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*República de Panamá
Ministerio de Economía y Finanzas
Departamento del Viceministerio de Economía
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January 19, 2015
DdCP/FOY022

Mr.
Jim Yong Kim
World Bank
Washington D.C.

Ref: Letter of Development Policy for the First Programmatic Shared Prosperity Development Policy Loan

Dear Mr. Kim:

Panama's new Government took office in July 2014 and has swiftly begun implementing a reform plan with development goals for human development, sustainable economic growth, and institutional strengthening.

I. The Strategic Government Plan

This Government announced a reform plan with a focus on human development, sustainable economic growth and institutional strengthening. The Government's plan centers on five pillars:

- Fostering wellbeing and human development.
- Strengthening democracy and rule of law.
- Fostering sustainable economic development.
- Ensuring citizen security.
- Protecting the environment.

Within the first pillar, the Government emphasizes culturally appropriate development of Indigenous Peoples, promotes youth employment, and invests in signature projects such as the basic sanitation plan "100/0" that provides potable water to 100 percent of Panamanian households and leaves zero latrines. Under the second pillar, the Government focuses on increasing transparency and promoting decentralization. The third pillar comprises policies to enhance fiscal sustainability, the efficiency of public service provision, and the sustainability and efficiency of energy supply, among others. The fourth pillar supports citizen security through prevention, institutional strengthening, and victim protection. Within the fifth pillar, the Government

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focuses on disaster risk management and protection of the environment, for example in the form of biodiversity.

II. Macroeconomic policy

Maintaining macro-fiscal stability is the highest priority of this administration. The macroeconomic policy pursued since the beginning of the current administration, is aimed at ensuring economic stability, strengthening the investment climate through healthy and prudent management of public finances and prioritizing social investment.

Panama has recovered from the 2008 global financial crisis faster than other countries in the region. While most countries have not yet been able to return to their pre-crisis growth rates, Panama realized higher rates of economic growth following the global crisis than preceding it (9.4 percent on average over 2010-2013, compared with 7.0 percent on average between 2002-2007). The key drivers of this growth performance are strong public investment, a parallel increase in Foreign Direct Investment (FDI) and private investment in general, and the continued importance of the Panama Canal and its expansion, which has fed back into other sectors, including transport and logistics as well as the financial sector. The strong growth performance has started to moderate since 2013, but remains at high levels.

On the public finance side, Panama's fiscal deficit is expected to narrow in the medium term. Even though the Government has amended the fiscal ceiling few times in the recent past, this law has helped the Government to conduct its fiscal policy in a prudent manner given that any increase needs to be approved by the Congress. Thus, the Government is committed to reach its fiscal deficit goal of below 1 percent of GDP before 2018 as it is mandated by the Social Fiscal Responsibility Law.

III. Objectives and components of the program

The Development Policy Loan will provide important support to the Government's strategic plan, in particular with regards to promote human development, sustainable economic growth, and institutional strengthening, through the following actions:

• Expanding inclusion and opportunities

The Government is supporting key steps that Indigenous Peoples have articulated, consulted upon and prioritized to strengthen inclusion and opportunities for Indigenous Peoples. The Government is committed to use the momentum created by the formulation of Indigenous Peoples' National Development plan and agreement between different Indigenous Groups on this plan. The Indigenous Peoples' National Development Plan in Panama was elaborated by a round table including a representative from each Indigenous Peoples' Congress or Council, a representative from the Executive Branch and a representative from the National Assembly. After an 18-month process of comprehensive consultations in all the Indigenous Peoples territories and a national conciliation and prioritization process, the Platform produced the Indigenous Peoples' National Development Plan as well as a proposed law to convert the Platform into a legally established permanent advisory and coordination Council for Indigenous Peoples.

To improve inclusion and opportunities for Indigenous Peoples, the Government is strengthening the institutional framework, is building capacity, and is culturally differentiating existing social programs. In

terms of strengthening the institutional framework for the coordination among different Indigenous Peoples at the national level and their participation in Government processes, the Government is taking three major steps: 1) the legal establishment of the National Indigenous Peoples Council; 2) the upgrading of the Vice Ministry of Indigenous Affairs into a Ministry; 3) the approval of the national development plan as law to ensure the commitment to the inclusion and opportunities of Indigenous Peoples according to their cultural identity beyond the current administration. As this topic has been neglected in the past and has created tensions this institutional reform effort will be accompanied by a thorough consultation process with the civil society to ensure a broad consensus in Panama. In terms of capacity building, the Government is preparing capacitation for key stakeholders within relevant sectoral ministries and Indigenous representations to ensure that they can accompany the project cycle to ensure an efficient use of public resources spent following the priorities defined in the Indigenous Peoples' National Development Plan. Finally, the Government is adjusting existing social protection programs such as Red de Oportunidades according to specific needs and the cultural identity of Indigenous Peoples.

The Government has launched ProJoven Panama, and has updated the system of baccalaureates to align the skill set of young graduates more closely with labor market demand. The program aims to give graduates a chance to foster their technical skills to facilitate their transition into the labor market, and help them attain a level sufficient to start university studies. The Government has also approved and implemented a selection of new baccalaureates including science, engineering, business, etc., with the aim of updating and providing education and training for the youth that better respond to labor market needs. Furthermore, the Government has increased payments of the Conditional Cash Transfer program Beca Universal and differentiated them by student grade level. It is estimated that a half million Panamanian students will benefit from the increase.

The Government has expanded the coverage and the benefit of the 100 a los 70 program, which became 120 a los 65 through law 15 of September 1, 2014. It is estimated that over 30,000 people will receive the benefit, further reducing poverty. The Government has also transformed the role of social workers to improve the quality of assistance to the poor. Furthermore, social workers will also provide training to beneficiaries for certain programs. For example, the Government is planning a banking strategy of social program to promote financial inclusion; once launched, social workers will be giving training to the beneficiaries to access the benefits. In addition, the Government has initiated the recertification of Red de Oportunidades. This will significantly reduce targeting errors and ensure an appropriate expansion of a very progressive scheme.

- **Improving service delivery**

The new Government has made water sanitation services a priority and has made progress in increasing access to water and improving sanitation services. With the ultimate goal of improving quality of life by providing reliable water 24 hours a day and eliminating the use of latrines, the Government has launched the basic sanitation plan "100%". Despite the relatively well designed legal framework, the sector has a number of institutional weaknesses, including unclear roles among the different sector actors, lack of coordinated investment, weak regulatory capacity and limited operational and financial autonomy of the Instituto de Acueductos y Alcantarillados Nacionales (IDAAN). The Government has initiated the modernization process of IDAAN by establishing the Transformation and Modernization Unit, responsible for identifying and addressing structural institutional issues that are preventing IDAAN to increase its efficiency.

Through the Secretary of Energy, the Government has taken steps to increase the efficiency of the energy sector through the removal of tariff distortions. It has identified the main distortions associated with electricity tariffs and has formed a committee to elaborate a plan for subsidy adjustments. In the last five years the government has taken steps to put in place incentives for the promotion, development, and use of a wider range of alternatives. This has included Law 44 (2011) and Law 37 (2013) which establishes the framework for wind, solar, and other sources. In part, due to the policy measures, a number of renewable energy projects have been contracted.

- **Modernizing fiscal management**


A major challenge in Panama is the lack of a centralized treasury account for Government revenues and expenses which would allow better management of public resources and an adequate evaluation of how resources are transferred. In addition, available technology could be further enhanced in order to become an integrated system for Government resource planning. Both actions would increase transparency in different areas, and would reduce public perception of corruption present in the Government. The Government has taken measures to introduce a Single Treasury Account and implement a new integrated information model, based on the unity of cash principle and on the centralized administration by the National Treasury of the public funds.

In addition, the Government has taken measures to cover the fiscal risk due to the impact of natural disasters. The Investment Office, the Dirección de Inversiones, Concesiones y Riesgos del Estado (DICRE), has designed the strategic framework that defines the guiding policy framework to cover the fiscal risk due to the impact of natural disasters. The ultimate goal of better disaster risk management is to contain fiscal risk when facing natural disasters by having a set of financial instruments and procedures in place.

The support of the World Bank will be essential to implement the above mentioned actions and to support the ambitious strategic objectives that the Government has set for itself.

The Government of the Republic of Panama requests the approval of the program.

Yours sincerely,


Duccio De La Guardia
Minister
DDLG/KCVMRC

