Panama undertook a structural adjustment program in the early 1980s during a period of intense political turbulence. An OED audit draws useful lessons about the need for agreement with the borrower on country development strategy, for political analysis, and for consultation and consensus building.

The oil price crisis of 1979, followed by sharp increases in international interest rates and recession in world trade, slowed the expansion in Panama's service and international banking sectors that had fueled GDP and employment growth in the 1970s. Panama was caught with an uncomfortably high public sector debt. Stabilization efforts in 1980-82 could not prevent a fiscal crisis, an economic recession, and growing urban unemployment.

Political turbulence unleashed by the death of General Torrijos in July 1981 lasted several years. By 1987 there had been six presidents, and cooperation between the executive and legislative branches of government had been eroded away.

Adjustment program

In late 1982 the administration of President de la Espriella embarked on a structural adjustment program to:

- reorient the incentive structure toward exports and employment generation; and
- raise agricultural productivity and output.

The Bank supported the program through two Structural Adjustment Loans (SAL I & II) of $60 million and $100 million, and a Technical Assistance Loan (TAL) of $5 million. The IMF provided support with a standby arrangement.

SAL I supported retroactively a series of measures not requiring legislative approval: sale or closure of some unprofitable public enterprises; introduction of central control of public sector borrowing; improved procedures for public investment programming; withdrawal of the social security agency (CSS) from financing housing construction; lifting of some export restrictions; lowering of support prices on some crops and removal of price controls on beef; and replacement of quantitative restrictions with tariffs.

SAL II supported measures requiring legislative action: continued tariff and price reform; and a contraction in the role and number of parastatal agencies in agriculture.

Implementation

In each of the SALs, Panama complied with most of the conditions of the first tranche and with few or none of those of the second tranche. SAL I's second tranche in fact had very few conditions, and after its release some measures taken earlier were reversed.

In response, during the appraisal of SAL II, which was delayed by more than a year, the Bank insisted on full compliance with SAL I conditionality and front-loaded the conditions on the new loan. Most of the important policy changes supported were achieved during this period. But soon after drawing the first tranche of SAL II, Panama showed signs of abandoning the program, and did so within a year of approval without drawing the second tranche.

On balance the adjustments made under the program were significant. Though the subsequent political and financial crisis meant that the potential level of benefits from the program was not attained, present efforts at adjustment have benefitted from this earlier attempt.

The TAL, which provided for studies and technical assistance, was well implemented and successful.
Issues

Design of industrial policy adjustments: The design of both SALs was closely linked to recent Bank and Fund macroeconomic work and Bank sector work, but the adjustment program was launched without being based on a coherent set of policy objectives agreed on by the key ministries that would be involved in implementation.

Though there was broad agreement within the government that Panama should export more, there was disagreement about how. The SAL program reflected the preferences of those officials closest to the Bank's own preference, at the time, for open economic development strategies. The program emerged as a list of actions to correct for policy-created market distortions, without a clear relationship to a strategy or an indication of their relative importance, mutual consistency, or proper sequencing.

Design of adjustment in agriculture: The Bank's approach did not adequately consider the need for consistency with existing agricultural development goals—national food security and economic opportunities for the rural poor—and did not promote a program that would improve efficiency consistent with these goals.

Trade regime and the exchange rate: The program seems not to have been sufficiently adapted to Panama's use of the US dollar as its currency. Where a country is not free to vary the nominal exchange rate and cannot use monetary policy to pursue stabilization goals, the trade regime serves a stabilization function as well as a protective one. Greater care was called for in timing the liberalization of imports, to avoid undue risk of deterioration in the external account; fiscal measures should have been taken enough in advance of trade liberalization to compensate for the impact of tariff reduction on revenues.

Political factors, borrower commitment: This was a politically difficult adjustment program. Businessmen, farmers, organized labor, pensioners, government workers, and the military all stood to lose from specific aspects of the program during a fairly short time span. Only a very strong executive branch could have confronted this array of interests. The rapid succession of six presidents during the SAL period weakened the power of the presidency and the executive branch to win consensus among ministers, and hence to ensure that the adjustment program would be broadly supported within government. Other changes in the power structure impaired the cohesiveness of the party, and this reduced the power of the executive to secure legislative action. Although the passage of the industrial incentives law was secured the president decided to abandon the SAL II program rather than confront the legislature over more difficult legislation such as the reform of social security.

With hindsight, the evidence suggests that the government was not committed to the program. It took the measures consistent with the strategy it had been pursuing; it started to modify the Labor Code early and set up a tripartite commission for adjusting the Code; it willingly took the measures to strengthen public finances; and it made revisions in the incentive framework. It moved reluctantly toward—and eventually balked at—reducing protection. Subsequently, it reversed many agreed measures and did not introduce the legislation to reform the CSS.

Consultation and ownership: For the public, the program was shrouded in secrecy, and within government, consultations were limited. The preferred strategy of officials in the planning ministry was not shared by all members of the cabinet. As the design process was to be protracted, a process of continuing consultation would have been valuable, especially given the frequent changes in the presidency.

Lessons

- Agreement on the underlying economic development strategy is essential in the design of an effective structural adjustment program.
- The program must be sensitive to the peculiar features of the economy which might affect the tools that can be used and the priority and timing of their use.
- Commitment to the whole package and a sense of ownership of the program by the political directorate and officials in the government are essential to the acceptance and successful implementation of the program. In this connection a participatory approach, characterized by close consultation within the government and between the government and the private sector, is essential.
- The political context in which adjustment is to take place is sufficiently important to warrant expert analysis and monitoring. This is particularly necessary in countries where recent changes are likely to affect political stability.
- Certain types of measures which are within the power of the executive—such as removal of price controls and price supports and the lifting of quotas—are easily reversed. Potentially reversible changes should be required to be implemented early in the adjustment period.
- The linkage of commercial bank support to Bank structural adjustment operations is a two-edged sword: it gives the Bank additional leverage in getting the client to undertake adjustment measures, but it creates another source of pressure on the Bank to relax tranche release conditions.

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