November 6, 2013
DdCP/DS/799

Mister
Jim Yong Kim
President
World Bank
Washington D.C.

Ref: Letter of Development Policy for the Third Programmatic Fiscal Management and Efficiency of Expenditures Development Policy Loan

Dear Mr. Kim:

The Government of Panama is committed to the strategic objectives established four years ago to address key development challenges, including the expansion of economic opportunities to reduce poverty.

Over the course of four years in the office, the Government has delivered on several of its public policy goals. The Government has implemented tax reforms that widen the tax base and improve the efficiency of tax administration, and has made significant progress on negotiating a series of bilateral tax information sharing agreements. These measures have been complemented by financial management and procurement reforms to increase the efficiency and transparency of spending. The Government has also improved social protection by introducing and later improving the targeting of a non-contributory pension program 100 a los 70, by introducing and expanding a universal scholarship program Beca Universal to grades from 1 to 12, and improving the targeting of conditional cash transfer (CCT) programs such as Red de Oportunidades, and by introducing a transfer for citizens with severe disabilities Ángel Guardián.

I. The Strategic Government Plan

The Strategic Government Plan is comprised of a Social and Economic Strategy, a Financial Plan and a Public Investment Indicative Plan for the 2010-2014 period. It unites the goals agreed within the framework for the Dialogue for National Consensus and its own electoral commitments. It is the first time that an administration, at the beginning of its mandate, has
presented a comprehensive strategic plan for the development and execution of economic, social, investment and financial policies in the country. The plans aim at following objectives:

- Promote opportunities for the less developed segments of the society to improve the distribution of wealth and reduce poverty;
- Strengthen public institutions and their relationship with the private sector to develop knowledge, maximize efficiency and promote social inclusion;
- Ensure a simple and fair distribution of the tax burden, while maintain competitiveness;
- Strengthen the domestic market to create a secure and transparent environment, increasing producers and investors’ confidence and, in turn, reducing unemployment levels.

II. Macroeconomic policy

The ultimate goal of implementing the Strategic Government Plan is to accomplish sustained economic growth as well as reducing income inequality, poverty and unemployment. Maintaining macro-fiscal stability is one of the top priorities 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 prudent management of public finances and prioritizing social investment.

Despite the global financial crisis and subsequent slowdown of the world economy, Panama has experienced a robust economic growth of 7.5 percent in 2010, 10.8 percent in 2011, and 10.7 in 2012. In the first half of 2013, growth moderated to 7.3 percent due to external factors. Consumer price index averaged at 5.9 percent in 2011 and 5.7 in 2012.

Government fiscal balances have remained in compliance of the Social Fiscal Responsibility Law. In 2012, the Non-Financial Public Sector fiscal deficit has been contained at 2.1 percent of GDP, while the legal limit was 2.9 percent. The ceiling for 2013 fiscal deficit has been slightly increased by 0.3 percent of GDP in April 2013 to reach 3.1 percent on account of reconstruction effort after a flood occurred in November 2012. The fiscal reforms led to higher tax revenues, amounting to 12.9 percent of GDP in 2012 and are projected to have grown to 11.6 in 2013 due to external factors. Gross public debt stood at 39.3 percent of GDP in 2012 and is estimated to decline to 38.3 percent of GDP in 2013.

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 improving fiscal management, enhancing transparency, improving the efficiency of public spending and strengthening social programs, through the following actions:

- Mobilizing domestic tax revenue

The Government has strengthened the Large Taxpayer Unit’s (LTU) by the monitoring of tax compliance through the execution of 10 audits in 2013 that have generated additional tax revenue of US$13 million. These audits were based on training that the auditors of the large...
taxpayer unit received in advanced audit techniques. 5 additional audits are underway and are expected to significantly increase tax revenue.

- **Increasing tax transparency**

The Government has made substantial progress towards greater tax information sharing. The bearer shares legislation is one of the most relevant recent steps to increase tax transparency. The enacted Law establishes a custodial arrangement system by which will help Panama’s competent authority to identify the owners of these shares. The law will become effective in two years’ time followed by a transitional period.

- **Modernizing public procurement practices**

The Government is committed to reform procurement processes. The envisaged reforms are expected to be completed in the coming months. And while these actions are not recognized as part of the program of the requested loan, the Government is already well on track to reach the program objectives. In particular, the Government is pursuing (i) the use of standard bidding documents and contracts by all Central Government agencies; (ii) the formulation and publication of guidance notes with evaluation criteria in addition to the price for selecting and contracting; and (iii) the update of the regulatory framework for public procurement to improve processes for bidders’ pre-qualification, to create the legal basis for environmental and social criteria in bid evaluations; and to align regulations to technological updates in particular in the framework agreement module of Panama Compra.

- **Improving the institutional arrangements for debt management**

The Government has taken measures to further develop the domestic debt market as part of the development of a medium term debt management strategy. Specifically, measures to increase the liquidity of the domestic debt market include:

(i) giving a stronger institutional backing to the primary dealers program through an executive decree; (ii) having domestic sovereign bonds rated by major rating agencies; and (iii) preparing the integration of a platform to conduct local bonds auctions with an internationally known platform which will allow the prices of Panamanian Government bonds to be immediately available to investors worldwide. These measures resulted in an increase of domestic debt as share of total from 24.4 percent in 2012 to 27 percent in 2013.

The Government is committed to formulate its first formal medium term debt management strategy by the first quarter of 2014. Such a strategy is the result of a thorough cost-risk analysis of alternative debt strategies under different risk scenarios. It will contain an optimal cost-risk profile of the Government and guarantee consistency of the debt management operation over time. Finally, the strategy will increase transparency to all stakeholders bringing down the borrowing cost over time.
Expanding and improving targeting of social transfer programs

The Government has adopted a policy for the better targeting of beneficiaries of the 100 a los 70 program including provisions for the verification of compliance with co-responsibilities and processes for entry and exit, for the incorporation of beneficiaries in the single registry, and for the formal incorporation of the Secretaría Ejecutiva del Programa 100 a los 70 into MIDES. Moreover, the Government has developed a single registry of beneficiaries for the following three social protection programs, Red de Oportunidades, 100 a los 70 and Evaluación Social, in order to improve coordination between them. In the future, the Government will also integrate Ángel Guardián and Beca Universal into this single registry. In addition, the Government has advanced in monitoring and evaluating the Beca Universal program by including individual based questions on scholarship benefits into the household survey 2013. Finally, the Government created the Ángel Guardián program for people with severe disabilities and in poverty or vulnerable condition. The program is the first of its kind in Central America. The first payment to 1,671 beneficiaries was made in August 2013. Through US$80 per month, the program improves the living conditions of beneficiaries and reduces the impoverishing effects on their families.

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,

[Signature]

Frank De Lima
Minister

FDEL/DAER/VMRC/DC