June 17, 2016
DdFPN/RU706

Mr. Jim Yong Kim
President
The World Bank
1818 H Street NW
Washington D.C. 20433
United States of America

Dear Mr. Kim:

On behalf of the Government of Panama, I have the pleasure of submitting to you the letter of development policy for a Second Shared Prosperity Development Policy Financing (DPF) in the amount of US$300 million. This operation will support the Republic of Panama in continuing to pursue its ongoing reform program and will assist in sustaining the achievements made thus far.

This operation will enable our Government to advance three objectives: (1) strengthen the framework for international tax transparency, financial integrity, and fiscal management; (2) strengthen institutional arrangements to support social assistance and education; and (3) enhance the regulatory and financial sustainability framework of service delivery in the energy and water sectors.

I would like to express my gratitude for the World Bank’s continued support to the reform process in Panama. Budget support operations, technical assistance projects, and knowledge activities continue to play a significant role in supporting the economic and social reforms undertaken by the Panamanian Government, amid what remains a turbulent and uncertain external environment. In particular, this operation supports strategic priorities of our Economic and Social Strategy 2015-2019, which aims to promote inclusion and increase the competitiveness of Panama’s economy.

Macroeconomic Framework

Maintaining macroeconomic stability is a high priority for our Government. Since taking office in June 2014, our administration has aimed to strengthen the investment climate through a prudent management of public finances, while prioritizing social investment and boosting the competitiveness of the economy.

In the past few years, in spite of the uncertain external environment, Panama’s economic fundamentals have remained strong. Our country recovered from the 2008 global financial crisis faster than other countries in the region and was able to realize higher rates of economic growth following the global crisis than preceding it. The average annual growth rate was close to 5 percent during 2009-2014, slowing to 5.6 percent in 2015 due to a moderation in investment activity, as major infrastructure projects including the expansion of the Panama Canal have been largely completed.

Importantly, the high rates of economic growth have been accompanied by job creation and a significant reduction in the poverty rate, which fell from 26.2 percent in 2006 to 18.7 percent in 2014.
(using a poverty line of US$4 per day). Inequality of income has also fallen, from a Gini coefficient of around 0.54 in 2008 to around 0.51 in 2014

Panama’s fiscal position has also improved. The fiscal deficit of the non-financial public sector narrowed to 2.2 percent of GDP in 2015, down from 3.4 percent in 2014, and well below the initially-budgeted deficit of 3.7 percent of GDP. In the medium term, our Government is committed to stay within the deficit limit set forth in the Social and Fiscal Responsibility Law and reduce the fiscal deficit to 1.5 percent of GDP by end-2017. To this end, we are strengthening fiscal management, supported by the World Bank’s DPF. In particular, we are enhancing public debt management, gradually pursuing fiscal decentralization, and improving public financial management and disaster risk management. At the same time, we are strengthening tax administration, reducing spending on electricity subsidies, and improving the targeting of social programs, all of which will support fiscal consolidation.

Going forward, we expect that the annual economic growth will stabilize at around 6 percent. Growth will be supported by the operations of the expanded Canal, an increase in copper exports with the start of operations of the Minera Panama copper mine, and strong public and private investment.

Strong macroeconomic fundamentals and sound policies have helped Panama withstand several waves of global market turbulence and paved the way for sustained economic growth and poverty reduction. Nonetheless, while benefiting from its trade and financial openness, Panama’s economy continues to be exposed to external shocks and thus needs to further strengthen macroeconomic resilience through reforms in the areas supported by this DPF, notably: international tax transparency, financial integrity, fiscal management, social inclusion, and service delivery.

Objectives and Components of the Program

The reforms outlined below are designed to help safeguard economic growth and ensure that prosperity continues to be shared across society.


In order to strengthen the frameworks for international tax transparency and financial integrity, our Government is committed to implementing the automatic exchange of tax information and adhering to the Common Reporting Standards by 2018. This milestone is key for Panama, especially in the context of the recent leak of documents from one legal firm based in Panama. Furthermore, enhancing our country’s institutional and legal frameworks for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) is a high priority for us. We are committed to bringing our AML/CFT regime in line with international standards of financial integrity and transparency. Significant achievements have been made thus far in this area. Our Government agreed with the Financial Action Task Force (FATF) on an AML/CFT Action Plan, which was fully completed in 2015. As a result, the Paris Plenary removed Panama from the observation list in February 2016. Panama was also able to move to Phase 2 of the Global Forum’s peer review process, and our Government recently signed a tax information exchange agreement with the United States, and is currently negotiating double taxation agreements with Germany, Japan, and other countries. Building on the recent progress, our Government is determined to further strengthen the frameworks for international tax transparency and AML/CFT, and ensure their effective implementation. To this end, we will collaborate with international institutions to make sure that our reform efforts are well aligned with the internationally-accepted standards.
2. Strengthening Institutional Arrangements to Support Social Assistance and

definitions and responsibilities of the states. To avert the risk of over burdening the
budgetary burden of the states, the Centre has issued guidelines for the
implementation of the social assistance programme. The states are also
required to establish a mechanism for the effective implementation of the
programme. The states are also required to ensure that the social assistance
programme is implemented in a transparent and accountable manner. The
programme is designed to provide direct cash transfers to the beneficiaries
who are living below the poverty line. The programme is implemented in
two phases. In the first phase, the focus is on providing cash transfers to
the vulnerable sections of the population, such as the elderly, disabled,
and children. In the second phase, the focus is on providing cash
transfers to all the beneficiaries who are living below the poverty line.

In conclusion, the social assistance programme is an essential
element of social security in India. It plays a significant role in
reducing poverty and increasing the standard of living of the
vulnerable sections of the population. The programme is designed to
ensure that the beneficiaries receive the benefits in a timely and
transparent manner. The programme is implemented in a
coordinated and effective manner, ensuring that the benefits are
provided to the eligible beneficiaries. The programme is
expected to have a significant impact on reducing poverty and
improving the quality of life of the beneficiaries.
3. Enhancing the Regulatory and Financial Sustainability Framework of Service Delivery
   in the Energy and Water Sectors

Our Government is also committed to improving public service delivery in the water and energy
sectors by enhancing the regulatory framework and financial sustainability of service providers. We
continue to reform the energy subsidy scheme by substituting the country-wide Energy
Compensation Fund (FACME) with the geographically-targeted Tariff Fund for the Occidental Region,
a new fund created in 2015 that targets its resources to the western region. This reform is expected
to improve the fiscal sustainability of the energy sector and going forward could allow for increased
investment in environmentally sustainable power generation to improve service delivery.

In the water sector, we continue the coverage expansion with the “1000” program which aims at
providing reliable potable water 24 hours a day and eradicating the use of latrines. In addition, we
have taken institutional steps to establish asset management practices between Ministry of Health
and the National Water Supply and Sanitation Administration in order to improve sewerage service
delivery and water quality in the Panama Bay area.

Conclusion

Our Government hereby reiterates its strong commitment to undertake necessary reforms to
strengthen the frameworks for international tax transparency, financial integrity, and fiscal
management; strengthen institutional arrangements to support social assistance and education; and
enhance the regulatory and financial sustainability framework of service delivery in the energy and
water sectors. The World Bank’s support is a crucial impetus toward the fulfillment of the program’s
objectives.

In light of the prudent macroeconomic policy framework, the actions already carried out, and our
commitment to advance further across all pillars of this DPF series, our Government requests the
favorable consideration of its operation and the approval of the Second Shared Prosperity
Development Policy Financing operation.

Yours sincerely,

[Ivan A. Zangue]
Vice President