled with the economic recession the country experienced at the end of the 1990s, hobbled public finances. The central government reacted by modifying the fiscal decentralisation system within the legal framework set by the Constitution (OECD, 2013a).

A set of fiscal reforms were passed to control public expenditure, boost sub-national own resources and limit municipalities' and departments' access to debt.[1] In 2001, a reform of the system of transfers was conducted, with two main objectives: first, to reduce exposure to a global fiscal crisis, as a consequence of the increasing pressures from transfers on the national budget; secondly, to improve the transfer allocation mechanisms in education and health with new distribution criteria. They are now based on coverage (e.g. by the number of students per region) instead of current expenditure (e.g. measured by the number of teachers per region). The reform consolidated several individual transfers into a single General System of Transfers (*Sistema General de Participaciones*, SGP). It also defined the rules of evolution of the SGP over time. Instead of an automatic revenue-sharing system, it is now indexed to several rates, mixing the growth of current central government revenue and the change in real GDP, which also ensured more predictable and stable revenue flows.

The most recent reform of sub-national public finances was the reform of the General System of Royalties in 2012. Colombia has modified the way it handles the royalties from the exploitation of crude oil, gas and natural resources, from a system that fundamentally benefited departments where the natural resources are located to one in which the allocation of royalties is spread out more evenly across the country.

Today, Colombia is the most decentralised unitary country in Latin America. Compared with OECD countries, it ranks among countries with an intermediate level of decentralisation (Figure 6.1). At the sub-national level, Colombia is made up of 32 departments and 1 101 municipalities (including the 5 districts).[2] The Constitution also recognised indigenous territories as territorial entities that are to be governed by indigenous communities according to their own customs and by their own representatives.[3]

Figure 6.1. **Relative importance of sub-national governments in the economy: Country by country**

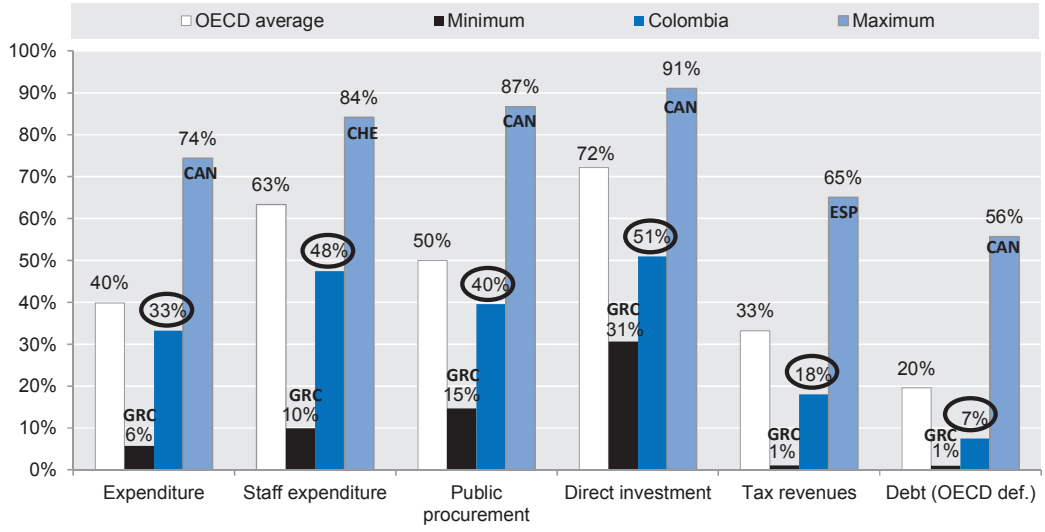


Notes: This figure is compiled using data from OECD National Accounts. The National Accounts are compiled by the OECD Secretariat with data sent by member and non-member countries. The Secretariat also co-ordinates this data to guarantee comparability across countries. It should be acknowledged, however, that in the case of Colombia, these figures present some differences from the ones provided by the National Planning Department. 2011 figures for Colombia.

Source: Own research based on OECD (2014b), *OECD Regional Outlook 2014: Regions and Cities: Where Policies and People Meet*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264201415-en and OECD National Accounts (database), http://dx.doi.org/10.1787/na-data-en.

Substantial resources and key responsibilities are allocated to Colombian sub-national governments. In 2011, sub-national government[4] expenditures accounted for 33.2% of the total Colombian general government expenditures (Figure 6.2) and 10.9% of GDP, compared with the OECD average (39.9% and 17.2% respectively). Sub-national governments accounted for almost half of public staff expenditure (47.5%) and 39.6% of public procurement. Sub-national direct capital expenditure represented 1.7% of GDP (vs. 1.9% in the OECD), and 51.0% of direct public investment was carried out by sub-national governments (vs. 72.2% in the OECD). Sub-national government tax revenue represented 18% of all general government tax revenue (excluding social contributions). Sub-national government debt amounted to 7.5% of public debt and 3.0% of GDP (vs. 19.6% and 22.0% respectively in the OECD).

Figure 6.2. **Sub-national government as a percentage of general government, 2012**



Notes: This figure is compiled using data from OECD National Accounts. The National Accounts are compiled by the OECD Secretariat with data sent by member and non-member countries. The Secretariat also co-ordinates this data, to guarantee comparability across countries. It should be noted, however, that in the case of Colombia, these figures present some discrepancies with those provided by the National Planning Department. 2011 figures for Colombia.

Source: Own research based on OECD (2014b), *OECD Regional Outlook 2014: Regions and Cities: Where Policies and People Meet*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264201415-en and OECD National Accounts (database), http://dx.doi.org/10.1787/na-data-en.

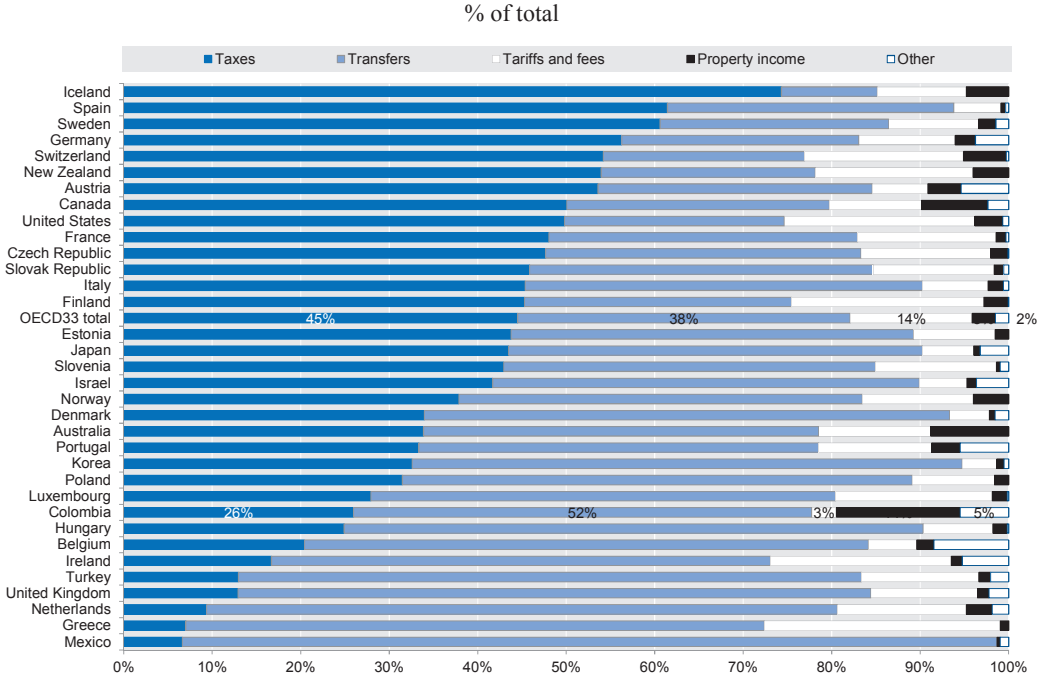
Revenue structure of Colombian sub-national governments

With sub-national borrowing constrained by law, the current financing model for sub-national governments is based mainly on three pillars: direct transfers from the central government, sub-national tax revenues and income from assets (royalties). These royalties are particularly developed in Colombia compared with those in other OECD countries (Figure 6.3). The other sources of revenues are mainly tariffs and fees (with restrictions imposed on sub-national governments to modify tariffs) and transfers from co-financing schemes (Figure 6.4).

Transfers from the central government are the main source of revenues for sub-national governments

The bulk of sub-national revenues comes from transfers from the general budget. The first transfer mechanism was created in 1986 for the municipalities. The 1991 Constitution established new transfers for the departments, districts and municipalities in the form of *situado fiscal* and participation in current revenues. All these transfers

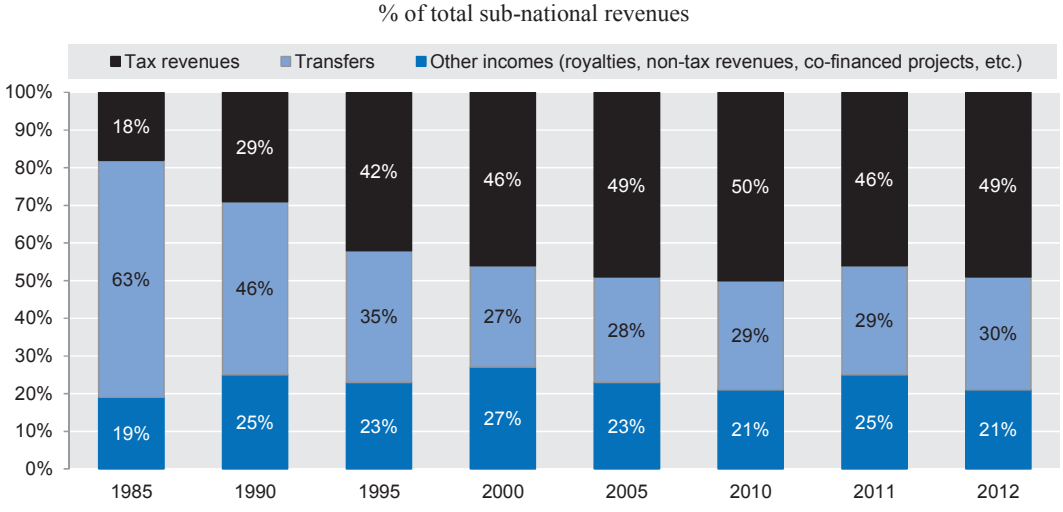
Figure 6.3. **Categories of sub-national government revenues in OECD countries and Colombia, 2012**



Note: Data for Canada and New Zealand are from 2010; data for Australia, Japan, Korea, Israel, Mexico, Switzerland, Turkey, the United States and Colombia for 2011. Data are not available for Chile.

Source: Elaboration from OECD (2013f), *OECD Regions at a Glance*, OECD Publishing, Paris, http://dx.doi.org/10.1787/reg_glance-2013-en and OECD National Accounts (database), http://dx.doi.org/10.1787/na-data-en.

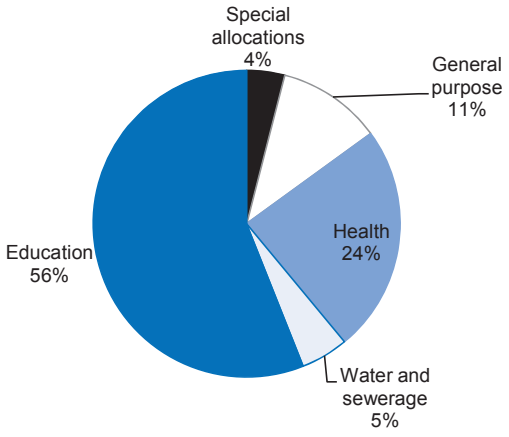
Figure 6.4. **Main sources of revenues at sub-national level between 1985 and 2012**



Source: National Planning Department of Colombia (2013a), "Background report prepared for the *OECD Territorial Review: Colombia*", unpublished.

were unified in 2001 by the Law No. 1 to create the General System of Transfers, the core mechanism of the decentralisation process. These transfers represent half of municipal and departmental revenues, a share larger than in the OECD area on average (38%; see Figure 6.3). One of the main features of the system is that the transfers are earmarked, that is, that the resources are pre-allocated to sub-national entities. The allocation of the SGP is determined under the Law 715/2001 and other regulations enacted in 2007. These resources are split into two different blocks: 4% for special allocations and 96% for sectorial distribution purposes: education, health, water and sewerage, and general purpose. Overall, 56% of transfers are dedicated to education and 24% to health (Figure 6.5). The main objective is to guarantee that every citizen in Colombia has access to a basic basket of key public services of comparable quality. The SGP is a key tool for horizontal redistribution, affording citizens equal access to key public services, regardless of where they reside in the country. However, since the transfers have specific purposes, sub-national governments' ability to pursue their own projects is limited.

Figure 6.5. **Targets of the transfers of the General System of Transfers**



Source: Own research based on Law 715/2001, Legislative Act 04/2007 and Law 1176/2007.

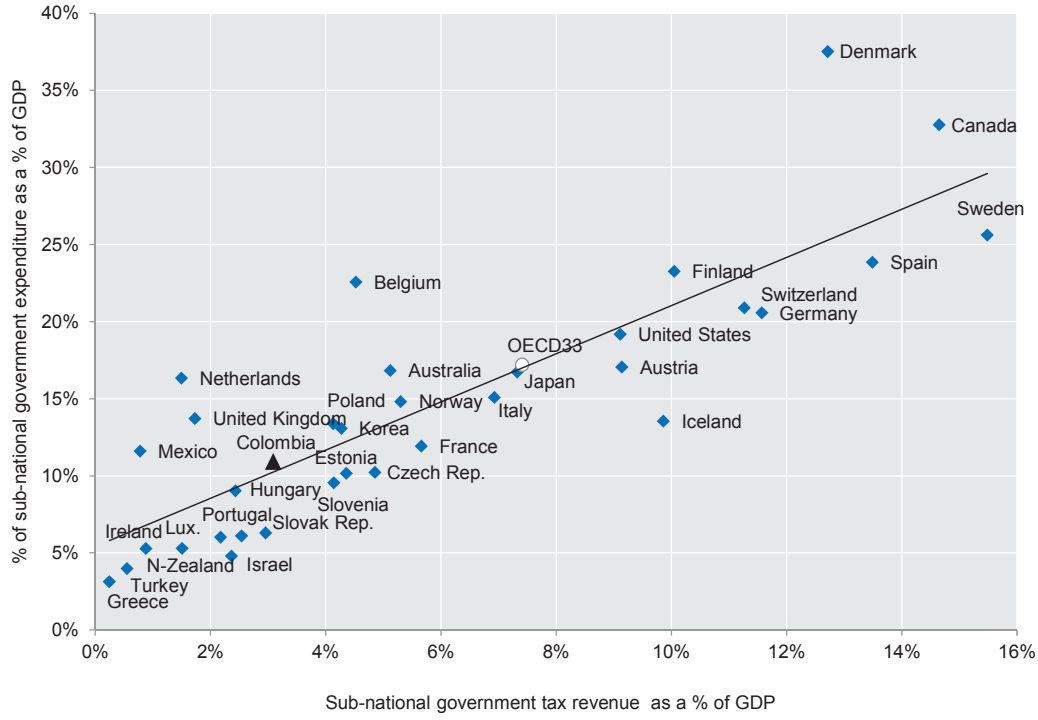
The central government fixes universal coverage targets and quality standards in each sector (education, health, water and sewerage). Only after a territorial administration meets these targets is it entitled to use the surplus resources for other areas within its jurisdiction. According to information from the National Planning Department (DNP), no sub-national administration has yet achieved the targets. In the best cases, some territorial entities have provided universal coverage in the water sector, but quality standards have not yet been satisfied. Certification is granted at the request of the territorial entity. Universal coverage must be satisfied in the sector to be certified and indicators of quality met, as defined by the central administration.

The SGP is intended to finance basic public services in departments and municipalities (i.e. mainly current expenditures), and the General System of Royalties to fund investment projects. The rationale is clear: royalties, as windfalls, can only be used for capital development projects, but current expenditures are excluded because they are incurred on a recurrent basis (see below).

Sub-national governments have relatively weak revenues

Although Colombia's Constitution grants departments and municipalities the authority to collect their own taxes, they collect only 18% of the total share of tax revenues (as against 33% in OECD countries, excluding social contributions). In terms of GDP, tax revenues from the sub-national level represented 3.1% in 2011 (as opposed to 7.4% in the OECD; see Figure 6.6).

Figure 6.6. **Sub-national government expenditure and tax revenue as a percentage of GDP, 2012**



Note: Data for Canada and New Zealand are for 2010; data for Australia, Japan, Korea, Israel, Mexico, Switzerland, Turkey, the United States and Colombia are for 2011. Data are not available for Chile.

Source: Own elaboration from OECD (2013f), *OECD Regions at a Glance*, OECD Publishing, Paris, http://dx.doi.org/10.1787/reg_glance-2013-en and OECD National Accounts (database), http://dx.doi.org/10.1787/na-data-en.

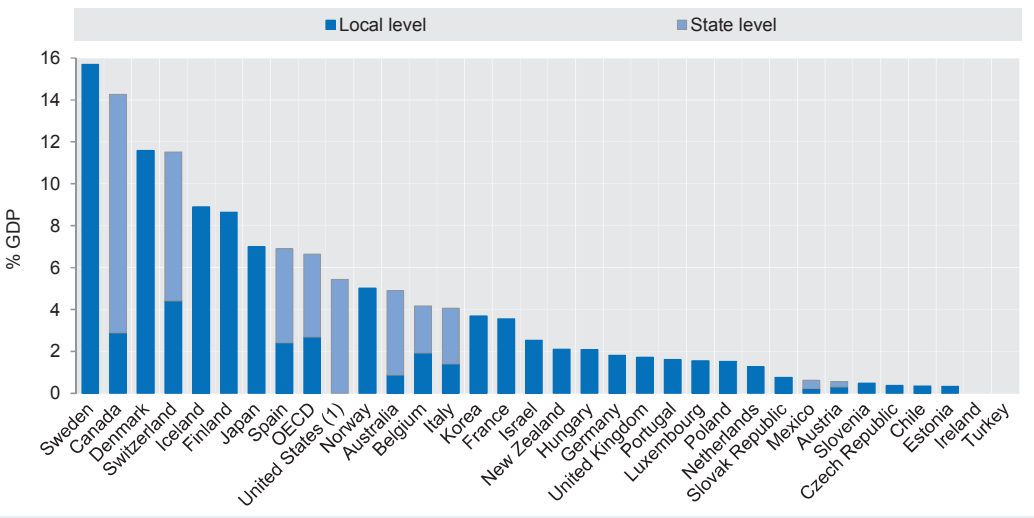
Neither departments nor municipalities are entitled to create new taxes. This power is a right of the Congress, and they can only collect the taxes specified by the central administration. Only for a very few taxes do sub-national authorities have room for manoeuvre to establish fiscal benefits or to vary the tax rate within a maximum and minimum rate fixed by law. This undermines the fiscal autonomy of the sub-national tier in Colombia, which is low compared to that of other OECD countries (see Box 6.1). Moreover, sub-national governments' freedom to dispose of this income is limited, since the legislation defines which purposes several taxes (environment tax and oil surtax) should be spent on. Few tax receipts can be freely disposed of.

Box 6.1. **The tax autonomy of sub-central governments in OECD countries**

Most sub-central governments enjoy some fiscal authority (i.e. to set the tax base and/or tax rates) and may therefore compete on tax policy, although such authority varies considerably across countries. Fiscal authority is greatest in "classic" federations such as those in Canada, Switzerland and the United States, where the Constitution prevents the central government from interfering in sub-central governments' tax policy. Some unitary countries, for example the Nordic countries, also have a long-standing tradition of local self-government and taxing prerogatives. Sub-central governments generally enjoy greater autonomy over property taxes than income or consumption taxes, which are often embedded in tax-sharing systems in which an individual jurisdiction has no taxing power.

The fiscal autonomy of sub-national governments

Countries where sub-central governments have power to set the tax base and/or tax rates, 2008



Note: 1. Local governments in the United States have a wide variety of fiscal powers, but it is not possible to identify the share of each.

Source: OECD (2013c), *Fiscal Federalism 2014: Making Decentralisation Work*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264204577-en.

Compared to the OECD average, Colombia has a bimodal distribution of tax revenues. The central level has higher tax revenues than an average OECD country, with 4.7% of total tax revenue. Departments come in largely below the OECD average, with 11% of the total, and municipalities have higher tax revenues than the average OECD municipality (OECD, 2013a).

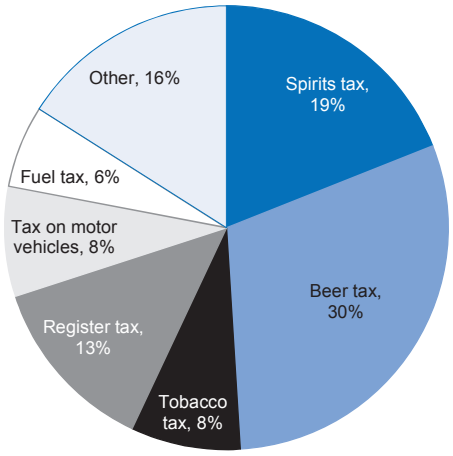
In addition to these significant discrepancies in tax collection between the departmental and the municipal level, the disparities between individual governments are also large. As noted below, given the differences in development across Colombia, tax revenues of municipalities and departments vary enormously. Typically, large urban municipalities and wealthy departments, with a concentration of firms and economic actors, enjoy higher tax revenues than remote, impoverished municipalities and departments.

- Tax revenues at departmental level. Departments have the lowest levels of tax revenues, at less than 1% of GDP, or 4.7% of the total tax collection. The tax base

of the departments is much smaller than that of the municipalities. They receive mainly excise taxes, such as taxes on beer, tobacco, liquor (which make up 57% of the total), registration tax and vehicles tax (Figure 6.7). On the other hand, the income is very steady, since it is not directly related to the economic cycle, and does not increase at the same pace as the national economy. This explains why departmental tax revenues have lost ground as a percentage of total revenues in recent years. In 2000, departmental tax revenues represented 5.6% of total general government tax revenues, which dropped to 4.7% in 2011. The departments have not benefited from the recent economic boom. The level of taxes and the limited room for fiscal manoeuvre are incompatible with the competences departments are called on to exercise. Quite apart from their own responsibilities, departments are responsible for basic service delivery in smaller municipalities of lower capacities. The seven largest departments in terms of population collect almost 40% of their revenue from taxation. This stands in sharp contrast to the less than 10% raised by the 11 smallest departments.

Figure 6.7. **Departmental tax revenues, 2012**

% of total departmental taxes

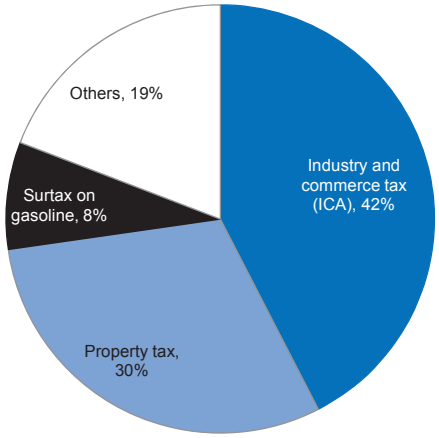


Source: Own research based on National Planning Department of Colombia (2013b), *Desempeño Fiscal de los Departamentos y Municipios 2012*.

- Tax revenues at municipal level. The municipal level collects 19 types of taxes and fees, although 80% of the amount derives from three taxes: the industry and commerce tax (ICA), the property tax (*predial unificado*) and the surtax on gasoline (Figure 6.8). Municipalities rely heavily on the property tax and are entitled to set the rate of the property tax from a minimum of 1 per mil to a maximum of 16 per mil (in some cases, the maximum tax rate can be 33 per mil). Surprisingly, the current tax rate on average is around 7 per mil, an indication of municipalities' weak fiscal efforts. Municipal tax revenues represent on average 32% of municipal revenues and 2% of GDP. However, large discrepancies between municipalities exist. The 42 largest municipalities in Colombia obtain more than 40% of their revenues from local taxation. This is higher than the funding they receive from government transfers. By contrast, the 1 012 smallest municipalities receive only about 13% of their revenues from local taxation, making them much more dependent on government transfers (Figure 6.9).

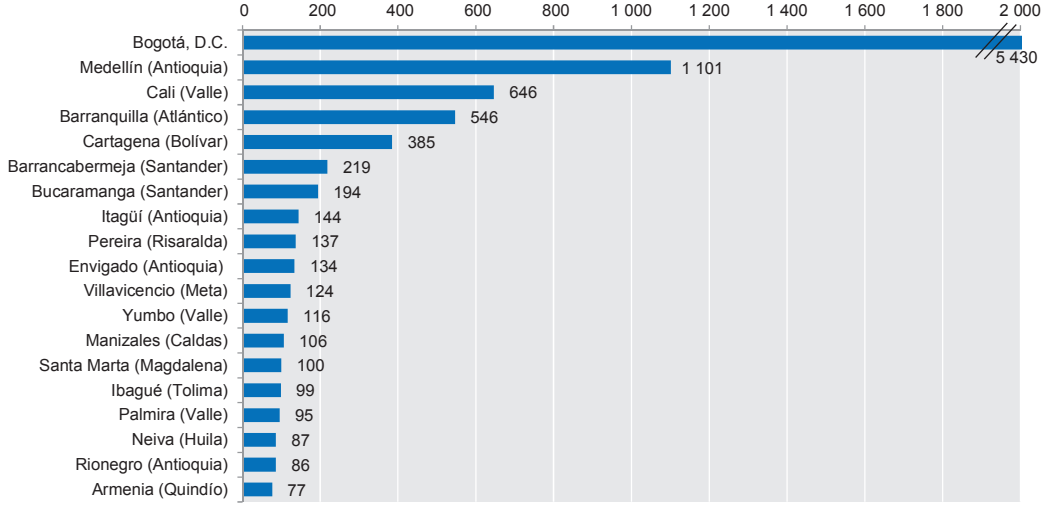
Figure 6.8. **Municipal tax revenues, 2012**

% of total municipal taxes



Source: Own research based on National Planning Department of Colombia (2013b) *Desempeño Fiscal de los Departamentos y Municipios 2012.*

Figure 6.9. **Total municipal tax collection, 2012**



Source: National Planning Department of Colombia (2013b), *Desempeño Fiscal de los Departamentos y Municipios 2012.*

Revenues from royalties are increasing and their distribution improving

Royalty payments are the third source of funding for sub-national governments and mainly dedicated to departments. In 2012, royalties represented 11.6% of departmental and 3.1% of municipal revenues. In smaller departments, royalties can account for the bulk of revenues, or as much as 35%.

In 2012, the central government drastically reformed the General System of Royalties, both to equalise these revenues between sub-national governments and to encourage investment in all regions. Before 2012, the bulk of royalty payments went to sub-national governments in resource-rich regions. Although local governments were free

to allocate funds from royalties according to their needs, they invested additional revenues within the framework set up for national transfers. In other words, additional revenues generated by royalty payments were used to provide basic services (education, healthcare, water sanitation and basic infrastructure), rather than to stimulate economic development. In some cases, funds from royalties also fed into a system of political clienteles and corruption. Since 2012, all 33 departments and 1 061 municipalities have received funds from the royalty payments. To be able to invest these funds, sub-national governments are required to present investment projects consistent with a local development plan. The project must be approved by a collegial body (OCAD) of public authorities from all levels.

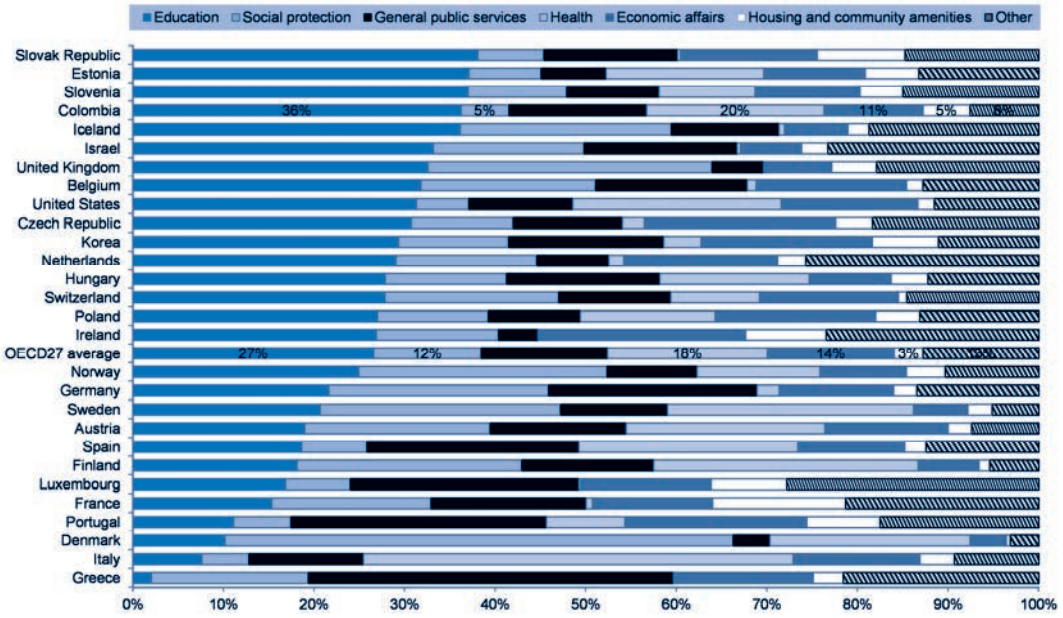
Decentralisation of expenditures

Sub-national public expenditure represents one-third of the country's total expenditure. The volume of public expenditure by departments and municipalities increased about 150% between 1984 and 2011 (National Planning Department of Colombia, 2013a). The distribution of competences among different tiers of government is extremely complex. The majority of the competences attributed to municipalities are shared with departments or the central administration. With 36% of sub-national expenditure, education is the top budget item for the sub-national public sector. This is followed by health (20%), general public services (15%) and economic affairs, i.e. mainly transport (11%) (Figure 6.10). The cumbersome allocation of responsibilities across different levels of government makes the funding system complex, and it is difficult to assess if a specific service, whose management corresponds to different layers of the administration, is appropriately financed.

However, the percentage of public expenditure administered by departments and municipalities is not a measure of their real autonomy. Even if they manage a significant amount of money, they have limited authority over how expenses are allocated, since most sub-national taxes and transfers from the SGP are earmarked, especially in the education and health sectors. Operational expenditure is also limited by Law 617/2000, which establishes a budgetary classification of municipalities and departments based on their population and current income. The law sets limits on administrative expenditure according to this classification. The role of sub-national governments is thus limited to "a payment function" in the vast majority of services provided at sub-national level, with no discretion over managing these services.

Sub-national governments play an important role in public investment in Colombia. Around 51% of direct public investment[5] is undertaken by sub-national governments, as compared with the OECD average of 72.2%, although there are notable variations among countries (Figure 6.11). In Colombia, direct public investments represent 10.4% of total public expenditure. This has progressively increased in recent years, to 3.4% of GDP in 2011, a figure above the OECD average.[6] However, the level is low given Colombia's infrastructure needs.

Figure 6.10. **Breakdown of sub-national government expenditure by economic function in OECD countries (2011) and in Colombia**



Note: COFOG data are not available for Australia, Canada, Chile, Japan, Mexico, New Zealand and Turkey; data for Canada and New Zealand are for 2010; data for Australia, Japan, Korea, Israel, Mexico, Switzerland, Turkey and the United States are for 2011. Data for Colombia are for 2009-12. Data are not available for Chile.

Source: Own research based on OECD (2013f), *OECD Regions at a Glance*, OECD Publishing, Paris, http://dx.doi.org/10.1787/reg_glance-2013-en and Sistema de Integral de Información Financiera (SIIF); "Ejecuciones presupuestales entidades ambientales"; Formulario Único Territorial (FUT); Estados Financieros de entidades no incluidas e información recopilada por el DANE Cálculos: DANE.

Budget balance and debt

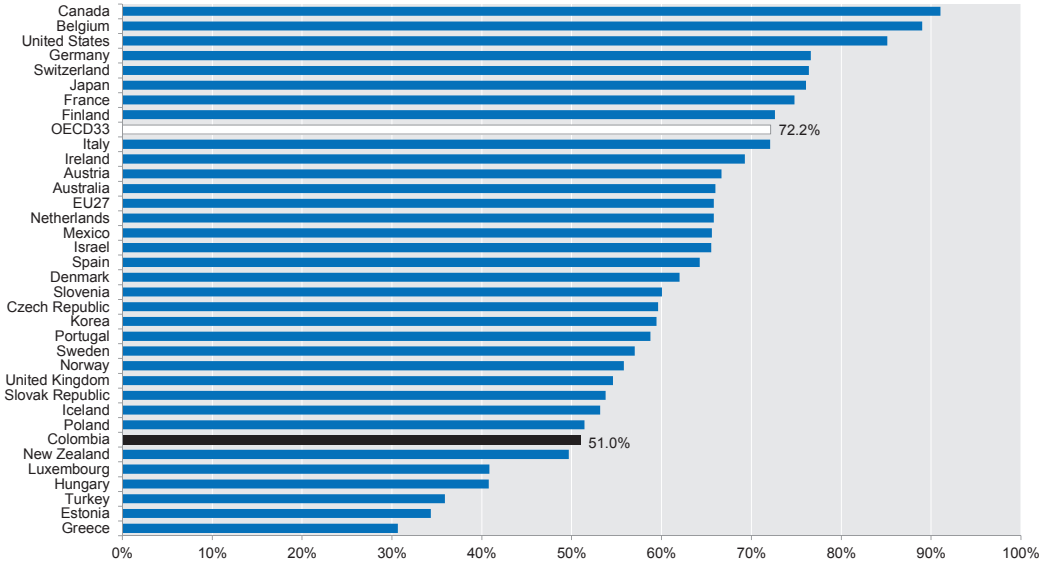
Since 2000, sub-national government accounts have had a budgetary aggregate surplus amounting to 1% of GDP in 2011 (Figure 6.13). After increasing slightly from 2000 to 2003, sub-national government debt[7] has fallen (Figure 6.12). It was 4.4% of GDP in 2000 and 3% in 2011, as compared to 39.8% of GDP for the total public sector.

This positive situation is the result of fiscal responsibility rules enacted between 1997 and 2003 that introduced restrictions on excessive spending and constraints on sub-national borrowing, which had dramatically increased since the 1991 decentralisation reform. The devolution of new responsibilities resulted in a considerable increase in expenditures, which was not compensated for by revenues. Sub-national governments had to borrow steadily to cover their deficits. Sub-national government debt attained unsustainable levels at the end of the 1990s (from 2.6% of GDP in 1991 to 4.6% in 1997), jeopardising overall public finances in the country.

This obliged the central government to enact fiscal discipline laws to address the imbalances. To increase the central government's control over sub-national debt, the so-called Traffic Light Law 358/1997 (*Ley de Semáforo*) was adopted, introducing prudential rules for territorial governments, based on liquidity and solvency ratios (caps on outstanding debt and debt service). Highly indebted local governments were prohibited from borrowing (or in other words, given a red light). Those in green-light

zones were allowed to borrow. Intermediate cases were given a yellow light, which meant that they had to obtain prior approval from the central Ministry of Finance for borrowing.

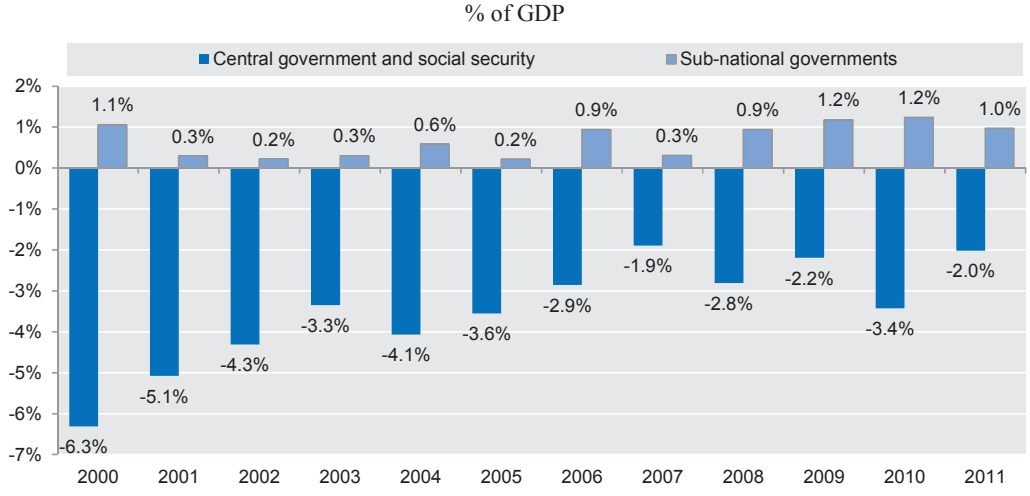
Figure 6.11. **Sub-national government direct investment as a percentage of public investment in the OECD and Colombia, 2012**



Note: Data for Canada and New Zealand are for 2010; data for Australia, Japan, Korea, Israel, Mexico, Switzerland, Turkey, the United States and Colombia are for 2011. Data are not available for Chile.

Source: Own research based on OECD (2013f), *OECD Regions at a Glance*, OECD Publishing, Paris, http://dx.doi.org/10.1787/reg_glance-2013-en and OECD National Accounts (database), http://dx.doi.org/10.1787/na-data-en.

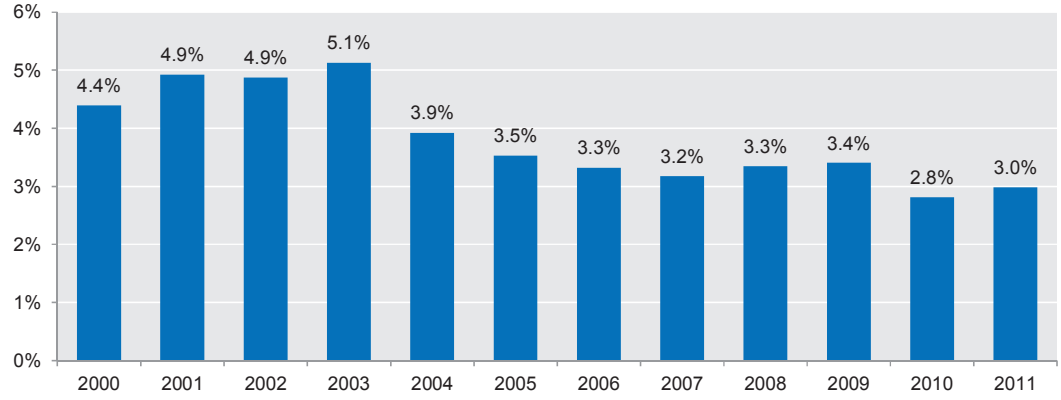
Figure 6.12. **Public budget balance of government sub-sectors, 2000-11**



Source: Own research based on OECD National Accounts (database), http://dx.doi.org/10.1787/na-data-en.

Figure 6.13. **Government sub-sectors' public debt, 2000-11**

% of GDP



Source: Own research based on OECD National Accounts (database), http://dx.doi.org/10.1787/na-data-en.

This law was reinforced in 2000 by Law 617, which limited growth of current expenditure. It set limits on municipal expenditure based on the demographic size of the municipality, forbade transfers to other public entities, created new municipalities (municipalities proven to be non-viable are required to merge with others), and adopted two-year rescue plans in cases of financial distress and non-compliance with fiscal rules.

In 2003, fiscal rules were tightened again by a Law on Fiscal Transparency and Responsibility (Law 819/2003) giving more institutional backing for national fiscal-balance strategies. This law, which applies both to national and sub-national governments, sets budget targets for sub-national levels and links them to target ranges for debt and deficits. The law eliminated the "yellow-light" category in the Traffic Light Law. It also tightened the regulations on the credit supply side (banking sector) and required that departments and large municipalities obtain satisfactory credit ratings from international rating agencies before they could borrow on the market. Besides, to discourage linking fiscal policy to the electoral cycle, it prohibited governments in an election year from committing future spending (*vigencias futuras*) or increasing personnel spending. In general, the rules tightening controls on sub-national expenditure have been successful, as indicated in Figure 6.14, which shows the share of sub-national government debt of total public debt in relation to GDP.

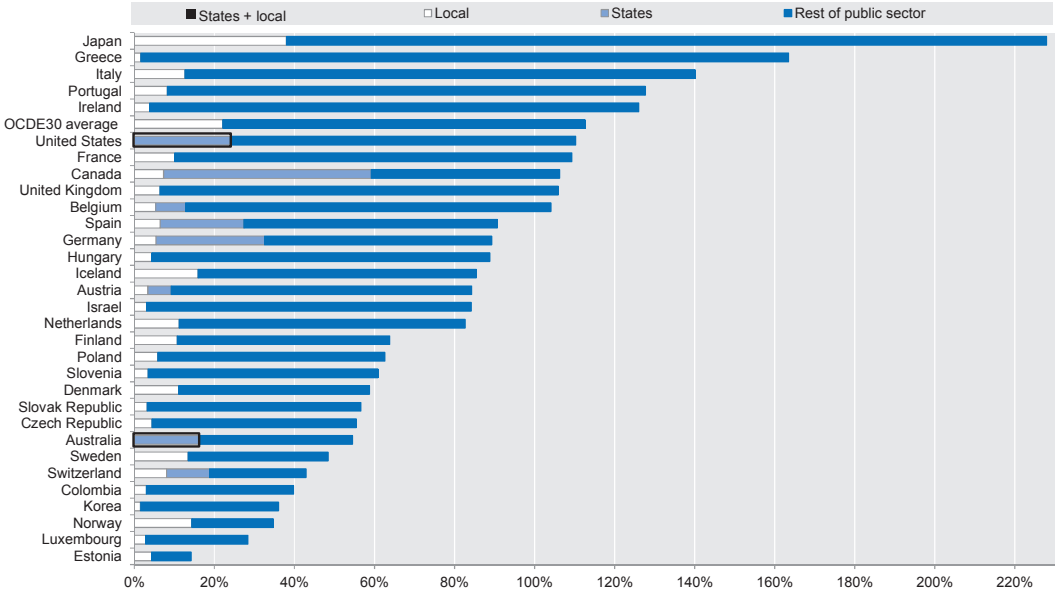
Assessment of the fiscal decentralisation

The sub-national fiscal framework in Colombia has been broadly reformed over more than two decades, as noted above, in an attempt to accelerate fiscal decentralisation. Colombian authorities consider the significant increase in sub-national revenues a major success of the fiscal decentralisation process. Nevertheless, decentralisation is not yet complete, since sub-national governments have not had the fiscal autonomy and responsibility to manage these resources.

Meanwhile, as administrative and political decentralisation had advanced, fiscal reforms were not focused on increasing the fiscal autonomy of sub-national governments. The first wave of reforms, introduced by the 1991 Constitution, aimed to increase the efficiency of the central government's public expenditures by transferring resources to departments and municipalities. Sub-national governments were considered a vehicle

through which the central government could channel central government funds to territories. This amounted more to a "deconcentration" reform than a decentralisation with supposed transfers of fiscal power. The second set of reforms, developed at the end of the 1990s, aimed to guarantee fiscal discipline at sub-national level, since the overall fiscal system had been put at risk.

Figure 6.14. **General government gross debt as a percentage of GDP and breakdown by level of government, 2012**



Source: Own research based on OECD (2013f), *OECD Regions at a Glance*, OECD Publishing, Paris, http://dx.doi.org/10.1787/reg_glance-2013-en and OECD National Accounts (database), http://dx.doi.org/10.1787/na-data-en.

Despite the efforts at decentralisation, the current fiscal system does not encourage responsibility. Both governors' and mayors' powers are limited on the revenue and expenditure side. Sub-national finances remain to some degree in the hands of the national government, and the territorial agenda is largely controlled from the centre.

The current fiscal framework at sub-national level poses some challenges that can be summarised in the following three points:

- First, the system is extremely rigid. Sub-national governments, especially departments, have an inflexible funding framework, in a dynamic country whose population has growing needs. On the expenditure side, the rigidity of the system is evident in the limited powers of sub-national authorities to determine the allocation of public resources.
- Second, there are no incentives to improve the effectiveness of public finance at sub-national level, because there are no apparent incentives to raise sub-national taxes. This encourages fiscal inertia. Reducing public expenditures through sound management is another option.
- Third, these challenges hamper fiscal accountability and co-responsibility. The central government is still considered chiefly responsible for the delivery of public goods and services at the local level.

The system of central government transfers is inadequate

Sub-national governments depend too much on central government funding, in particular on the General System of Transfers. Moreover, the current system does not reflect the country's needs. Although basic public services are financed (education, health, water and sewerage), other issues with a major impact on territorial development, such as transport, are not addressed in the system. Besides, the system is inflexible. The same basket of public services is provided in all territories, but some differentiation of types of service might be desirable in a country with significant differences in needs and development.

The differentiation between the SGP and the SGR, while reasonable on its face, is likely in practice to be challenging in the long term. Most capital investments (building roads, schools, hospitals, etc.) require recurrent expenditures for their maintenance. This comes mainly from the SGP, since sub-national tax receipts are small. To face this problem, any project funded through royalties is required to be financially sustainable, and the central administration must certify that the operating costs will be funded by the SGP or other sources of revenue. In some cases, the central administration has approved a raise in the transfers from the SGP to underwrite the current expenditure of an investment project financed by royalties.

The new royalty system will significantly revise the outlays of public expenditure at sub-national level. Capital expenditures at sub-national level will increase in the coming years, as capital projects are developed, while operating expenditure at sub-national level will rise dramatically in the medium term, after these projects are completed. Two significant consequences are worth noting:

- First, the SGP will absorb increasing operational expenditure in the near future, since departments and municipalities have no other source of revenues.
- Second, the criteria for allocating resources under the SGP are at present transparent and based on unbiased variables (i.e. population coverage). However, the system is becoming more complex as transfers from the SGP are increased to finance operating costs of royalty projects. In the long run, managing the SGP may not be straightforward.
- Finally, the resources of the SGP do not seem adequate to fund the basic public services demanded by territorial governments. To make up for this gap in resources, sub-national authorities use royalties to finance some projects that should have been funded by the SGP or other sources. This denies Colombia the opportunity to devote royalties to capital projects that can have a major impact on the development of the country.

The tax-raising power of sub-national government is insufficient

Sub-national governments have little fiscal room for manoeuvre, since they are not allowed to create taxes, and the tariffs can only be set within a range fixed in advance by law. In addition, regulations on territorial taxes do not take into account the territories' economic differences. Consequently, in certain areas, some tax receipts are limited, and local authorities are not authorised to replace them with new taxes, e.g. revenue from the vehicle tax in areas where boats are the main means of transport.

In a country with a low level of revenues, departments and municipalities do not make significant fiscal efforts to increase their tax collection. In Colombia's case, the fiscal inertia observed at sub-national level is a consequence of the existing tax regulations, under which the room for fiscal efforts is limited. In addition, sub-national governments have no clear incentives to improve their tax collection. Territorial governments have no incentive to assume the political cost of raising taxes if the extra funds are to fund a basket of goods and services selected by the central government. Since territorial governments cannot establish new taxes, they rely on transfers from the national government to finance basic public services, the main source of revenue for the majority of departments and municipalities.

Spending autonomy is too limited, both for current and investment spending

Departments and municipalities have no real budgetary autonomy, as transfers are earmarked and they have limited leeway to increase taxes, which are largely earmarked as well. To some extent, this implies that local public goods and services do not meet the local community's needs. Conceived mainly as a conduit for paying local services, sub-national budgets do not fully reflect the priorities of sub-national governments' territorial development. Little correlation exists between local taxes and the delivery of services, compromising the accountability of the management of public resources.

Regarding public investment, financial and technical capacities of sub-national government to invest are insufficient for the needs of the country. Enhancing the efficiency and effectiveness of public investment is thus crucial, as they are directly linked to territorial development.

Ensuring an appropriate fiscal framework adapted to the different investment objectives is a key challenge in Colombia. Only a clear fiscal framework, with timely and predictable transfers between levels of government, can promote an environment that encourages investing.

In Colombia, a cumbersome allocation of responsibilities among levels of governments can hamper the effectiveness of public investments. Substantial co-ordination across levels of government is needed to bridge information, policy or fiscal gaps that may occur, as well as critical governance capacities at different levels to design and implement public investment projects. Colombia has adopted instruments to promote co-ordination between sub-national entities without requiring the creation of new institutional arrangements.

A key challenge in Colombia, directly linked to decentralisation, is to create enabling conditions so that sub-national governments have the opportunity to increase their own revenues, not only to finance investment, but to allow for participation in co-financing arrangements and contribute to financing for long-term operations and maintenance.

The extensive earmarking of the Colombian fiscal framework limits sub-national governments' ability to deliver public investments. Nevertheless, the benefits of earmarked and matching grants should be considered. OECD experience shows that earmarked grants and matching arrangements are appropriate when public investment projects generate positive spillovers on neighbouring areas, such as transport infrastructure. They are also useful for risk sharing or temporary co-operation, when guidance from the national to the sub-national level is useful and when it is desirable to align priorities across levels of government.

Borrowing constraints have a negative impact on public investment, as the rest of public revenues for sub-national levels are largely earmarked. Sub-national governments can freely allocate borrowing resources, and borrowing could thus be a lever to promote public investment, although it must be controlled to avoid a negative impact on public finances.

Budgeting transparency also helps to promote the climate for public investments. Budgeting transparency throughout the investment cycle provides visibility for investments, clarifies recurrent budgetary implications and strengthens public accountability. Colombia has made significant progress in transparency, especially at the central level. The key challenge is to focus on the quality of this information. Budgetary information on public investments should be made publicly available to citizens and other stakeholders in a timely and user-friendly format.

From fiscal discipline at sub-national level to better fiscal co-ordination

Fiscal discipline has been the driving force of Colombia's fiscal reforms over the last 15 years, as noted in Chapter 1. In general, the rules to enhance controls on sub-national expenditure have been quite successful. Since 2001, these have led to a significant reduction in transfer/GDP ratios, helping to level out the ratio of public expenditures to GDP. This reduced the central government's deficits, and made possible aggregate surpluses in sub-national balance sheets in years of positive economic performance.

Today, however, there is room for adjustment. The reform of the royalty system has significantly increased the income of some departments, and discipline mechanisms could be used to control these changes.

Moreover, a new fiscal responsibility reform was passed in 2011. The Colombian government passed a new budget balance rule and deficit reduction targets.[8] This fiscal rule is only applicable at central government level, but it could have an impact on sub-national governments. The new consolidation objectives adopted for the coming years may help cut central government expenditures, e.g. reduce its transfers to sub-national governments, but they could put those that are most dependent in a difficult situation.

And, finally, if further fiscal decentralisation is promoted, it will become all the more necessary to strengthen the budgetary framework at all levels of government and implement new co-ordination instruments between the central and sub-national governments.

Conclusions

Key recommendations

Since today's objectives (i.e. reduction of income inequality and improvement in the quality of public services) differ from earlier priorities (i.e. to reduce sub-national fiscal deficit), several recommendations can be made to address the major challenges of the decentralisation process in Colombia. In light of the previous analysis, Colombia should consider reforming sub-national public finances, to make progress in the decentralisation process and promote a fiscal framework to support regional development. While there is no ideal degree of decentralisation, ways to make it work by establishing a territorial approach to development can be recommended. Experience shows that decentralisation must be tailored to a country's institutional history, structure and culture.

To deliver public goods and services according to local preferences and needs, the original rationale for the decentralisation process, Colombian authorities should consider implementing a comprehensive reform to modernise the sub-national funding system and reinforce fiscal decentralisation. Any fiscal reform at sub-national level should follow an overall approach to better address the major problems observed in the current system. The sources of sub-national revenues cannot be seen as separate blocks. This should be rectified by increasing sub-national government autonomy from both the revenue and expenditure sides. In addition, horizontal equalisation mechanisms should be developed to promote territorial equity and solidarity and implementing renewed fiscal multi-level co-ordination tools to ensure fiscal discipline and sustainability.

Implement a reform of the General System of Transfers

The transfer system should be reformed in order to allow more spending autonomy, flexibility and responsibility, as well as more solidarity between sub-national governments. The following recommendations should be considered:

- Make the transfer system more flexible, by reducing earmarked transfers. Sub-national governments should have more autonomy to decide the expenditure allocation, to better meet local needs and, at the same time, assume their own responsibilities for the management of public expenditures. Increasing the leeway for determining budgetary allocations will promote efficiency in the management of public policies. Departments and municipalities will tend to generate savings if they can dedicate them to their own priorities. The UK example could inspire the Colombian government.
- Conduct an in-depth review of the way the SGP allocation criteria are determined, to simplify them and include new equalisation mechanisms.
- Enhance the co-ordination mechanisms between the General System of Transfers and the General System of Royalties, given that the General System of Transfers will need to support a dramatic increase in current expenditure as a consequence of capital investments built with royalties. Against this backdrop, a long-term vision of the development of both systems is needed.

Implement a sub-national tax reform

The share of tax revenues in the financing of sub-national government should be increased. This reform is necessary for several reasons: first, to offset a potential reduction in central government transfers that may result from a transfer's reform (see above) or from national consolidation strategy and targets (see Chapter 2) and then to reduce dependence on the central government; second, to increase resources for the development of public services and infrastructure so that sub-national governments may adjust their revenues to changing circumstances; third, to increase political ownership, accountability and responsibility of sub-national governments. This reform should consider:

- Reviewing the portfolio of taxes levied by the departments and municipalities. Many small taxes administered by sub-national governments do not bring in significant revenue but constitute a considerable administrative burden. This could take the form of creating more productive own-source taxes or introducing shared taxes (between the central and sub-national governments) to create

incentives for sub-national governments to become more active in the field of economic development.

- Increasing the room for manoeuvre to manage taxes by:
  - offering leeway with respect to rates and bases
  - allowing sub-national entities to decide the allocation of own taxation
  - reducing the number of earmarked taxes.
- Improving tax bases, in particular the municipal property tax. The cadastral and land registries should be updated to improve the performance of the municipal property tax.
- Improving tax collection by:
  - Establishing clearer and stronger incentives to enhance tax collection at sub-national level. For example, an efficient way to establish fiscal incentives for municipalities and departments is to link the general transfer system with the fiscal effort of sub-national governments to increase tax collection. This link already exists in the current system of the SGP allocation, but it should be reinforced.
  - Rationalising the tax collection system between the central and sub-national administrations, given that tax administration appears to represent a substantial cost for sub-national governments.
  - Combating tax evasion.
- Reflecting on the implementation of a horizontal equalisation mechanism based on tax resources.

Besides a tax reform, it could be worth considering granting more freedom to sub-national governments to manage tariffs and fees associated to the provision of local public services.

Review the reallocation of responsibilities across levels of governments

Targets for reallocation of responsibilities must be well defined, as must the means for reaching them. The responsibilities of the different levels of government must be clearly presented. In Colombia, as in many OECD countries, concurrent responsibilities across different levels of government create ambiguity, leading to inefficiencies in the provision of public services. Clearly defining the role and responsibilities of each level of government is a crucial issue in Colombia, as many sub-national authorities reported that their own responsibilities are not clear in important areas such as health or education, where municipalities and departments have shared responsibilities. The 2013 local government reform in Spain could serve as an example for Colombia (Box 6.2).

Promote a fiscal framework conducive to public investment

The major challenges in managing public investment in Colombia are comparable to those of OECD countries: insufficient financial resources at sub-national level (see Chapter 1), the quality of territorial governments and the lack of critical sub-national capacities. The experience of some OECD countries can be instructive for Colombia. Resources for public investment have been significantly, or even dramatically, reduced after the economic crisis. Tight fiscal conditions have forced OECD countries to improve the governance of public investment, where sub-national levels play a significant role.

Box 6.2. The Spanish local reform: Clarifying municipal powers while reducing public expenditure at local level

Spain is a broadly decentralised country, where autonomous communities and municipalities manage approximately 50% of total public expenditure. In 2013, the Spanish government approved a law reforming Law 7/1985 governing local authorities, aimed at the rationalisation of the administrative structure and the reduction of local public expenditure.

One of the key goals of the local reform was to clarify municipal competences and prevent duplication, under the principle "One administration, one competence". It aims to reduce competences that are not attributed by law or delegated by other administrations without adequate resources (known as "improper competences"). This had a negative effect on local public finances.

The local reform aims to improve the definition of local competences by drawing up a list of core competences. Competences not included in this list are referred to as "non-core competences". In the event of any agreements delegating competences from upper tiers of government (usually the autonomous regions) to lower levels of government, resources for financing the services must be mandated.

This clarification of powers at the municipal level seeks to guarantee appropriate funding for core competences, while eliminating or greatly restricting expenditure on non-core competences.

More centralised countries report difficulty co-financing and integrating sectorial priorities into a complementary policy mix for sub-national development. Colombia faces similar challenges, since the financial and policy autonomy of sub-national governments is limited. By contrast, in federal or quasi-federal OECD countries, where sub-national tiers of government are well established, national governments cite a lack of fiscal discipline at sub-national level. Since Colombia has a set of fiscal rules for sub-national governments, fiscal discipline does not appear to be a major problem.

The OECD developed 12 *Principles for Effective Public Investments across Levels of Government* (OECD, 2014c) to set priorities, overcome difficulties in these areas and improve multi-level governance in public investment (see Annex 6.A1). These provide useful guidelines for identifying good practices related to the multi-level governance of public investment and offer valuable guidance for countries at any stage of decentralisation.

The OECD *Principles for Effective Public Investments* exceed the scope of the assessment of sub-national public finances in Colombia, but some key challenges related to public finances include:

- Reinforcing co-ordination across levels of governments. The central government has a key role to play, setting the general legal framework to enable virtuous relations, vertically among the different levels of governments and horizontally among the different national sectorial policies and among the different regions or municipalities. This legal framework should target inter-regional disparities and regulate fair and effective fiscal relations among the different levels of government. Central governments may help local governments carry out their new mandates by offering technical support, co-ordinating the creation of economies of scale in the production of some local public goods and services, and perhaps most importantly, in monitoring and evaluating the performance of sub-national governments.

- Strengthen the use of a medium-term fiscal framework for developing public investment. Multi-annual budgeting allows for better management of investment projects and helps policy makers consider the longer term consequences of their spending decisions. At the central level, Colombia has developed robust multi-annual budgetary tools, which should be extended at sub-national level. One key challenge is to strengthen sub-national governments' capacities to use this instrument as a performance tool.
- Create new fiscal spaces to finance public investments, establishing a "golden rule" in the fiscal framework. Many OECD countries include a "golden rule" in their fiscal discipline to boost public investment. The rationale is that higher public investment translates into higher growth, and thus more revenues to sustain debt levels. The most common solution is to set a balanced budget, excluding public investments. Given the need to boost public investment in Colombia and the narrow resources of sub-national governments, introducing a "golden rule" in the sub-national fiscal discipline framework is worth considering. Colombia could make borrowing constraints flexible for resources devoted to public investment, while establishing certain limits to control sub-national public debt.
- Borrowing constraints for investment projects could be loosened. Spain's experience linking public investment with fiscal discipline at the local level is of interest here. Spain's recent reform allows municipalities with fiscal surpluses and low thresholds of public debt to invest their surplus in public investments that guarantee the financial sustainability of the projects.

Associating sub-national government with the governance of public finance

As already noted, greater fiscal discipline is ensured in Colombia, thanks to successive regulations adopted over the years to address significant fiscal imbalances. Today, however, new risks call for improving co-ordination mechanisms between central and sub-national governments over the management of public finance.

Sub-national governments should be considered partners and their representative associations involved in the discussion, definition and adoption of common objectives, budgetary rules and targets. This could be formalised in a "national stability pact", as in several EU countries (Austria, Germany, Italy, Spain) or in negotiated agreements (Belgium, Denmark, Netherlands) between central government and sub-national governments (Box 6.3). Another option would be to create an independent budgetary co-ordination council, as in Germany, Portugal and Spain, to promote dialogue and co-ordination on public finances.

Ensuring more integrity and transparency

Adequate control of institutions requires fighting corruption at the national and sub-national level without obstructing and slowing down public management. The decentralisation process may foster corruption, since the institutions at sub-national level are less mature and lack capacity. In a country like Colombia, combating corruption is necessary to guarantee institutional relations based on trust. Safeguarding sound public management at the sub-national level is a prerequisite for continuing the decentralisation process.

Box 6.3. The Spanish experience in improving multi-level co-ordination in public finance governance

Spain has one of the highest decentralisation rates in public expenditure: approximately 50% of public expenditure is managed by autonomous communities and municipalities.

The fiscal rules passed in 2001 and 2006 included special provisions for sub-central governments. However, given the need to boost fiscal discipline and co-ordination at all levels of the administration, the government approved fiscal legislation on May 2012 that includes detailed regulations for autonomous communities and municipalities:

- Deficit and debt targets are fixed for all levels of government.
- Preventive mechanisms were approved at sub-central level to guarantee the achievement of fiscal targets (early-warning mechanisms).
- Corrective mechanisms were reinforced by establishing an incremental system of sanctions.
- Economic transparency was enhanced at sub-central level by increasing the obligations related to providing economic and fiscal information. Schedules for publishing this information are fixed by law.

Applying the same fiscal rules for all levels of government has proved successful. Regions cut their deficit in half within a single year, and municipalities achieved a fiscal surplus.

Promoting citizen participation, open government and accountability

To provide an adequate response to local needs and improve the effectiveness of public spending, sub-national governments must have good information on local spending needs and preferences. Promoting open government and accountability will also help citizens engage in the decentralisation process.

Communicating the benefits of strengthening fiscal decentralisation

While the fiscal performance of Colombia's sub-national governments has been good in the past decade, a main cause of resistance to granting more autonomy to sub-national actors seems to be a fear of budgetary slippages. This is common in many OECD countries (Box 6.4). In Chile, one of the main barriers for the decentralisation reform proposed in 2009 was the fear of jeopardising the macroeconomic stability achieved in recent decades. The experience of OECD countries suggests that every initiative to extend the decentralisation process requires a special effort to communicate to the public the potential medium- and long-term efficiency gains the reform can bring, and the potential productivity and competitiveness both of the different regions and the country as a whole. In particular, it is important to demonstrate that the benefits of reform outweigh its costs.

Box 6.4. Several OECD countries are undertaking comprehensive reforms to fund sub-national governments and improve fiscal decentralisation

Several OECD countries confronted with the same challenges as Colombia are conducting comprehensive sub-national finance reform intended to improve grant financing, the tax system and equalisation mechanisms, as well as the allocation of tasks or fiscal responsibility rules for sub-national governments. Several countries' recent or ongoing reforms could be of interest for Colombia.

Reforming fiscal relations with sub-national governments in OECD countries

	Name of the reform, year of adoption	Main thrust of the reform
Australia	Intergovernmental Agreement on Federal Financial Relations, 2008	The system of intergovernmental grants is thoroughly revamped and simplified; grant funding to states is increased; performance-related funding is introduced.
Austria	Reform of the Financial Equalisation Law, 2007	Some intergovernmental grants are transformed into tax sharing; grant funding to states is increased; sub-central tax legislation is harmonised.
Belgium	Lambermont Agreement on Tax Autonomy and Community Refinancing, 2001	Federated states (regions and communities) receive more tax autonomy; grant funding to the regions for education is increased; regions are granted more regulatory power.
	Sixth Reform of the State, 2011, effective 2014	Devolution of additional competences and reinforcement of the tax autonomy of federated states and communities. Attribution of own-source revenue to compensate for the elimination of federal grants (larger surtax on the personal income tax) and larger competences for tax bases and exonerations.
Canada	Equalisation Reform, 2007	The national equalisation standard is redefined; the representative tax system is simplified; caps on equalisation payments are abandoned; natural resource revenue is partially taken into account.
Denmark	Local Government Reform, 2007	Municipalities are merged; the county level is abolished; a regional level for healthcare is created; a new funding and equalisation system is set up.
Finland	Restructuring of Local Government and Services, 2008	Financial incentives for municipalities to merge or to co-operate are created.
France	Local finance reform, 2010	Abolition of the local business tax, partially replaced by a new tax. New breakdown (specialisation) of taxes between levels of sub-national governments. Creation of new national tax transfers. Creation of a new horizontal equalisation system.
Italy	Law 42 on Fiscal Federalism, 2009 Decrees passed in October 2011	Framework law: spending obligations must be covered by own taxes; reform of the property tax; equalisation should be based on tax-raising capacity and standard cost; sub-national accounting should be harmonised; fight against tax evasion.
Portugal	Local Finance Reform, 2007	The grant system to municipalities is reformed and simplified; horizontal equalisation is introduced; municipal fiscal rules are tightened; municipal accounting is reformed.
	Regional Finance Law and Local Finance Law, September 2013, effective in 2014	– Improvement of co-ordination mechanisms between central and sub-national governments (including the creation of a budgetary co-ordination council). – Introduction of a multi-annual budgetary framework and tighter fiscal rules. – Creation of a Municipality Resolution Fund and of an early-warning system for debt accumulation. – Rationalisation of the local tax administration network. – Revaluation of cadastral value of 4.9 million properties to underpin the new property tax regime. Abolition of the existing tax on property transactions from 2018 onwards.

Box 6.4. **Several OECD countries are undertaking comprehensive reforms to fund sub-national governments and improve fiscal decentralisation** (*cont.*)

Reforming fiscal relations with sub-national governments in OECD countries (*cont.*)

	Name of the reform, year of adoption	Main thrust of the reform
Spain	Law 22 reforming the regime for financing the autonomous communities, 2009 In full effect since 2011	The share of the autonomous communities in shared taxes is raised; greater leeway with these taxes; equalisation is reformed; new intergovernmental grants are created and new criteria for grant allocation are established.
	Reform of the Local Government Law, 2013	Clarification of competences attributed to provinces and municipalities, with a clearer separation of mandatory and core competences and optional competences. Delegations of competence must be accompanied by matching resources.
Switzerland	Reform of Fiscal Equalisation and of Responsibility Assignment, 2004	Reassignment of several policy areas to either the federal or cantonal level; redesign of equalisation, rules for inter-cantonal collaboration.
United Kingdom (England)	Local Government Finance Act, October 2012	The fiscal reform is linked to the recent reform that pushed decentralisation (Localism Act, in effect since April 2012), which gave local authorities a general power of competence and transferred new responsibilities (health, housing). The financial reform aims to increase financial autonomy, granting local authorities greater freedom and flexibility and more control over budgets: increased taxing power (localisation of the council tax, business rates retention), simplification and reduction of earmarked grants (from more than 90 to less than 10); implementation of a new single non-earmarked "Local Services Support Grant". Only school funding and the new public health grant remain earmarked. Introduction of "community budgets" for shared services; new schemes to invest capital assets in buildings, land, vehicles and machinery.

Source: OECD (2013c), *Fiscal Federalism 2014: Making Decentralisation Work*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264204577-en; European Commission (2014), "Tax reforms in the EU member states in 2013: Tax policy challenges for economic growth and fiscal sustainability", *European Economy*, No.5 2013, European Union, Brussels; http://dx.doi.org/10.2765/40142.

Notes

1. Law 617/2000, Law 488/1998, Law 819/2003, Law 358/1997.
2. Bogotá, *Distrito Capital*; Cartagena de Indias, *Distrito Turístico y Cultural*; Santa Marta, *Distrito Turístico, Cultural e Histórico*; Barranquilla, *Distrito Especial, Industrial y Portuario*; Buenaventura, *Distrito Especial, Industrial, Portuario, Biodiverso y Ecoturístico*.
3. Legislation to allow indigenous reserves to function as territorial entities in their own right has never been passed. Indigenous special zones depend on the municipalities or departments (according to administrative arrangements) in which they are located, in particular for their funding.

4. According to the National Accounts classification, the sub-national government sector in Colombia includes local governments (municipalities, districts and departments) as well as local non-financial enterprises, comprising water, telephone and electricity companies and the Medellín metro system.

5. Defined as gross capital formation and acquisitions less disposal of non-financial non-produced assets.

6. In 2012, the amount OECD member countries spent in direct public investment represented 2.7% of GDP.

7. The debt definition here used is based on the System of National Accounts (SNA). It includes the sum of the following liabilities: currency and deposits (AF.2); securities other than shares (AF.33); loans (AF.4); insurance technical reserves (AF.6); other accounts payable (AF.7). Some liabilities, such as shares, equity and financial derivatives, are not included in this definition.

8. The new budget balance rule was approved in June 2011. The structural balance rule for central government sets a path for fiscal consolidation that lowers the structural deficit for the central government to 2.3% of GDP in 2014 and sets a ceiling for the deficit of 1%, effective in 2022. The rule also allows for fiscal expansion when the expected output growth rate is at least 2%á lower than the long-term growth rate (allowing for counter-cyclical fiscal policy in cases of emergencies and/or large macro shocks). It was also decided to create a sovereign wealth fund (SWF) to save windfall revenue from natural resources. Annual targets are framed by a medium-term fiscal framework. An independent advisory commission was also established to help put the structural balance rule into effect, and assess its implementation (IMF, 2013).

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Annex 6.A1.1
Recommendation of the Council on Effective Public Investment across Levels of Government

Members should implement the following principles to strengthen the effectiveness of public investment across all levels of government:

A. Co-ordinate public investment across levels of government and policies

1. Invest using an integrated strategy tailored to different places

1. Design and implement investment strategies tailored to the place the investments aim to serve. Public investment choices should be linked to a development strategy based on assessment of regional (or local) characteristics, competitive advantages, growth, innovation and job creation potential, and considerations of equity and environmental sustainability. Investment strategies should be results-oriented (with clearly defined policy goals), realistic and well-informed (based on evidence that points to the region's or locality's ability to make fruitful use of investments), and forward-looking (with investments that can position regions and localities for competitiveness and sustainable development in the context of global trends).
2. Seek complementarities and reduce conflicts among sectoral strategies. Mutually reinforcing impacts in the form of policy complementarities are often required to make the most of public investment. At higher levels of government, such complementarities can be facilitated by: *a)* using strategic frameworks for public investment to align objectives across ministries and levels of government; and *b)* minimising administrative barriers through co-ordination mechanisms such as, but not limited to, inter-ministerial committees and programmes, and harmonisation of programme rules. Governments can also establish joint investment funds that pool monies across public agencies/ministries to encourage consideration of a broader set of priorities.
3. Encourage the production of data at the relevant sub-national scale to inform investment strategies and produce evidence for decision making. Such data may be collected by statistical agencies but also from administrative records, other data sources and citizens themselves.

2. Adopt effective instruments for co-ordinating across national and sub-national levels of government

Co-ordination is necessary to identify investment opportunities and bottlenecks, to manage joint policy competencies, to minimise the potential for investments to work at cross-purposes, to ensure adequate resources and capacity to undertake investment, and to create trust among actors at different levels of government. Several tools can be used when coherence of investment across levels of government is required, such as co-financing arrangements, contracts between levels of government, formal consultation

processes, national agencies or representatives working with sub-national areas, or other forms of regular inter-governmental dialogue.

3. Co-ordinate horizontally among sub-national governments to invest at the relevant scale

Provide incentives and/or seek opportunities for co-ordination among regional and/or local governments to match public investment with the relevant geographical area. Horizontal co-ordination is essential to increase efficiency through economies of scale and to enhance synergies among policies of neighbouring (or otherwise linked) sub-national governments. Modes of co-ordination include contracts, platforms for dialogue and co-operation, specific public investment partnerships, joint authorities, or regional or municipal mergers.

B. Strengthen capacities for public investment and promote policy learning at all levels of government

4. Assess upfront the long-term impacts and risks of public investment

1. Use comprehensive, long-term assessments for investment selection. *Ex ante* assessments should be used to both clarify goals and reveal information. Appraisals should be technically sound, help to identify social, environmental and economic impacts, and investigate which investment method is likely to yield the best value for money. Policy makers should also consider policy and project complementarities, as well as alternatives to investment and efficient use of existing capital stocks to reach particular goals. Long-term operational and maintenance costs should be clearly assessed from the early stages of the investment decision.
2. Assess different types of risks and uncertainty associated with public investment, including longer term impacts, at an early stage of the investment cycle as part of an appraisal. This includes fiscal risks, such as contingent liabilities, as well as political, social and environmental risks. Such risks and adapted mitigation strategies should be re-evaluated as new information becomes available.

5. Engage with stakeholders throughout the investment cycle

1. Engage with public, private sector and civil society stakeholders in the design and implementation of public investment strategies to enhance social and economic value, and to ensure accountability. All levels of government should involve stakeholders in needs assessment and the design of an investment strategy at an early stage of the investment cycle, and, at later stages, in feedback and evaluation. Information on public investment plans, expenditures and results should be exposed to some level of public scrutiny to promote transparency and accountability.
2. Seek a balance when incorporating stakeholders' views, taking steps to prevent disproportionate influence by special interest groups. Consultation processes at all levels of government should be inclusive, open and transparent, as well as promote transparency and integrity in lobbying.

6. Mobilise private actors and financing institutions to diversify sources of funding and strengthen capacities

1. Match private financing arrangements to investment needs and government capacity, particularly at the sub-national level, through careful analysis of the pros and cons of different private participation arrangements and what they entail in terms of risk and government financial and administrative capacity. Decisions regarding public-private partnerships (PPPs) should be co-ordinated with the budget process and their potential value for money should be compared to that of traditional procurement.
2. Involve private actors and financing institutions in public investment to offer more than just financing. Involving private actors and financing institutions in the investment should be a way to strengthen the capacity of government at different levels and bring expertise to projects through better *ex ante* assessment, improved analysis of the market and credit risks, and achieving economies of scale and cost-effectiveness. Governments should mobilise innovative financing instruments or mechanisms, but do so with a clear understanding of the capacities such approaches require.

7. Reinforce the expertise of public officials and institutions involved in public investment

Bolster the capacity of both officials and institutions associated with public investment. Due attention should be paid to effective human resources management, as well as to cultivating knowledge (identifying, sharing and applying good practices such as the present principles) and relationships (refining mechanisms for vertical co-ordination, strengthening co-operation among sub-national governments and developing linkages to sources of expertise). Capacity at the sub-national level deserves particular attention; in some cases, financial resources, professional skills or institutional quality may be lacking. Not all capacities can be strengthened at the same time. It is therefore valuable to identify binding constraints and the proper sequence of reforms.

8. Focus on results and promote learning from experience

Clarify the outcomes to be achieved through public investment and pursue mechanisms to achieve them. Those mechanisms can include results-oriented investment strategies with clearly defined policy goals, well-designed tendering procedures, effective monitoring systems, high-quality *ex post* evaluation, regular reflection on and upgrading of investment choices, active exchange of information and ongoing, mutual learning among actors involved in public investment.

C. Ensure proper framework conditions for public investment at all levels of government

9. Develop a fiscal framework adapted to the investment objectives pursued

1. Employ a fiscal framework adapted to the different investment policy objectives pursued. Intergovernmental earmarked grants and co-financing (matching) arrangements are appropriate when projects generate positive spillovers, when economies of scale are needed, when risk sharing or temporary co-operation is sought, when it is necessary to align priorities across levels of government and

when capacities of sub-national governments need to be bolstered. Co-financing can also increase the commitment of different stakeholders to the success of a project as well as encourage resource pooling across sub-national governments.

2. Set enabling conditions for sub-national governments to be able to exploit their own revenue-raising potential, not only to finance investment, but to allow for participation in co-financing arrangements and to address long-term operations and maintenance costs.

10. Require sound and transparent financial management at all levels of government

Adopt good practices for budgeting and financial accountability, such as accurately costing public investment plans, reflecting them in budget strategies and allocation processes, fitting them into a medium-term budget framework and duly considering long-term operating and maintenance costs. This includes proper budgetary treatment of PPPs, local public enterprises and any associated contingent liabilities.

11. Promote transparency and strategic use of public procurement at all levels of government

1. Maximise transparency at all stages of the procurement cycle, promote the professionalisation of the procurement function, and establish clear accountability and control mechanisms. Procurement systems should be transparent, competitive and monitored to ensure funds are used as intended, and effective at registering and addressing complaints. Governments should invest in ensuring adequate capacity, in particular at the sub-national level, by employing and training procurement professionals, using collaborative procurement mechanisms and employing e-procurement tools.

2. Use procurement to ensure effective public service delivery while pursuing strategic objectives at different levels of government. To do so, the objectives of procurement should be clearly articulated and prioritised. These may be traditional value for money in the sense of price and quality, as well as wider governmental objectives such as sustainable development, innovation and the development of small and medium enterprises (SMEs).

12. Strive for quality and consistency in regulatory systems across levels of government

Pursue high-quality and coherent regulation across levels of government by evaluating the regulatory framework when establishing investment priorities and programmes. Use co-ordination mechanisms to develop coherent regulation across sectors and levels of government, ensure consistency in application and avoid duplication. National governments should regularly review the stock of regulation and assess the costs and benefits of new regulations, taking into account the costs of compliance for sub-national governments. All levels of government should be aware of and seek to minimise the administrative burden of government formalities for a typical public investment project.

Chapter 7

Integrity and citizen participation in regional Colombia

This chapter is divided into two main parts, discussing integrity in the public sector and citizen engagement with the policy process. The first, focused on integrity, explains the current legal framework, illustrates the challenges at stake and provides policy recommendations to encourage the current positive trend that characterises Colombia. The second section discusses citizen participation in Colombia, showcasing the current policy framework and – based on information collected in three local case studies – presents several policy recommendations to improve the current situation.

Key findings

- The Constitution allocates political power and key responsibilities to sub-national levels and mainstreams citizen participation across government functions. Since 2010, Colombia has put in place an all-round strategy to bring Colombia up to international standards in integrity, accountability, e-government and citizen participation.
- The approach to ethics is compliance-based, and involves a large number of rules and prescriptions. Strict regulations and the fear of contravening the law hampers the performance of the public sector at the sub-national level, jeopardising the efficiency of public administration and slowing down decision making.
- Local governments' limited fiscal and policy autonomy reduces the scope for citizen participation. This restricts local debate on how local revenues should be invested. Citizens see the central government as a source of funds, rather than as a political powerhouse they can influence.

Key recommendations for integrity

- Consider introducing a self-assessment tool to analyse weaknesses of the institutional framework from a sub-national perspective. This would be an in-depth assessment of the vulnerabilities affecting the sub-national public administration, by activity and by sector.
- Enhance co-ordination among oversight bodies at sub-national level. The role of territorial "moralisation committees" (*comisiones regionales de moralización*) could be enhanced, to co-ordinate oversight at the territorial level, and also to encourage joint audits carried out by mixed teams of *contralores* and *procuradores*.
- Clarify the roles and responsibilities of oversight bodies at the territorial level. Oversight bodies are inundated with work, due to the lack of hierarchy and their mandate to intervene in a long list of situations. Implementing the existing map of risk could allow them to focus on critical areas such as procurement, thus streamlining the system.
- Strengthen the National Secretariat of Transparency's work at sub-national scale. The *comisiones regionales de moralización* could be connected with the National Secretariat of Transparency. This would benefit the national strategy for integrity and transparency at the regional level. Departments should be in charge of implementing the national strategy.

Key recommendations for citizen participation

- Match devolution of power with tools to enhance citizen participation. The government should demonstrate to citizens and sub-national institutions that their involvement can influence policy making. This requires co-ordinating mechanisms for participation across sectorial policies, at different territorial levels, and also a campaign to inform citizens about these improvements and the role they can play in designing and implementing public policies.
- Focus actions to enhance citizen participation on policies that they care about. Citizens and businesses cannot engage in policies on every front; (regional) constituencies have specific priorities that will vary across territories. The central government should map these priorities and focus participatory tools accordingly. The current consultation process (*Pacto Agrario*) could facilitate the mapping process.
- Identify local best practices for engaging communities. Not all local communities are equipped to engage in a participatory system of policy making. The policy should establish a framework to promote the contribution of territories whose institutional setting, citizens and businesses are more willing to engage in public policy.

Introduction

Colombia's experience shows that promoting integrity in the public sector requires collective action, involving both citizens and sub-national governments. Integrity and citizen engagement are intertwined and represent two pillars of open government, a governing doctrine in which the public has full access to all information concerning the government and can use this information to engage and contribute to the functioning of the state.

Colombia has put the fight against corruption at the heart of its government agenda, and all levels of government are actively working to improve the current situation. Sub-national authorities are particularly exposed to corruption. Close to a third of the total sanctions in the public administration imposed between January 2000 and September 2012 were applied to mayors and local councillors. However, many sub-national communities chose not to wait for the central government to set a comprehensive framework for integrity, and started developing their own tools and institutions to fight corruption. Their pioneering work inspired the recently instituted anti-corruption strategy at the central level.

Promoting integrity also favours citizen engagement. Once a centralised presidential democracy based on a corporatist system of governance (Malloy, 1977; Faughnan and Zechmeister, 2011), Colombia is developing a more inclusive institutional framework, which takes into account economic and social stakeholders in the process of policy making. The Constitution of 1991 allocated political power and key responsibilities to sub-national levels (which are by definition closer to citizens) and mainstreamed citizen participation across government functions. The need for citizen engagement will increase due to recent key reforms and policies promoting regional development. For instance, the implementation of the reform of the system of royalty payments requires sub-national communities to define a development strategy to access funding. Hence local stakeholders, including citizens and business, have to share with public authorities their information about regional needs and opportunities.

This chapter provides insights on the current process in Colombia and identifies a series of key challenges facing integrity and citizen participation. One general challenge, as far as integrity is concerned, is that the approach to ethics is compliance-based, and involves a large number of rules and prescriptions. The focus tends to be more on strict adherence to the administrative procedures and rules (often detailed in legislation) that define what public servants should do and how. Because the oversight bodies at the local level reflect the oversight framework at the centre, auditing involves considerable duplication. Public managers in departments and municipalities take great pains not to inadvertently contravene the rules and face going to jail. This affects the efficiency of public administration and slows down the decision-making process and investment.

The legalistic approach to processes and policy setting may also have a negative impact on citizen participation and multi-level governance dynamics, which are required to occur within specific legal frameworks, where the scope of the participation is always pre-defined by public authorities. For instance, municipalities and departments operate in a policy framework that is mostly set by the central government. They have limited capacity to demonstrate their efficiency and effectiveness to citizens. The limited fiscal autonomy and the dependence on transfers from the centre restrict local debate on the way local revenues should be invested.

Citizens see the central government as a source of funding (and subsidies) rather than a policy powerhouse they can influence. Despite the remarkable improvements, and the positive signals that can be observed in several local communities, open government in Colombia still faces key challenges. Thanks to the corporatist legacy that prevails in the country, public authorities tend to patronise citizens and their organisations. In their turn, citizens are accustomed to a relationship with the public sector that is based on clientelist affiliation rather than on transparency and equal treatment under the law. This situation exposes local communities (and the public sector in general) to corruption and negatively affects their capacity to provide public deciders with information on the needs and investment opportunities in their regions.

In this context, the OECD recommends a shift from a compliance-based approach to an integrity-based ethics management, to promote ethical behaviour in the public sector, including at the sub-national level. This requires a radical change in the way in which oversight bodies are organised at the sub-national level and also improved co-ordination among them, to avoid duplication of audits and do away with the current complex system. A more flexible system of control would allow sub-national authorities to focus on the outcome of their policies rather than on formal issues. This, in turn, would allow citizens to have a clearer perception of the performance of the public sector and would facilitate their engagement. Finally, the scope of citizen participation should not be pre-defined by the central level. Local stakeholders should be free to decide the focus of their engagement with the public sector in a transparent and accountable framework. Empirical evidence collected in case studies shows that some local communities have successfully used the current tools to improve integrity and citizen participation. The central government should take into account these experiences – and look for others in the country – and use them to inspire the national strategy. This should be seen as a learning process, rather than a fixed objective: i.e. a policy for integrity and citizen participation rather than a law.

The integrity framework in Colombia

Diagnosis and key challenges at stake for sub-national governments

Colombia displays a high level of perception of corruption in its public sector (Table 7.1), and the country is actively working to correct this.[1] Colombia ranks 94th out of 177 in the Corruption Perception Index (Transparency International, 2013), which ranks countries based on the perception of corruption in the public sector. On a scale from 0 (highly corrupt) to 100, Colombia's score was 36 in 2013. Corruption manifests itself in various forms, including widespread financial and political corruption, patronage and misuse of power. Both petty and grand forms of corruption are prevalent in the country.

Sub-national governments are more susceptible to higher corruption ratios for two reasons. First, audit policies tend to be less stringent than at the national level; second, many sub-national governments lack adequate institutional capacities to address the complexity of national regulations. Close to a third of the total sanctions in the public administration (national and sub-national) administered between January 2000 and September 2012 involved mayors and local councillors. In 2011, more than 100 mayors (out of 1 123 municipalities) were punished by the Inspector General (*Procuradoría*), i.e. almost 10% of mayors, and more than 90% were suspended (Figure 7.1).

Table 7.1. **Corruption Perception Index, 2013**

Rank	Country name	Score	Surveys used	CI: lower	CI: upper	2012 score
1	Denmark	91	7	87	95	90
1	New Zealand	91	7	87	95	90
3	Finland	89	7	86	92	90
3	Sweden	89	7	85	93	88
5	Norway	86	7	82	90	85
5	Singapore	86	9	82	90	87
7	Switzerland	85	6	81	89	86
8	Netherlands	83	7	80	86	84
9	Australia	81	8	79	83	85
9	Canada	81	7	77	85	84
11	Luxembourg	80	6	75	85	80
12	Germany	78	8	74	82	79
12	Iceland	78	6	73	83	82
14	United Kingdom	76	8	74	78	74
15	Belgium	75	7	71	79	75
18	Japan	74	9	70	78	74
19	United States	73	9	66	80	73
21	Ireland	72	6	65	79	69
22	Chile	71	9	68	74	72
22	France	71	8	67	75	71
26	Austria	69	8	64	74	69
91	Malawi	37	8	34	40	37
91	Morocco	37	8	32	42	37
91	Sri Lanka	37	7	34	40	40
94	Algeria	36	6	31	41	34
94	Armenia	36	6	30	42	34
94	Benin	36	6	30	42	36
94	Colombia	36	7	33	39	36
94	Djibouti	36	3	22	50	36
94	India	36	10	32	40	36
94	Philippines	36	9	32	40	34
94	Suriname	36	3	31	41	37
102	Ecuador	35	6	29	41	32

Note: CI refers to confidence interval. The confidence interval reflects some of the uncertainty associated with a country's CPI score. It is calculated by looking at the range of scores given by all the data used to calculate that country's score, such that a wider interval reflects a wider variation in the data for that country.

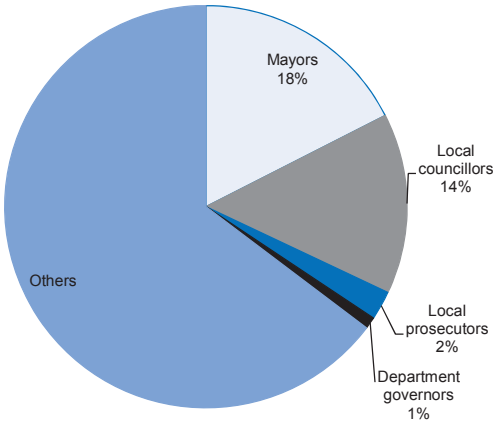
Source: Transparency International (2013), Corruption Perception Index 2013, www.transparency.org/cpi2013/results#myAnchor1.

Existing institutional frameworks to fight corruption

In recent decades, Colombia has made significant efforts to develop an integrity framework to address corruption. The 1991 Constitution established four major institutional changes that represent the basis of the current accountability system (Quiñones and Arciniegas, 2011):

Figure 7.1. **Sanctions for acts of corruption and disciplinary findings in the public administration at the sub-national level, Colombia**

January 2000-September 2012



Source: OECD (2013d), *OECD Economic Surveys: Colombia 2013: Economic Assessment*, OECD Publishing, Paris, http://dx.doi.org/10.1787/eco_surveys-col-2013-en.

- First, Colombia's Constitution recognised a new hierarchy between the three branches of government. The power of the legislative and judicial branches was enhanced, counterbalancing the power of the executive branch.
- Second, the Constitution established a set of principles for public service, designating the professionalisation of public employees as a way to fight corruption and pork-barrel politics.
- Third, the Constitution reinforced the power of control and audit institutions, as well as their independence. These include the Comptroller General (*Contraloría General*), Inspector General (*Procuraduría General*) and Attorney General (*Fiscalía*). The Constitution regulates the functioning of these entities at central level but also at sub-national level, taking into account the need to fight corruption in municipalities and departments.
- Finally, citizen participation was embedded in the Constitution, as a mechanism for social accountability and the protection of public interests (for example, the right to petition, the principle of transparency, etc.).

These provisions have been further developed in laws and regulations and have helped shape the integrity framework for departments and municipalities.

Reinforcement of audit institutions

Most of the reforms for fighting corruption in Colombia in the last 20 years have focused on establishing new audit bodies and reinforcing their authority. A number have been created and their powers expanded over time. In the current audit and control environment, a significant number of control institutions at the national and territorial level operate with broad responsibilities and complex inter-relations. The differentiation between external and internal auditing is anchored in the 1991 Constitution, which lays out the main components of Colombia's control system (Box 7.1).

Box 7.1 External control bodies in Colombia

The framework governing the public audit and control system is laid down in the Constitution, which establishes external control institutions independent of the three branches of government. The differentiation between external and internal auditing is also anchored in the Constitution, which sets out the main components of Colombia's control system. At the central level, the external control system is made up of several bodies, the most important being the Office of the Comptroller General of the Republic of Colombia (*Contraloría General*) and the Office of the Inspector General (*Procuraduría General de la Nación*). The Office of the Attorney General (*Fiscalía General de la Nación*) is not a formal part of the national control institutions, but plays a key role within the control system.

- The Office of the Comptroller General of the Republic of Colombia is an independent government institution that acts as the highest level of fiscal control in the country. The Comptroller General plays the traditional role attributed to supreme audit institutions: *i)* to oversee the fiscal management not only of the public administration but also of individuals or entities managing funds or assets belonging to the taxpayers (auditing oversight); *ii)* to establish where responsibility lies in fiscal management and impose financial sanctions as necessary (jurisdictional oversight). The audits developed by the Comptroller General cover a broad range of activities with various objectives: efficiency, economy, equity and the evaluation of environmental costs. To fulfil these objectives, the Comptroller General conducts three different audits: financial audits, management audits and performance audits. The Comptroller General also evaluates internal control quality and efficiency and assesses Colombia's national accounts. The Comptroller General can issue warnings about these activities to deter serious risks that could jeopardise public funds.
- The Office of the Inspector General of Colombia is an independent public institution overseeing the public conduct of officials occupying public office and exercising a public mandate, thereby overseeing the correct operation of government institutions and agencies (including the police). The Office of the Inspector General is not a judicial institution. The Inspector General is mandated to safeguard the rights of citizens, guarantee the protection of human rights and intervene in the name of the people to defend the public interest. The scope of the Inspector General is broad, ranging from human rights protection to guaranteeing the principle of transparency in public procurement. That said, while the Inspector General's preventive functions in theory take the form of advice, in practice it exercises strong *ex ante* controls, because the institution has strong disciplinary responsibilities. Indeed, the Inspector General's preventive role may be slowing down decision making, deterring civil servants anxious not to inadvertently contravene the Inspector General and internal disciplinary systems. This potentially wastes resources, in addition to slowing decision making.
- The Office of the Attorney General was incorporated in 1991 with the enactment of the new Constitution. While not formally part of Colombia's control institutions (it belongs to the judicial branch of government), it plays a key role in the country's control system. Its main purpose is to ensure the efficient and prompt administration of justice for citizens. This includes anti-corruption oversight, as well as oversight over the functioning of the public sector as a whole at all levels. In contrast to the institutions mentioned above, the Attorney General has exclusive power to deal with penal findings.

Another change introduced by the 1991 Constitution was the mandate to implement internal audit procedures within public entities. This plays an important role in detecting and preventing fraud, protecting the organisation's resources and restoring trust in the

public administration. The aim of internal control processes is to ensure operational effectiveness and efficiency, reliable financial reporting and compliance with laws, regulations and policies. The internal control system is extensively regulated in Colombia, not only because this is required by the Constitution but because the public sector is acutely aware of the need for internal controls to improve transparency and efficiency and fight corruption.

In 2005, a new internal control system was introduced whose main achievement was to define and implement the Standard Internal Control Model (*Modelo Estándar de Control Interno*). This has been carried out at all levels of the public sector. Responsibility for establishing and developing an internal control system lies with the senior management of each public entity. Each has an internal control office (ICO) in charge of auditing and supervising the internal control proceedings and advising the senior management of the host entity on implementing control processes and introducing necessary correctives, as required, to attain the entity's goals and objectives. In line with international trends, the Constitution also shifted from *ex ante* internal control processes to selective *ex post* audits. As in many OECD countries that have moved to *ex post* controls over the past decades, this puts a new burden on managers to set in motion processes for effectiveness, reliability and compliance (Box 7.2).

Box 7.2. **The transition from *ex ante* to *ex post* control in OECD countries**

The main trend of control in OECD member countries has been the move from *ex ante* to *ex post* control, and the development of stronger processes of internal control. This meant a shift from a system where transactions (payments) were approved prior to commitment from a controller outside the spending ministry to one where internal management makes many financial and non-financial resource allocation decisions that are externally checked after the fact. This puts a new burden on managers to implement processes to achieve effectiveness, reliability and compliance. In practice, it means trading the inefficient but relative certainty of checking the regularity and legality of individual transactions for the more efficient but relative uncertainty of verifying the proper operation of systems.

The trends to *ex post* controls and managerial flexibility do not mean there is less control. In fact, there are more and more varied controls. Up to 50% of the work of external auditors is now performance audits. Many more financial and non-financial reports are produced. *Ex ante* internal controls are being replaced with *ex post* internal audits. New and more complicated auditing and accounting regimes are being instituted, for example accrual accounting.

As control becomes *ex post*, accountability becomes more important. If decisions are audited after the fact but the audit is not made available to the public, and/or if there is no institution obliged to ensure that corrective action is taken for non-compliance or malfeasance, the purpose of control is not being served. If more controls exist, more information is generated. The formalisation of performance, and of controls of information generated, runs the risk of creating too much information and obscuring the most important controls of public service behaviour, which are the values public servants have internalised.

The tendency toward more internally controlled management applies to all OECD member countries, but countries are at different points on a spectrum. At one end are the heavily *ex ante*, externally controlled systems in classic continental European systems, as in France, Italy and Spain, where delegated treasury controllers and quasi-legal "courts" of auditors approve and oversee spending. At the other end are Westminster and the Nordic countries that are externally controlled but on an *ex post* basis. Each country appears to have moved relative to its starting position. Some have abandoned external delegated financial controllers in favour of internal auditors but have been slower to relax input controls, while others have delegated and decentralised more decision-making authority and are confronting challenges in employing risk management and more complex management controls.

Source: OECD (2005), *Modernising Government: The Way Forward*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264010505-en.

Anti-corruption at the Centre of Government: The Transparency Secretariat

One of the latest initiatives to boost the integrity framework in Colombia is the establishment of a new body: the Transparency Secretariat, part of the Council of Ministers. The Transparency Secretariat promotes an effective horizontal approach of the anti-corruption policy. It was created in 2011 as part of the Office of the President, as an agency responsible for advising the government on the definition and implementation of comprehensive policy for the fight against corruption. The Transparency Secretariat plays an important role in the fight against corruption at sub-national level, as it is responsible for:

- designing and co-ordinating anti-corruption strategy at the national and sub-national level
- defining, co-ordinating and implementing preventive anti-corruption tools by boosting institutional capacities, transparency and social control, and promoting the participation of civil society, access to information and accountability
- defining the methodology to monitor the fight against corruption
- analysing the internal control reports.

The Transparency Secretariat acts as the technical secretariat of the National Moralisation Commission (*Comisión Nacional de Moralización*), which is led by the President and was created in 2011. The *Contralor General*, the *Procurador General* and the Attorney General are among the members of this commission. Its main responsibility is to work jointly with the other control entities to fight corruption. In addition, territorial moralisation committees meet at least once every quarter to support the work of the national commission.

Strengthening control institutions and processes at the sub-national level

Audit and control institutions at sub-national levels replicate almost completely the functions of their national counterparts. The high number of control institutions, coupled with the limited capacities of most sub-national governments to cope with the complex requirements imposed by the control framework, result in a highly complex situation in which the focus is on the formal respect of the rules rather than a concrete effort to make the system more transparent and reliable (Box 7.3).

The major challenge of the audit institutions is to increase the efficiency of the system by fostering co-ordination and eliminating overlaps among institutions at the sub-national level. However, the punitive approach followed by control bodies has created a "culture of fear" and lack of trust in the administration, especially at sub-national level.

In this context, control institutions active at the sub-national level encounter specific challenges:

- The public sector tends to be less formalised, with a comparative lack of registers (information), weaknesses in accountancy and fewer statistics. This is not an issue specific to the control system, but it can affect its efficiency and effectiveness.
- The focus tends to be on processes rather than outcomes. Regulation in Colombia is extremely complex, detailed and, in some cases, difficult to apply. To comply with the meticulous procedures is especially challenging at sub-national level, where public employees tend to lack skills. Given the number of audits and control procedures public officials must conduct, they often adopt a compliance-based approach, emphasising process, not outcomes.

Box 7.3. **Audit and control institutions at the sub-national level in Colombia**

At local level, fiscal supervision is exercised by sub-national comptrollers' offices, so-called territorial *contralorías*, which are independent of the Comptroller General. They have a separate budget from the Comptroller General and full autonomy to execute their functions. The Comptroller is selected by the judicial branch (from a shortlist of candidates) and elected by the assembly of the sub-national entity (department or municipality) where the office is located. The local Comptroller's Office can start control procedures on its own initiative or following a citizen's complaint.

Likewise, the departments, districts and municipalities have the autonomy to organise their own internal control systems (ICO). The size of these systems need not be proportionate to the size of the territorial administration audited. The budget of these institutions is financed by the budget of the territorial entity.

The Inspector General (*Procuraduría*) has 32 regional offices, with jurisdiction over the public employees of the departments, and 52 provincial offices with jurisdiction over municipalities. At the local level, the Inspector General has representatives (*personeros*) active at the department and municipal levels. The representatives monitor the action of local authorities and have the power to sanction their action. However, the Inspector General has the right to revise their reports.

Overall, control bodies at the central and local levels have strong powers and responsibilities. They monitor the activities of public authorities and the allocation and use of public funds. They are also in charge of verifying the outcomes of public policies and assessing whether policy interventions deliver the expected results. Control bodies can remove elected officials; they co-operate with the Office of the Attorney General to prosecute them.

Source: National Planning Department of Colombia (2013), "Background report prepared for the *OECD Territorial Review: Colombia*", unpublished.

- The political independence of the control entities is a key issue. Mayors and governors directly appoint the heads of the ICOs, for a four-year term that is not permitted to coincide with that of the mayors and governors themselves. The appointment of the *contralores* also depends on political agreements between parties. In 2003, a referendum was held to eliminate the territorial *contralorías*, due to the political influences observed in these institutions. More than 90% of the voters voted to abolish the *contralorías*. Nonetheless, the referendum failed to achieve the required turnout of voters, and territorial *contralorías* were not abolished.
- Significant disparities in size and capacity prevail between regional *contralorías* and ICOs because there are no regulations establishing minimum capacity requirements. Territorial entities use their own budgets to pay for control institutions. Limited budgets may thus restrict the technical preparation and training of local audit staff.

Considerable effort has been made by the central Administrative Department of the Civil Service (*Departamento Administrativo de la Función Pública*, DAFP) to define methodological guides to standardise internal control procedures at the territorial level and offer training to territorial employees. Although the guidelines should be applied in internal control procedures at the territorial level, the lack of technical capacities at sub-national level make them difficult to apply in practice.

The key issue is to ensure that regional control institutions acquire the capacity to meet their audit and control responsibilities properly, as new resources are transferred to

sub-national entities. This is particularly true under the royalty reform, which entails a significant increase in public resources for many territories. Staffing levels in the *Office* of the Comptroller General have recently been increased for this purpose. The experience of countries that have undertaken ambitious decentralisation reforms suggests that the decentralisation process should be accompanied by a strengthening of control institutions. This should ensure that the resources expended in departments and municipalities are properly managed and achieve the intended policy outcomes.

Finally, a key question concerns the capacity of internal control offices and external control institutions to boost co-ordination. Common areas of work performed by internal audit authorities and the external control institutions (*contraloría* and *procuraduría*) offer opportunities for co-ordination and co-operation. It is thus important to assess whether these bodies should establish formal channels for co-ordination. There are pros and cons of boosting the co-ordination and co-operation of these institutions (Table 7.2), so the advantages and risks of any decision taken on this score merits careful consideration.

Table 7.2. **Advantages and risks of co-ordination between internal and external audit**

Advantages	Risks
Exchange of ideas and knowledge between audit professionals	Compromising confidentiality and subsequently management's trust in the role of internal audit
Increasing efficiency and effectiveness of audit in planning audits and communicating audit findings	Differing conclusions or opinions on the work performed by the other party
Reducing the likelihood of unnecessary duplication of audit work (economy)	Communicating the preliminary findings to an external party before sufficient audit evidence exists to support those findings
Mutual support on audit recommendations, enhancing the effectiveness of audit service	If not properly defined, imposing additional burdens of co-ordination and co-operation on either party in the audit activities of the other party

Source: Adapted from INTOSAI (2010), *Co-ordination and Co-operation between SAIs and Internal Auditors in the Public Sector*, INTOSAI GOV 9150, www.issai.org/media/13353/intosai_gov_9150_e_.pdf

Key recommendations for improving the effectiveness of the audit agencies at territorial level

National authorities might consider several recommendations for improving the effectiveness of audit bodies at the sub-national level.

- A first, overarching, recommendation is that any reform of the current framework should avoid establishing more audit institutions or additional rigid procedures. Colombia could consider enrolling national and sub-national audit institutions to offer intrinsic oversight and assessment of any reform developed in this field, to guarantee its effectiveness.
- Consider introducing a self-assessment tool to analyse the weaknesses of the institutional framework. An in-depth, bottom-up assessment of the vulnerabilities in the sub-national public administration (by activity and by sector) could enhance any initiative to improve the institutional framework. The Netherlands has some interesting instruments of this kind (Box 7.3).

Box 7.4. **Assessment tools: The experience of the Netherlands**

The Netherlands Court of Audit, in co-operation with the Ministry of the Interior and the Bureau of Integrity of the City of Amsterdam, has developed the Self-Assessment Integrity (SAINT) tool. This is a self-diagnosis tool that is presented and discussed in a one-day workshop that can help public organisations assess their vulnerability to integrity violations and their resilience in response to those violations. SAINT also issues recommendations on how to improve integrity management. Its main features include:

- Self-assessment: The organisation itself must take the initiative to test its integrity, drawing on the knowledge and opinions of the staff. The organisation reveals its own weaknesses, and the staff members make recommendations on how to strengthen resilience.
- An assessment targeted at prevention: The tool is not designed to detect integrity violations or punish unacceptable conduct but to identify the main weaknesses and risks and to strengthen the organisation's resilience in the face of those weaknesses and risks.
- Raising awareness: The SAINT workshop significantly increases awareness of integrity, through participants' collective discussions of its importance, which can be of great value.
- Learning to think in terms of vulnerability and risk: During the workshop, participants identify the main vulnerabilities and risks and subsequently make recommendations on how to minimise them.
- Producing a concrete management report/action plan: Under the expert leadership of a trained moderator, the participants formulate recommendations for their organisation. The report explains to management where urgent measures must be taken to strengthen its resilience in response to integrity violations.

During the workshop, participants assess the maturity of the measures that constitute the organisation's integrity management system.

Source: Benner, H. and I. de Haan (2008), "SAINT: A tool to assess the integrity of public sector organisations", *International Journal of Government Auditing*, April, available at: www.intosaijournal.org/pdf/2008_staats_award_articles.pdf.

- Enhance co-ordination and co-operation among the audit institutions at sub-national level through three simple steps:
  - Territorial moralisation committees should play a stronger role in co-ordinating the existing agencies, since the heads of the main institutions (Comptroller General, Inspector General and Attorney General) are part of these committees and hold quarterly meetings. Over-regulation of these committees should be avoided and spontaneous dialogues among the control agencies encouraged, without insisting on formal procedures.
  - Encourage joint audits between institutions to make the system more efficient, with a mixed team of *contralores* and *procuradores*. These joint audits could be a good opportunity to share knowledge.
  - Define a performance protocol on how to proceed when a single case involves more than one control institution. Once the hierarchy is defined, each control institution can proceed in its area of responsibility.

- Rationalise the responsibilities of control bodies at territorial level by clarifying their roles. Control bodies are overloaded with work, for two reasons: First, these agencies have broad competences, as noted above. Second, Colombia's complex and detailed legislation complicates their task, since they are charged with supervising compliance with such exhaustive regulations. Control institutions should focus on institutions, areas and procedures more exposed to corruption, e.g. public procurement (see Chapter 6). Risk mapping should be promoted, in line with OECD countries' practices, to identify the areas and procedures vulnerable to corruption. Manuals could be developed to guide public employees in risk areas.
- Consider internal audit bodies strategic partners in the management of public organisations. Internal audit bodies can play a key role at territorial level, preventing irregularities in the use of public funds and promoting efficient public policies. Colombia could consider establishing common minimum provisions regarding the internal audit offices at territorial level, taking into account territorial specificities. Departments, districts and municipalities now have the autonomy to organise their own internal audit systems, and the size of the ICO is not always proportional to the dimension of the host territorial administration.
- Build the professional skills of the staff of the audit institutions, especially internal controllers, who can play a major role in anti-corruption policies. This will not only improve the performance of these institutions but ensure their independence from political influences. One option might be to consider centralising the recruitment and training of auditors in a national institution (e.g. the DAFP or the *Escuela Superior de Administración Pública*). In Spain, internal controllers at the local level are recruited on the basis of a national competition, to guarantee their independence from their host entity. Training for these public employees is also centralised at the national level in the Public Administration National Institute, to guarantee a certain level of technical competence. Municipalities are ranked by category, to determine the size of the internal audit office and the number of internal controllers assigned.
- Improving the quality of regulation to mitigate the risk of breaking the law. This would be especially effective at local level, where many irregularities stem from public officials' lack of capacities.

Strengthen sub-national capacities for public procurement

Public procurement in Colombia, as in OECD countries, is particularly exposed to corruption. This is due to its complexity, the close interaction between the public and private sectors, and the size of the cash flows it generates. It accounts for 15.8% of Colombia's gross domestic product (GDP), as opposed to an average of 12% in OECD countries. Tender specifications tailored to a particular company as well as the abusive use of contract amendments to modify the initial contract are some of the risks Colombian authorities report.

The experience of OECD countries shows that risks of fraud, embezzlement and corruption exist throughout the entire public procurement cycle. In 2008, the OECD developed its *Principles for Enhancing Integrity in Public Procurement* (Box 7.5), which aims to promote transparency, good governance, prevention of misconduct, accountability and oversight in the public procurement process.

Box 7.5. **OECD Principles for Enhancing Integrity in Public Procurement**

The OECD has elaborated the following principles to support the effort of member countries to improve integrity in public procurement. They are:

1. Transparency: *i)* provide an adequate degree of transparency in the entire procurement cycle to promote fair and equitable treatment for potential suppliers; *ii)* maximise transparency in competitive tendering and take precautionary measures to enhance integrity, in particular for exceptions to competitive tendering.
2. Good management: *i)* ensure that public funds are used in public procurement according to the purposes intended; *ii)* ensure that procurement officials meet high professional standards of knowledge, skills and integrity; *iii)* prevent misconduct, compliance and monitoring; *iv)* put mechanisms in place to prevent risks to integrity in public procurement; *v)* encourage close co-operation between government and the private sector to maintain high standards of integrity, particularly in contract management; *vi)* provide specific mechanisms to monitor public procurement, as well as to detect misconduct and apply sanctions accordingly.
3. Accountability and audit: *i)* establish a clear chain of responsibility, together with effective control mechanisms; *ii)* handle complaints from potential suppliers in a fair and timely manner; *iii)* empower civil society organisations, the media and the wider public to scrutinise public procurement.

Source: OECD (2009), *OECD Principles for Integrity in Public Procurement*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264056527-en.

The excessive regulation and rigidity of public procurement procedures in Colombia are becoming counterproductive, leading to limited competition and high procedural costs. In addition, due to the high number of audits and control procedures public buyers must undergo, public procurement officials are adopting a compliance-based approach to procurement, giving priority to process rather than outcomes.

At sub-national level, the exposure of public procurement to waste, fraud and corruption is even higher, because in some places, civil servants with weak professional skills have to apply a detailed and complex regulatory framework devolving from the centre. Public procurement regulations are complex, with many overlapping rules, and are often not easy to implement. This is not specific to Colombia and is the case in many OECD countries, where procurement can be problematic for sub-national governments with weak internal audit systems (OECD, 2013c). This is due in some instances to decentralisation that has outpaced improvements in administrative capacity. That is why the OECD recommends, as part of its *Recommendation of the Council on Effective Public Investment across Levels of Government*, promoting the professionalisation of the procurement function. "Governments should invest in ensuring adequate capacity, in particular at the sub-national level, by employing and training procurement professionals, using collaborative procurement mechanisms and employing e-procurement tools" (OECD, 2013c).

Challenges to strengthening the governance of procurement across levels of government in Colombia

Colombia is developing a reform of public procurement, to be set out in the National Development Plan 2010-2014. A new central procurement agency, the *Agencia Nacional de Contratación Pública* or *Colombia Compra Eficiente*, was created in 2012, to

introduce a commercial approach and professionalise public procurement. This agency can also play a major role improving the integrity framework of public procurement, reinforcing the preventive mechanisms for fighting corruption through the following initiatives:

- Building the professional skills of procurement officials, especially at the sub-national level: *Colombia Compra Eficiente* can bridge the procurement capacity gap between central and sub-central authorities, as officials tend to possess less specialised procurement knowledge and skills at the local level. Specific training on integrity should be promoted by this agency. Professionalisation will not only help achieve an effective use of procurement but also mitigate the risk of corruption.

- Simplifying public procurement regulation: The agency is already working on simplifying the legal framework. This regulation is implemented in departments and municipalities with low capacities, which means that the simpler it is the better. Several OECD countries have recently changed their procurement legislation to simplify procedures or improve value for money. Portugal, for instance, introduced a new Code of Public Contracts in 2008, which integrates dispersed regulations regarding public procurement. Slovenia has simplified procurement procedures and increased technical assistance to municipalities.

- Supporting sub-national officials in interpreting procurement regulation: One of the mandates of *Colombia Compra Eficiente* is answering and resolving general queries on application of the procurement rules. However, sub-national authorities request more support in this field.

- Standardising procedures and reducing exceptions: Colombia permits a wide range of exceptions to the procurement rules; these allow specific entities to procure goods and services outside the competitive tendering process (e.g. for the defence and health sectors, public universities, the central bank of Colombia, etc.). In 2011, almost half of the total number of public contracts in Colombia were awarded on the basis of exceptional procedures (OECD, 2013a). By reducing exceptions to general rules, transparency is boosted and exposure to corruption reduced. The city of Manizales has introduced a promising experiment to promote transparency and integrity in the public procurement framework, standardising tender specifications of commonly procured products and services. This reduces arbitrariness in the public procurement process, reducing the possibility of tailoring tender specifications to a particular company. This successful experience could be mandated for all levels of the administration. Standardising tender specifications will decrease the risk of exposure to corruption, especially at sub-national level.

- Offering guidance on measures that cultivate the integrity framework and the fight against corruption at all levels. *Colombia Compra Eficiente* can provide useful inputs to risk mapping public procurement procedures. This could help fine-tune the audit and control bodies, and help detect mistakes in public procurement processes. The World Bank "Red flags of corruption" in procurement can provide useful guidance here (Table 7.3).

Table 7.3. **Red flags of corruption in procurement**

Red flag	Description
Complaints from bidders	Complaints from bidders and other parties may indicate a need to investigate potential underlying misconduct, even if it is not noted in the complaint.
Multiple contracts fall just below procurement thresholds	Public officials may tailor a contract to fall just under the procurement threshold, or split one contract into several smaller ones to keep them under the procurement threshold (contract splitting). This can eliminate the need for competitive bidding or higher level review while steering contracts to particular firms.
Unusual bid patterns	Collusion in bidding can be indicated by unusual bid patterns, such as (but not limited to) bids that differ from each other by a systematic percentage, losing bidders becoming subcontractors, rotation of winning bidders or bid prices that are significantly above government estimates.
Seemingly inflated agent fees	Unnecessary middlemen may be used to prepare or carry out a contract. Their fees may hide bribes, kickbacks, etc.
Suspicious bidder	Individuals may submit bids through fictitious or shell companies. Due diligence may reveal a lack of permanent business facilities, an official listing or business assets.
Lowest bidder not selected	Bid rigging may be indicated when the lowest evaluated bid is unjustifiably declared non-responsive by a bid evaluation committee.
Repeat awards to same contractor	Requests for an exception to an approved procurement plan in order to award multiple contracts to a single contractor that cannot be well justified may suggest awards that are being made on the basis of false justifications, or contract splitting.
Change in contract terms and value	Changes to a contract that occur after a contractor is selected but prior to signing the contract may indicate an effort to increase profitability by altering the scope, quality (e.g. personnel), unit rates or other terms of the contract.
Multiple contract change orders	Changes occurring after a contract has been signed or during its implementation may be justified, but may also signal an attempt to increase the contract value without changing the product or services delivered.
Poor-quality work/services	Poor-quality or undelivered goods or services may indicate that a contractor has tried to recover the cost of bribes, kickbacks or collusion with other firms by lowering the quality of goods/services produced or by delivering less than originally specified.

Note: In the source below, these red flags refer to indicators of fraud and corruption in World Bank financed projects. However, the "red flags" are a useful reference for procurement generally.

Source: World Bank (n.d.), "Most common red flags of fraud and corruption in procurement", pamphlet, Operations Policy and Country Services, Integrity Vice Presidency, Washington, DC, http://siteresources.worldbank.org/INTDOII/Resources/Red_flags_reader_friendly.pdf.

Colombia's government is considering the introduction of an advanced electronic platform. Italy's experience developing a national database on public procurement could be helpful, particularly in the use of such data to strengthen the integrity framework (Box 7.7). Such initiatives can also occur at the regional/local levels. At the regional level, Galicia (Spain) has developed a web platform for public procurement procedures for all public entities, including municipalities. The goal is to integrate all public entities and private companies in a one-stop shop for public procurement. Collaborative procurement across levels of government and at regional level can also help improve procurement capacity (e.g. purchasing alliances, networks, framework agreements as well as central purchasing bodies) (OECD, 2013a).

Box 7.6. National database on public procurement in Italy

In Italy, the Authority for the Supervision of Public Contracts was created in 1994. Its aim was to supervise public contracts in order to grant compliance with principles of transparency, fairness and competition among operators in the public procurement market. The authority is responsible for enforcing the law by delivering an identification code to public procurement payments. Guidelines are also available to promote conformity with the law.

The Authority for the Supervision of Public Contracts created a national database on public procurement in 2010. This ensures the collection and processing of data on public procurement, to provide specifications for the supervising departments and to orient the regulating activity towards transparency, simplification and competition. In addition to collecting data, it also provides market analysis.

The authority has improved its performance thanks to the quality of the data provided by the database on public procurement. In particular, it has reinforced its oversight and supervisory role, which has enabled it to offer guidance on the measures needed to encourage transparency, streamlining and competition throughout the entire public procurement process, and, perhaps most significantly, during the phases preceding and following the calls for tenders.

More specifically, the database collects and assesses data on the following issues:

- The structural characteristics of the market of public procurements and its evolution: Statistics on the amount and value of awarding procurements are grouped by locality, procurement entities and awarding procedures; and the different typologies of procurement are periodically published.
- Conformity with the criteria of efficiency and value for money during the procurement process: Changes of the earlier contractual conditions are recorded in the database.
- Dysfunctions and anomalies of the market that are detected through the following measures: *i)* signs of excessive tendering rebates, by comparison with average rebates; *ii)* the number of bids presented in each awarding procedure; *iii)* the location of successful companies in relation to that of the contracting authority.

Source: OECD (2012c), "Progress made in implementing the OECD Recommendation on Enhancing Integrity in Public Procurement", internal working document, OECD, Paris.

Transparency and accountability as key levers to strengthen integrity at sub-national level

The National Development Plan: The horizontal approach in the fight against corruption

The National Development Plan 2010-2014, "Prosperity for All" ("*Prosperidad para Todos*"), considers the fight against corruption as a pillar of democracy and mainstreams the implementation of a strategy against corruption across planned actions. In recent years, Colombia has adopted a new anti-corruption approach, through initiatives in areas such as transparency, social accountability, participation and access to information. These are closely related to the principles of good government and open government, with positive spillovers to strengthen Colombia's integrity framework. Some of the most important initiatives undertaken can be summarised as follows:

- Accountability: Since April 2010, Colombia has strengthened its policy for accountability, setting guidelines for the use of a single methodology and ensuring institutional co-ordination and civic participation. A dedicated

commission, including the Presidency of the Republic, Ministry of Interior, Ministry of Justice, the DAFP and the National Planning Department (DNP), was set up to co-ordinate this process.

- Social control through "visible audits": The government has developed a strategy for social control through "visible audits", which seek to provide local follow-up to the investment of royalty funds, and promote good practices through forums with the beneficiary communities, actors involved in execution and audit institutions. From 2008 to 2010, 318 projects were audited, with the participation of more than 29 500 people (National Planning Department of Colombia, 2013).
- Anti-corruption Statute: The Anti-corruption Statute introduces measures to encourage honest action and strengthen civil participation, through the creation of a National Citizens' Commission (*Comisión Nacional Ciudadana para la Lucha contra la Corrupción*). It includes representatives of civil society (media, non-governmental organisations [NGOs], professional associations, etc.) appointed by the President for a four-year mandate. The commission's function is to follow up on evaluation and on recommendations for policies, plans and programmes employed in the fight against corruption. The statute also gave the President the authority to modify and eliminate procedures in public agencies, to guarantee transparency and administrative efficiency. Under this statute, each level of the administration is required to have a plan to fight corruption.
- Engagement of civil society in the fight against corruption: In December 2011, the National Civil Commission was set up to fight corruption. It is composed of leading representatives of industry associations, academia, the media, workers and NGOs related to issues of transparency. The commission oversees the commitment of civil society to fighting corruption.
- Participation and access to public information: The most important initiative in this field is the new Transparency Law, passed in March 2012, which guarantees citizen access to national public information, proposes the regulation of rights of access to public information, the exceptions to publicising information and the role of a regulatory organisation in public information. One of the law's major achievements is that its scope includes all layers of government: districts, municipalities and departments. It also establishes specific provisions for public budgetary outcomes and public procurement information (included in the newly established agency *Colombia Compra Eficiente*), which are susceptible to corruption.
- Mechanisms of participation and civic control: A number of instruments have been developed so that civil society can play an active role in the construction of an open and participatory government. These include, among other initiatives, prosperity agreements (where the President meets with local governments and communities to agree upon the local development plans), the economic transparency site (where the public can access budgetary information on the different agencies) and the ambitious initiative *Urna de Cristal* (Crystal Urn). In September 2010, the government set up the Crystal Urn, a multi-channel mechanism for civic participation. It is used by the public to: *i)* monitor the results and progress of government initiatives; *ii)* share their concerns and proposals; and *iii)* interact and learn about state actions, in order to create a more transparent and participatory government.

These initiatives are valuable for fighting corruption and to boost trust in the public administrations. However, key challenges for sub-national governments remain:

- The complex allocation of responsibilities across levels of government (and the fact that allocation of responsibilities has not resulted in a real devolution of powers and resources) clouds the accountability of governors and mayors. Citizens cannot clearly allocate responsibilities to levels of government, which may penalise sub-national levels more than the central level.
- Some of the initiatives mentioned above are focused on the central administration, with the intent that regional agencies/governments replicate actions taken at the central level. However, this "mirror effect" is not always possible, owing to particular features of territorial governments. The Secretary of Transparency can play an important role in introducing a sub-national perspective in the strategy for fighting corruption in Colombia, pursuing an overall approach.
- The new legal framework, based mainly on the Anti-corruption Statute and Transparency Laws, may be difficult to implement, especially for sub-national governments. This situation could be improved by making progress in the adoption (including appropriate funding and capacity-building) of new guidelines for implementing the new legislation. These guidelines should have a practical approach and include examples. Developing explicit protection mechanisms for whistle-blowers and witnesses will help enforce and boost the new legal framework, and develop a comprehensive capacity building programme for the civil service for the new anti-corruption framework.
- The quality of the information supplied at sub-national level should be improved. Sub-national governments should face increasing transparency obligations established by the new Transparency Law. However, it seems necessary to focus not only on the quantity but the quality of the information supplied. The information published should be organised and disclosed in clear, comprehensible language for citizens. Adapting the information and making it easy to understand for citizens are key issues in promote transparency.

Promoting social accountability at local level: The case of the veedurías ciudadanas

OECD experience shows that involving citizens in the fight against corruption is an effective strategy. At the local level, citizens are closer to public management, and social accountability can play an effective role in the fight against corruption.

Colombia's citizen watchdogs, *veedurías ciudadanas,* are probably its most successful example of social accountability. They promote the social surveillance of public management at the local level. A total of about 500 have been created by civic leaders, which operate democratically. Their aim is to stimulate citizenship and participation, mobilise volunteer work in social responsibility activities and offer anti-corruption education. The *veedurías* are essential for raising awareness of the importance of fighting corruption, and deal with mounting public demand for more transparency and accountability at the local level. They also play an important role in preventing corruption. Obstacles to these mechanisms of social control include political influences and lack of institutional capacities. At the national and departmental level, an institutional network to support the *veedurías* has been created (*Red Institucional de Apoyo a las Veedurías Ciudadanas*), involving the main control bodies as well as the

DNP and the DAFP. Its main role is to provide *veedurías* with training, information and legal advice.

The success of the *veedurías* in different regions has been mixed. In Valle del Cauca and Caldas, resources provided by the *Ciudadanos al Cuidado de lo Público* fund have helped citizen watchdogs to manage USD 2.5 million to finance education and health projects (*Trasparencia por Colombia*).

The potential of *veedurías ciudadanas* for enhancing social accountability at the sub-national level could be expanded. International experiences provide inspiration for further experimentation with such bodies (Box 7.5). Social accountability can be improved by such actions as:

- Promoting social control from the control institutions. Continuing dialogue among external accountability agencies and *veedurías ciudadanas* will build the accountability framework.
- Boosting the political independence of these mechanisms.
- Strengthening communication strategies to publicise the results achieved.
- Promoting local networks and strengthening the existing ones (at national and departmental level) to reduce financial obstacles and translate local demands into action at the national level.

Box 7.7. **Social control in Brazil: Maringá's Social Observatory**

In 2006, Maringá's Social Observatory was created by an NGO with long experience of social accountability. The observatory is a tool for preventing the mismanagement and misappropriation of public funds, and seeks to guarantee transparency in the city's public tender and procurement processes.

The observatory's volunteer members are professionals from different disciplines: lawyers, accountants, economists, public servants, business managers and students. Initially, the members were trained by the *Controladoria Geral da União e TCU* (the central government´s accounting inspection office), and by its equivalent provincial institution for the state of Paraná. This training gave observatory members detailed knowledge of public procedures, specifically related to public tenders and procurements. The observatory's "citizens' watchdog" role has drastically reduced the misappropriation of Maringá's public funds, and as of today, 52 of the 5 565 Brazilian municipalities have established observatories along these lines.

The observatory's role in the prevention of corruption and in public awareness campaigns on taxes and transparency have been acknowledged both nationally and internationally. In 2009, competing with 1 000 other projects, it was awarded 1st place in the fifth Social Innovation Award contest, sponsored by the United Nations Economic Commission of Latin America (ECLAC). The ECLAC selected it as an efficient project with high social impact, easily adaptable to other cities and proposed it as a model for Latin America and the Caribbean. Since it depends mainly on volunteer work, it does not require substantial funding.

Source: Rose, C.S. (2012), "La sociedad civil para la Transparencia y la Rendición de Cuentas", ECLAC.

It is clear that the numerous national reforms aiming to improve integrity at the sub-national level require the active participation of citizens. A shift in relations between citizens and the state is called for, and citizen participation should be made appealing and actionable. The next section of this chapter focuses on this issue, investigates current challenges and presents a series of local case studies to show how effective citizen

participation can be in improving the performance of the government, and in particular, its integrity, transparency and accountability.

Citizen participation in Colombia

Colombia is narrowing the gap between citizens and the state. Efforts to achieve a more transparent and accountable public sector also relate to the aim to improve citizen participation. Colombia is developing a more inclusive institutional framework, aiming to involve economic and social stakeholders in the process of policy making. The goal is to create direct links between communities and the presidency, increase transparency and help citizens provide feedback on the performance of the public sector at all levels.

This shift is particularly important in Colombia, due to its complex democratic evolution. As already discussed in OECD (2013a), centralisation was a reaction to the centrifugal forces of interest groups, extra-democratic insurgencies and regionally based ethno-cultural minorities that dominated the political debate. In many cases, the political system and legitimate interests were bound up with illegitimate forces. The relationship between citizens and the public sector was contaminated by clienteles, nepotism and corruption. In this context, Colombia's decentralisation strategy can be seen as a response to pressure groups operating outside the legal political framework as much as to the agenda of legitimate interest groups exerting democratic pressure on the government.

Informal networks of political and economic actors have shaped multi-level governance in Colombia in the last two decades, in reaction to the shortcomings of the various approaches to decentralisation and the norms and institutions they produced (OECD, 2013a). The capacity of citizens to engage with the public sector has been hampered by a lack of vision about decentralisation and in particular about the role of sub-national levels. This has generated a situation that has deprived regional and local authorities of political responsibility (OECD, 2013a). Most policy initiatives to implement decentralisation had only "fiscal and/or administrative content and impact", while merely a few focused on political reforms (Castro, 2007). The result is that the sub-national social and political leadership has not been able to govern decentralisation and regional development policy. The traditional local groups in charge were suddenly awash in new fiscal resources that they had no meaningful capacity to manage.

Since 2010, Colombia has instituted a series of reforms, policies and legal frameworks to reshape the informal power-grids active in departments and municipalities, and substitute for them more transparent and accountable institutions. "Formalised" communication channels would allow interactions between citizens and the public sector to be based on transparency and equal treatment under the law, which are crucial for facilitating citizen engagement. The National Development Plan 2010-2014, "Prosperity for All", is the cornerstone of this process. It sets up an all-round strategy to modernise public administration, facilitate access and the availability of government information, and promote citizen participation.

Several reforms Colombia has implemented have a major impact on open government. The so-called agreements for prosperity (*acuerdos para la prosperidad*) directly connect the presidency with requests made by citizens and local groups of a given community. *Urna de Cristal* is an ambitious initiative to enhance transparency and communication with citizens through different channels, including the Internet and social networks. The government is also developing a large framework to consult citizens all over the country (*pacto agrario*, see below). This general consultation mechanism will

positively affect the National Development Plan. Finally, a set of policies and new practices also require more open government: the reform of the system of royalty payments; the LOOT and the *Contratos* Plan, each oblige the different levels of government to co-operate and also to communicate with and become accountable to citizens. It is worth noting that these reforms make Colombia eligible to become a member of the Open Government Partnership (Box 7.8).

Box 7.8. **Overview of the Open Government Partnership**

The Open Government Partnership (OGP) was launched in 2011 "to provide an international platform for domestic reformers committed to making their governments more open, accountable and responsive to citizens." This new international organisation has grown quickly from 8 members to 63 as of early 2014. While its membership is made up of states, civil society and other stakeholders also participate directly in its governance.

The OGP's approach has attracted the participation of many of the world's leading advocacy organisations for democracy, transparency and good governance. Four core principles expressed in the OGP's Declaration, to which member countries must commit, include:

- access to information (government transparency)
- civic participation (including civic engagement)
- integrity (including anti-corruption)
- access to technology to support openness and accountability (including ICT).

The OGP process sets criteria for eligibility and the requirements of members once they have been granted eligibility. This begins with the development of a two-year action plan to strengthen open government.

The OGP Action Plan is required to include a number of specific commitments to strengthen open government. The OGP requires that these commitments advance at least one of the OGP's Grand Challenges. These include: *i)* improving public services; *ii)* increasing public integrity; *iii)* more effectively managing public resources; *iv)* creating safer communities; and *v)* increasing corporate accountability. Although Tunisia has not as of this writing designated which of the Grand Challenges will be the focus of its action plan, each of these areas intersects with more than one of the OGP's four pillars. For example, steps toward budget transparency support both the second and the third Grand Challenge and contribute indirectly to all of them.

Policies and tools promoting citizen engagement in Colombia, an overview

The President's Acuerdos para la Prosperidad *within the national strategy for open government*

Colombia's presidency is actively involved in supporting citizen participation. The most important public institution in the country started directly interacting with citizens in 2006. The first goal of these visits was to physically reconquer areas of the country that had been outside government control for a relatively long time, during the civil war. The High Presidential Advisory Council for Citizen Participation (*Alta Consejería para las Regiones y la Participación Ciudadana*) was created to facilitate meetings between the President and local communities. Its intention was to present the President as a *deus ex machina* intervening in favour of citizens and against the public sector, after it had failed to deliver a specific public good or service (housing, healthcare, basic infrastructure, for instance). This increased the President's popularity, but compromised the functioning of the government, because sectorial ministries were publicly held responsible for the local

malfunctioning of the policy they were responsible for. This approach suffered from populism and a lack of sound information about local needs.

Since 2010, this system has been radically modified. The meetings between the President and local communities were formalised in the agreements for prosperity. The new system retains the idea that the President should leave the capital and meet local communities, but as a broker or facilitator of institutional solutions to specific challenges. In other words, the President is cast as part of a legal and fiscal framework that constrains his power to find an *ad hoc* solution for the community in question. Moreover, the President's decision must be coherent with the National Development Plan. In resolving a specific problem affecting a citizen or a group of citizens or businesses, he can communicate the issue to its government and identify a solution that is in line with legal and fiscal requirements. The new system has increased the visibility of processes that show the citizenry the progress of interventions specifically sponsored by the President. The co-ordination of the system has become a responsibility of the High Council, which must maintain communication with communities and regions to inform the President and the government of local needs and opportunities.

The system created by the "Agreements for Prosperity" may have reached a good equilibrium in terms of the role of the central government and the engagement of local communities in problem solving. The physical presence of the President can generate trust between the public and the government. However, a new president may reject the fiscal and policy constraints now in place and revert to the previous model, in which the head of state was able (at least on paper) to solve any problem presented by the local populace.

A last note concerns citizen participation. Under the agreements for prosperity, citizens are a source of information about existing problems, but policy solutions are worked by the national government, rather than by local agents. The accent is still on a centralised system built on an institutional framework made up of the President, the legal system, fiscal sustainability and the National Development Plan.

Mainstreaming transparency through public functions and policies: The Crystal Urn

In 2010, the government launched the *Urna Cristal*, an all-round policy for transparency. The intent was to make the government's actions, policy and decisions visible and intelligible to the public. The strategy capitalises on Colombia's progress with evidence-based policy making, and on its ability to collect data on policy performance to feed into monitoring and evaluation (OECD, 2013a). Monitoring and evaluation practices helped the government to understand policy trends and impacts, and made it possible to disseminate this information to the public. The initiative also intends to streamline bureaucratic procedures in an "anti-procedure crusade".

Information about the initiative is communicated to citizens through different media. This includes a number of platforms: online through a web portal, radio and television; social media, such as Facebook, Twitter and Google+, and Google+ Hangouts, which is used to organise virtual meetings between citizen constituencies and the President. While not all channels have the same visibility, the multimedia approach is likely to help reach broader segments of the population.

National consultation of citizens: The rural pact and the National Development Plan 2014-2018

Colombia's rural-urban split is another important facet of open government. Historically, rural communities have often been excluded from the legitimate political debate. Only powerful rural constituencies and their organisations, such as coffee producers or large-scale mining companies, have been able to influence the political agenda. Interaction took place between a given sector and the government, not between a territory and the public sector. The lack of legitimate interaction between the public sector and rural citizens, including small farmers and miners, erupted into social unrest in 2013, across Colombia's rural areas.[2] Rural development policy plays a major role in the pacification process and the post-conflict policy framework.

A key component of the current rural development policy is the rural pact (*Pacto Agrario*). This is financed by an *ad hoc* tax on financial transactions, which increased the total budget for rural development to USD 2.3 billion in 2014 (compared with USD 1.2 billion in 2012). Most of these funds are used for subsidies to farmers to help them weather the increased competition brought about by free trade agreements. The pact also allocates resources to rural development, for the first time in Colombian history. The strategy is to improve service delivery in rural areas and to transfer skills and capabilities to rural households. USD 400 million has been allocated for a broad consultation process, based on 1 500 "round tables", to cover all departments, municipalities, aboriginal and Afro-Colombian communities.

The consultation process is based on public hearings involving discussion between citizens and representatives of the government (sectorial ministries and the National Department for Planning), co-ordinated by facilitators. The aim of the hearings is to listen to citizens and invite them to suggest potential interventions for their communities. After this process of consultation, in May 2015, the pact will select some of the suggestions from the round tables and finance them. The consultation process will also inform the National Development Plan 2014-2018, which is currently in preparation.

It is too early to evaluate this process of consultation, but it clearly has potential for positive impact on Colombia's development. In the event that peace agreements are signed with Colombia's rebels, this National Development Plan will be the first to be implemented in a post-conflict pacification period. It is thus of paramount importance that the plan focus not on sectors or constituencies that have dominated the political and economic scene for the last 40 years but serve citizens, territories and stakeholders that have been excluded from legitimate relations with the government. The process has great potential for building institutional capital in the country and generating trust between the government and the public.

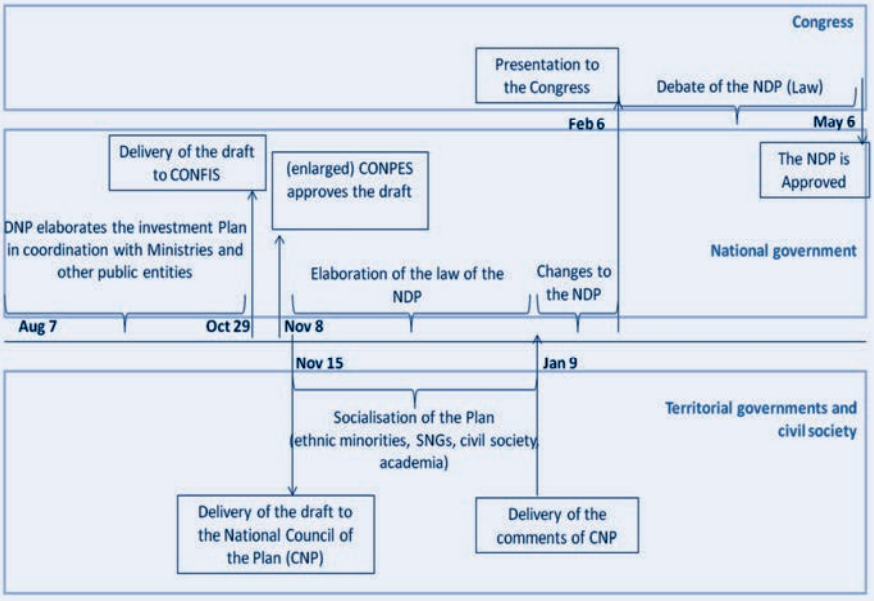
Box 7.9. How Colombia's National Development Plan is formulated

Since 1961, Colombia has organised public investment through detailed quadrennial National Development Plans (NDP). The NDP is both a technical and political document. It is technical in that it is co-ordinated and compiled by the National Department for Planning, and political in that the department's task is to transform the elected President's campaign platform into the plan, to guide his or her four-year term of office. Given the strategic importance of the NDP, Colombia has developed a legal and procedural framework that details the process.

- The National Department for Planning develops guidelines and co-ordinates the contributions of ministries, administrative departments and other authorities in fleshing out the NDP. A first draft is then submitted for approval to the Superior Council of Fiscal Policy (CONFIS), which must verify that the investment budgets identified in the draft NDP are coherent with both the Department of Finance's ten-year national fiscal framework and the government's yearly fiscal plan and budget.
- The draft is then sent to the Council on Economic and Social Policy (or CONPES, the most important political authority in the country) for a thorough discussion of policy content.
- The draft is then sent to the National Council of the Plan for a round of formal consultations; actors consulted include sub-national governments, ethnic minorities and civil society. This council can make suggestions to amend the draft based on the results of these consultations.
- Based on these suggestions, the National Planning Department adjusts the draft NDP. Once the draft is finalised, the Minister of Finance (*Ministro de Hacienda*) presents the NDP to the Congress.
- The Congress then approves the NDP by passing a specific law (*Ley Orgánica del Plan de Desarrollo*).

It is important to note that this entire rollout process is outlined in the Constitution and covers a timeline of ten months, from the beginning of August (right after the election of the President) to the NDP's final approval in the form of the *ley orgánica* the following May. The figure below summarises the main steps in the development and approval process of the National Plan.

Main phases of the NDP legislative process



Source: OECD (2013a), *Colombia: Implementing Good Governance*, OECD Public Governance Reviews, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264202177-en.

The reform of the General System of Royalties has made open government "actionable"

Among the national reforms listed above, the reform of the General System of Royalties has the merit of making decentralisation and citizen participation "actionable". As discussed in Chapter 3, the reform of royalty payments provides sub-national authorities with additional funds to deliver policies to citizens and business. To use the additional revenue, departments and municipalities have to design a development strategy and a set of coherent investment projects, which need to be approved by an OCAD before they can be implemented. This system established the basis for interaction between public authorities at the sub-national levels and local stakeholders, as the public sector needs to identify investment opportunities based on local needs. These can be better identified with the help of citizens and businesses.

Local experiences of open government and citizen engagement in Colombia: Case studies

Most local governments in Colombia are currently implementing actions that involve citizens, encourage transparency and engage with key local stakeholders in a legitimate way. In many cases, the local government has literally taken to the street to facilitate access to services for citizens. These initiatives are often called *ferias* (literally, fairs). Many municipalities and government agencies publish their budgets online, to raise accountability and awareness among citizens. In some departments, the public sector is capitalising on the presence of regional commissions for competitiveness (*commisiones regionales de competitivitad*), which are part of a national network (*Sistema Naciónal de Competitivitad*). These commissions' potential to affect regional development in Colombia is discussed elsewhere in this report, but it is important to stress that they help create a legitimate environment where business and public authorities can co-operate, limiting the risk of corruption in public-private partnerships.

This chapter considers three case studies, selected in co-operation with national authorities, representing three different ways in which local governments can enhance open government. These are:

- the municipality of Chía – transparency in planning, monitoring and evaluation of policies implemented at the local level
- the municipality of Manizales – e-government to promote transparency and trust
- the municipality of Chaparral – citizen consultation in a post-conflict area.

Case study #1: Offering citizens the capacity to monitor, evaluate and inform policy – The experience of Chía

Chía is a municipality in the Cundinamarca department, located in the Colombian *Sabana*, a large, industrialised area on the outskirts of Bogotá and one of the richest territories in the country. Its population is around 120 000, and due to its proximity to Bogotá (2.7 kilometres), it has become a suburb of the capital. Yet, despite its functional relationship with Bogotá, Chía is not part of the capital's metropolitan area. This causes issues of traffic congestion (due to a series of toll roads), land management, water management (Bogotá supplies water to Cundinamarca), etc. This relatively small municipality is thus confronted with the challenges of a large city, which may help explain how it has led to a climate of more openness to citizen participation.

The population of Chía doubled in the last eight years. This socio-economic boom has obliged the municipal government to respond to local needs and to look for further economic development opportunities. First, the municipal government designed a local development plan (LDP) that tries to manage the current demographic boom. In Colombia, all local governments are required to produce a local development plan, inspired by the mayor and aligned with the main objectives of the National Development Plan. In several small municipalities, however, the LDP is considered a bureaucratic formality rather than a strategic document to link local interventions with the national policy framework. In Chía's case, the city government has tried to identify local competitive advantages and build on them. For instance, the LDP identifies advanced services, such as healthcare and financial services, as important economic activities for the city. Likewise, the local government is trying to capitalise on the presence of a relatively skilled population to attract knowledge-intensive sectors. Conversely, the municipality is not planning to attract traditional manufacturing activities, to avoid putting further pressure on land use and pollution.

Chía is well connected with and supported by the National Department for Planning (DNP), which helped the city develop a complete system of evaluation of the LDP called *Sinergia Territorial*. The system provides the local government with monitoring of investments and makes publicly available some key information, which is necessary to promote the active engagement of the citizens. Part of the team involved in the LDP is also engaged in capacity building – a programme called *Escuela Publica de Gobierno* – which operates both with civil servants and citizens with the aim of raising awareness about the LDP. The local government stresses that capacity building is important not only for the design of the LDP but also to engage with the DNP and take advantage of the support of the central government.

The city is adjacent to Bogotá and is part of the functional area of the capital city, although no formal institutional co-ordination between the two centres exists. In the past decade, Chía has been attracting residents and firms, and is now one of Colombia's fastest-growing cities. Economic development has resulted in new requests from local stakeholders. Citizens and firms have started requiring better planning, housing, improved road connectivity and access to ICT. The local government has been able to take advantage of the increased participation of local stakeholders and put in place several tools to promote and support citizen engagement. Information on policy and policy implementation has been made available online, and has made it possible for citizens to help monitoring and provide feedback to local authorities.

Case study #2: A local landmark for transparency: The Urna Cristal *in Manizales*

Manizales is the capital of the department of Caldas, in the centre of Colombia. It is one of Colombia's medium-sized cities (with population of less than 500 000) that play an important role for their regional economies in providing services and economic development planning. The city has been attracting population from surrounding rural areas over the last two decades, and the population has been growing rapidly. The additional revenue generated by royalty payments (which Manizales had not been receiving as the city is not located in a resource-rich area), financed the local investment necessary to cope with the demographic increase. To improve transparency, the municipality initiated a policy to promote integrity in the public procurement framework.

Manizales has made efforts to standardise the features and requirements of public procurement procedures using ICT. The local government perceived that challenges in implementing transparent procurement were related to the lack of a standardised process

setting the price of goods and services requested by the public sector. Local civil servants in charge of evaluating bids were manipulating documents to favour a bidder from whom they had received a bribe. The government established a price range for a large list of goods and services, building a matrix that takes into account the expected outcome, needed input and financial cost. To counter the problem of civil servants manipulating documents that support bids, the municipality literally built a "Crystal Urn": a small building, just outside the town hall, with walls in Plexiglas and with a series of cameras videotaping civil servants assessing the documents. Documents related to bidding offers are not permitted to be removed and are stored in specific cupboards, also in Plexiglas. The webcam broadcasts on an Internet site that the public can access 24/7.

The *Urna Cristal* has improved the public procurement process, reducing the possibility of tailoring tender specifications to a specific company. The Plexiglas building and its webcam have also become a visible symbol for transparency, concretely offering citizens a demonstration of what transparency means. By increasing trust, this may in turn increase citizens' willingness to pay taxes.

This technocratic approach suffers from a major shortcoming concerning the municipality's approach to procurement. The degree to which local government can evaluate and standardise costs related to the production of goods and services is limited. While the matrix created by the mayor and his team lends transparency to the procurement for small investment projects, this approach does not translate to large-scale investments outside the standards. An important complementarity between the simplification and standardisation of rules (bureaucracy) and the adoption of open government practices clearly emerges in Manizales.

Case study #3: Engaging rural citizens in consultation: Public hearings and the municipal budget in Chaparral

Chaparral is a rural town and municipality of 50 000 inhabitants in the Tolima department, 250 kilometres south-west of Bogotá. The municipality covers an area of more than 2 000 km². Its population is dispersed into more than 100 *veredas*, which may be small towns or simply small clusters of neighbouring houses. The local economy is based on agriculture, and in particular on smallholdings specialised in tropical agriculture and coffee.

Chaparral offers a good illustration of the isolation that rural communities have suffered in Colombia in recent decades. Until the early 2000s, the community lacked basic public services such as education, water sanitation and healthcare. This affected poverty rates in the municipality, which are still very high compared to the national average. These conditions made Chaparral a focus of social unrest that led to the creation of a guerrilla group, the Revolutionary Armed Forces of Colombia (FARC, in the Spanish acronym). Between the 1980s and early 2000s, the area was dominated by the guerrilla forces and the production of illicit crops, including cocaine and opium poppies.[3] Small farmers (thanks to coercion) specialised in these crops, generating a large local illegal economy. This caused an institutional vacuum in the area, and resulted in the absence of law enforcement and the rule of law.

Isolation and the illegal economy were reduced when the Colombian government, supported by the US government, launched "Plan Colombia", which went into effect between 1998 and 2004. The plan was originally proposed as a peace programme, but soon became a military strategy aimed at weakening the link between illicit drugs and insurgency (Acevedo et al., 2008). It was based on four principles. First, the army, with

help from the United States, was to patrol the region. Second, illicit crops were to be sprayed: planes sprayed glyphosate over large areas. Third, the land of farmers involved in the production of illegal crops was to be confiscated. Fourth, the local population was to be provided with subsidies to compensate for the loss of income.

Assessing the success of Plan Colombia is beyond the scope of this volume, but local stakeholders have mixed views on the impact of the intervention.[4] In particular, they mention the negative impact of glyphosate on farming, and the distortions on the local economy introduced by direct (and relatively high) subsidies to households. Plan Colombia, although it effectively eradicated illicit crops in many areas of the country, was a spatially blind policy that did not take into account the legacy of the intervention on regional economies.

In 2004, after the experience of Plan Colombia and of other national programmes against illicit cultivars, Colombia launched the Consolidation Plan (*Plan Nacional de Consolidación Territorial*), which introduced a more holistic approach to development. Several small, historically ungoverned regions of the country have been chosen as targets for a phased, co-ordinated "hold and build" effort (OECD, 2013a). A new agency in Colombia's central government, the Centre for Co-ordination of Integrated Action (CCAI), co-ordinates military efforts to establish security conditions in these territories, followed by civilian efforts to introduce the government and the services it provides. The desired outcome is that violent, lawless zones become integrated into national civic and economic life, their inhabitants becoming full citizens, supporting the state and abandoning illegal activity. In some zones, the Consolidation Plan has been operating long enough to make evaluation possible. Some aspects of this experience appear to be working well: drug production has been reduced, and security, particularly in town centres, has improved. The plan also gives priority to the municipalities involved in the Consolidation Plan for a range of national sectorial policies focusing on development and delivery of services. In general, through the Consolidation Plan, Colombia is regaining control over regions involved in the civil war.

Some questions remain about the results of the Consolidation Plan. As noted by the OECD in a previous report on Colombia's public governance (OECD, 2013a), militarisation, lack of co-ordination and participation by civilian agencies, local corruption, human rights abuse and land tenure, among other things, have compromised the country's economic development. The field research revealed an additional challenge. Both Plan Colombia and the Consolidation Plan have generated an army of intermediate institutions that brokered dealings between territories and international aid organisations, and have become a drain on the system. These absorb a significant share of the funds from international co-operation groups and also from the central level to local governments involved in the plan. These bodies justify their existence by continuing to manage interventions at the local level. Quite apart from reducing the resources available for local communities, this reduces the capacity of elected authorities, such as mayors, to engage in policy making and implementation in a pacified governance system.

Chaparral, meanwhile, is engaging its citizens in policy making and allocation of public funds. This has been facilitated by a series of enabling factors, thanks to the inclusion of Chaparral in the Consolidation Plan, which has made the city a priority for national policies. First, through the pacification process, the municipality regained control of *veredas* isolated by guerrilla activities.[5] Second, the reform of royalty payments has brought additional revenues to Chaparral, which is not located in a resource-rich department and did not benefit from the commodity boom. Third, the government of

Tolima and the presidency have concluded an agreement for a *Contrato* Plan in South Tolima, where Chaparral is located. Finally, the National Department of Planning selected Chaparral as a pilot project in its new strategy for rural development, based on the Integrated Programme of Rural Development with Territorial Approach (*Programa de Desarrollo Rural Integral con Enfoque Territorial*, PDRIET).

Public hearings are evolving into local institutions that may prove helpful at informing policy making and orienting investment decisions. Due to the concentration of policies and funds, and also of its visibility in Colombia's public sector, the municipality of Chaparral has started meeting with representatives of all *veredas* every six months to discuss allocations in the municipal budget. This exercise began as something like a public hearing. The availability of funds and the stratification of different policies, however, turned the meetings into a sharing of information about local processes and key decisions. As a result, when citizens realised that consultation was not going to be only a formal exercise, they began to engage in policy making and in the discussion of budget allocation. The municipal government benefited from their feedback on short- and medium-term needs and opportunities. This has translated into an increased capacity to absorb funds allocated by the national government and the royalty system: more roads, better schools, public transport, etc.

Chaparral is a good example of citizen engagement, yet it is something of a special case. There is a risk of "policy crowding". Chaparral is the focus of so many policy initiatives that it has become difficult to assess their overall effectiveness. Moreover, despite its success, it would be difficult to generalise this approach across the country, given the concentration of resources and technical effort that the government has devoted to this one municipality. A second issue is the role that the central government plays. The municipality has been assisted by large numbers of incoming officials from the National Department of Planning, the presidency and sectorial ministries. This impinges upon the municipality's autonomy and capacity building, which is already compromised by the number of groups brokering interventions funded by international organisations.

Recommendations: How to improve citizen engagement in Colombia

Despite the remarkable improvements, and the positive signals that can be seen in several local communities, open government in Colombia still faces key challenges. Due to the corporatist legacy prevalent in the country, public authorities tend to patronise citizens and their organisations. In their turn, citizens are accustomed to a relationship with the public sector based on clientelist affiliation rather than on transparency and equal treatment under the law. This exposes local communities, and the public sector in general, to corruption and negatively affects the capacity of local communities to provide public decision makers with information about needs and investment opportunities in their regions.

In Colombia, citizen participation is also constrained by the way in which the national level finances local governments and by the framework governing regional development policy. Despite their broad set of responsibilities and level of autonomy (at least, on paper), over half of a local government's yearly budget depends on earmarked funds from the central level (the General System of Trasfers, discussed in Chapter 6). As the sectorial allocation of funds is decided at the central level, sub-national governments have limited autonomy to fine-tune public investment to local issues. Local stakeholders cannot engage in a transparent democratic debate on how to prioritise the funds transferred from the centre.

In the case of regional development policy, the methodology for drawing up the National Development Plan may work against citizen engagement. On paper, compiling the plan requires a series of public hearings and the direct involvement of key local stakeholders. In reality, given the time constraints – the law states that the planning document has to be prepared with in a six-month period – regional and local constituencies have a limited window in which to influence the strategy of the plan.

While Colombia should continue experimenting with open government and encourage policies that involve citizens in key policy decisions, the government may consider reviewing the following issues:

- First, sub-national authorities need more flexibility in the use of funds earmarked by the centre. Transfers from the centre reduce local communities' ability to engage in a debate on local priorities for public expenditure, as the allocation of public resources is already set by the central government. Instilling more transparency and accountability in the system could offset the need to earmark funds and enhance trust among levels of government. The central level could set up a system of conditions and sanctions to retain some control of public expenditure at the local level. This would also require better fiscal autonomy at the sub-national level, as noted in Chapter 6.
- The second recommendation concerns the National Development Plan. The process for compiling the plan is mandated to occur over a tight six-month period. Some modifications have been put in place, but this process reflects a national governance system that is no longer in effect, given the increasing decentralisation of powers to municipalities and departments. One solution would be to change the law and extend the compiling period, allowing more stakeholders to be involved. This solution, however, would also involve the country in a long process of discussion to identify priorities and funding, limiting the new government's ability to implement its political agenda. Another, more radical, solution would be to streamline the National Development Plan to a few key principles and strategic goals, and to allocate the responsibility for detailed investment interventions to departments or – better – a group of departments (regions). This solution would require the creation of a network of regional technical bodies facilitating and overseeing the process, to guarantee that the principles of open government are respected across the country. One of the key problems of the government is how to manage the distribution of royalties among regions. Meanwhile, regions will have the problem of managing the resource. Open government could be a powerful tool for increasing the capacity of regions to absorb investment and to align investment agendas.
- Finally, civil society in all regions must be empowered to allow citizens to engage with the public sector on topics of concrete interest to them. Regional Colombia faces a key institutional challenge. After decades of armed conflict and highly centralised decision making, civil society in many parts of the country is weak. This is especially true outside the large cities and in many of the rural departments and municipalities, where the newly decentralised territorial development system has to be implemented. It creates a situation whereby, on the one hand, there is relatively little demand for bottom-up development approaches at the local level and, on the other, the *dirigiste* tradition of the national government is hard to overcome. This is all the more true given increasing pressure for a shift from a sectorial to a more territorial approach to development. Decades of top-down

sectorial policies and of key decisions taken by ministries in Bogotá, together with the risk linked to associationism in many parts of the country in the period of conflict, have left several of Colombia's peripheral areas without dynamic stakeholders and organisations of civil society (i.e. civic associations and groups). These, by facilitating citizen participation, could act as a catalyst in the development process. In this context, Colombia needs to focus on setting up the basic institutions to allow for transparency and greater participation by local stakeholders. Some international experiences, such as that of Quebec, Canada, could be instructive for regional Colombia (Box 7.10). Territorial communities could benefit from the presence of development agents from an organised, nationwide network connected to the central government, but independent of political dynamics. Such a network could also improve territorial communities' participation by letting citizens decide on what issues they would like to engage with the public sector, according to their needs and aspirations.

Box 7.10. **Quebec's rural policy provides territorial communities with development agents**

In Quebec, the provincial government has implemented a rural development policy – the Rural Pact – that aims to strengthen social capital and participation in sparsely populated regions. This requires that each community identify a seven-year development plan and use funds from the centre to carry it out. Rural development agents are essential in this framework for creating a vision for local development in territorial communities and helping policy implementation and monitoring, to guarantee accountability. Rural development agents help local committees and project promoters develop investment projects, facilitate knowledge sharing and help monitor the national rural development policy. County governments or regional development centres can hire the agents financed by the government of Quebec's Rural Pact commitments.

The 136 current agents receive annual updated training organised by the advisory body *Solidarité Rurale du Québec* and financed by Quebec's Ministry of Rural Development and Land Occupation. This training includes annual meetings of agents from all over the province and an interactive online portal that facilitates the exchange of experiences. The commitment, qualification and experience of rural development agents, along with a competitive salary, are important for their success. It is the agents' responsibility to link local project developers with county governments and municipalities, but also to develop connections between project developers and the funding instruments available in regional development centres. Since successful local development depends on a community's capacity to facilitate connections across different socio-economic groups, the agents also have a major role to play in building bridges between social and economic development and creating teams of people and groups in a given territory which otherwise do not necessarily interact. Finally, the collective experience of the network of rural agents is important for the government's efforts to develop its rural development policy; it was consulted, for instance, in preparing the second round of the seven-year rural policy, in 2007. The funding provided by the Directorate for Public Governance and Territorial Development is a critical element. To guarantee that qualified people are hired, and to avoid excessive turnover, development agents are well compensated. Funds are provided by both the provincial government and county governments. In counties where development challenges are more intense, the provincial government assumes the largest share of the salaries, and can also provide the community with several agents.

Source: OECD (2010), *OECD Rural Policy Reviews: Québec, Canada 2010*, OECD Publishing, Paris, http://dx.doi.org/10.1787/9789264082151-en.

Notes

1. Colombia recently signed the OECD's Anti-Bribery Convention and is a signatory to the Inter-American Convention against Corruption and the United Nations Convention against Corruption (UNCAC). To implement the UNCAC, it has approved a comprehensive Anti-corruption Public Policy (*Política Pública Integral Anticorrupción*). It also participates in the UNCAC's voluntary Pilot Review Programme and has committed to the Extractive Industries Transparency Initiative.

2. In the summer of 2013, Colombia suffered from a national strike that started in the north-east region of Catatumbo. The strike represented several different rural constituencies that created a common front for the first time to oppose the national government. They included coffee producers, small-scale miners, truckers and students. These groups sought more national support for their businesses or living standards in the form of better regulation, direct subsidies or better public goods and infrastructure. A full assessment of the social unrest exceeds the scope of this report. However, it could be argued that one of the reasons the country is exposed to social unrest is the lack of formal (and functioning) channels citizens and business can use to represent their needs to the public sector.

3. One kilo of dried latex obtained from opium poppies could fetch COP 1.5 million, or USD 500, in 2005. A 125-kilogramme bag of green coffee (the form in which coffee is traded and transported) fetches COP 0.5 million (or about USD 250 at the current exchange rate, thanks to the appreciation of the Colombian peso). Meanwhile, poppies can be produced in four months, rather than the two years coffee plants require before they produce coffee beans.

4. An assessment of Plan Colombia is available at: http://reformdrugpolicy.com/wp-content/uploads/2011/10/paper_16.pdf.

5. This is isolation within isolation. The central government perceived Chaparral as an isolated community, and in Chaparral, the central town saw the peripheral settlements as remote and impossible to govern.

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Annex 7.A1.1

OECD Principles for Managing Ethics in the Public Service

The 12 OECD *Principles for Managing Ethics in the Public Service* (OECD, 1998) are designed to help countries review the institutions, systems and mechanisms they have for promoting public service ethics. They identify the functions of guidance, management or control against which public ethics management systems may be checked. These principles distil the experience of OECD countries, and reflect shared views of sound ethics management. Member countries will find their own ways of balancing the various aspirational and compliance elements to arrive at an effective framework to suit their own circumstances.

The principles may be used by management across national and sub-national levels of government. Political leaders may use them to review ethics management regimes and evaluate the extent to which ethics is operationalised throughout government. The principles are intended to be an instrument for countries to adapt to national conditions. They are not sufficient in themselves – they should be seen as a way of integrating ethics management with the broader public management environment.

1. Ethical standards for public service should be clear: Public servants need to know the basic principles and standards they are expected to apply to their work and where the boundaries of acceptable behaviour lie. A concise, well-publicised statement of core ethical standards and principles that guide public service, for example in the form of a code of conduct, can accomplish this by creating a shared understanding across government and within the broader community.
2. Ethical standards should be reflected in the legal framework: The legal framework is the basis for communicating the minimum obligatory standards and principles of behaviour for every public servant. Laws and regulations could state the fundamental values of public service and should provide the framework for guidance, investigation, disciplinary action and prosecution.
3. Ethical guidance should be available to public servants: Professional socialisation should contribute to the development of the necessary judgment and skills enabling public servants to apply ethical principles in concrete circumstances. Training facilitates ethics awareness and can develop essential skills for ethical analysis and moral reasoning. Impartial advice can help create an environment in which public servants are more willing to confront and resolve ethical tensions and problems. Guidance and internal consultation mechanisms should be made available to help public servants apply basic ethical standards in the workplace.
4. Exposing wrongdoing: Public servants need to know what their rights and obligations are in terms of exposing actual or suspected wrongdoing within the public service. These should include clear rules and procedures for officials to follow, and a formal chain of responsibility. Public servants also need to know what protection will be available to them in cases of exposing wrongdoing.

5. Political commitment to ethics should reinforce the ethical conduct of public servants: Political leaders are responsible for maintaining a high standard of propriety in the discharge of their official duties. Their commitment is demonstrated by example and by taking action that is only available at the political level, for instance by creating legislative and institutional arrangements that reinforce ethical behaviour and create sanctions against wrongdoing, by providing adequate support and resources for ethics-related activities throughout government and by avoiding the exploitation of ethics rules and laws for political purposes.
6. The decision-making process should be transparent and open to scrutiny: The public has a right to know how public institutions apply the power and resources entrusted to them. Public scrutiny should be facilitated by transparent and democratic processes, oversight by the legislature and access to public information. Transparency should be further enhanced by measures such as disclosure systems and recognition of the role of an active and independent media.
7. There should be clear guidelines for interaction between the public and private sectors: Clear rules defining ethical standards should guide the behaviour of public servants in dealing with the private sector, for example regarding public procurement, outsourcing or public employment conditions. Increasing interaction between the public and private sectors demands that more attention be placed on public service values and requiring external partners to respect those same values.
8. Managers should demonstrate and promote ethical conduct: An organisational environment where high standards of conduct are encouraged by providing appropriate incentives for ethical behaviour, such as adequate working conditions and effective performance assessment, has a direct impact on the daily practice of public service values and ethical standards. Managers have an important role in this regard, by providing consistent leadership and serving as role models in terms of ethics and conduct in their professional relationship with political leaders, other public servants and citizens.
9. Management policies, procedures and practices should promote ethical conduct: Management policies and practices should demonstrate an organisation's commitment to ethical standards. It is not sufficient for governments to have only rule-based or compliance-based structures. Compliance systems alone can inadvertently encourage some public servants simply to function on the edge of misconduct, arguing that if they are not violating the law they are acting ethically. Government policy should not only delineate the minimal standards below which a government official's actions will not be tolerated, but also clearly articulate a set of public service values that employees should aspire to.
10. Public service conditions and management of human resources should promote ethical conduct: Public service employment conditions, such as career prospects, personal development, adequate remuneration and human resource management policies should create an environment conducive to ethical behaviour. Using basic principles, such as merit, consistently in the daily process of recruitment and promotion helps operationalise integrity in the public service.
11. Adequate accountability mechanisms should be in place within the public service: Public servants should be accountable for their actions to their superiors and, more broadly, to the public. Accountability should focus both on compliance with

rules and ethical principles and on achievement of results. Accountability mechanisms can be internal to an agency as well as government-wide, or can be provided by civil society. Mechanisms promoting accountability can be designed to provide adequate controls while allowing for appropriately flexible management.

12. Appropriate procedures and sanctions should exist to deal with misconduct: Mechanisms for the detection and independent investigation of wrongdoing such as corruption are a necessary part of an ethics infrastructure. It is necessary to have reliable procedures and resources for monitoring, reporting and investigating breaches of public service rules, as well as commensurate administrative or disciplinary sanctions to discourage misconduct. Managers should exercise appropriate judgement in using these mechanisms when actions need to be taken.

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